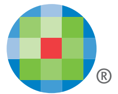
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GLOBAL TAX WEEKLY
a closer look

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

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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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a closer look

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Tax Compliance For Business Travelers To The US: More Difficult, But More Important Than Ever

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Introduction

Today's global workforce is constantly crossing borders – whether international or interstate – leading to more extensive employee and employer tax reporting and payment obligations. These business travelers are employees who travel for a variety of reasons, including project-based travel, visits to suppliers or customers, or to attend training or business meetings. The destinations for such travel can be as varied as the length of the trip. The duration of a business traveler's trip may be only a day, several weeks, or multiple months, but due to policy and tax requirements, typically not more than a year.

Business travelers are frequently not on a company's radar for tracking, neither by Human Resources nor covered under short-term assignment policies. This leads to a state of anxiety among many employers as they struggle to identify their business traveler population, traveler destinations, their tax compliance requirements, and the extent of any other tax obligations. It is clear that more can be done to manage these requirements if the employer wants to protect its reputation in the US, and limit potential penalties and other consequences associated with non-compliance.

This article will highlight the complexity of employer compliance with the state and Federal tax requirements associated with travel to the US.

For the rest of the article, we will follow an employee of XYZ UK Limited as he travels to the United States from the United Kingdom for a duration of two weeks. While in the United States, the employee spends one week in New York City, including a visit to the stock exchange to sound the opening bell, and then spends one week in South Carolina to attend business meetings with colleagues of XYZ US Inc., a branch entity of XYZ UK Limited. The question posed for discussion is whether this business traveler is subject to federal income tax, US social security taxes, state income tax in New York and/or South Carolina, and whether the reimbursed expenses paid for the trip are taxable to the employee.

Are Business Travelers Subject To Tax At Their Destination?

Federal Income Taxes

To paraphrase Benjamin Franklin, there are only two certainties in life: death and taxes. Business travelers are no exception to this axiom. An international business traveler is subject to US tax if the business traveler is engaged in business in the United States during the tax year for more than 90 days or if the wages attributable to such services performed exceed USD3,000.[1]

The wages attributable to service in the US are calculated by allocating an employee's compensation based on the number of US workdays. Let's revisit our business traveler from XYZ UK Limited: if he worked a total of 240 days during the year and ten of those workdays were in the US, the US-sourced income would be his total compensation multiplied by a faction of 10/240. Assuming an annual salary of USD100,000, the employee would have USD4,167 of US-sourced income. For many business travelers, the USD3,000 limit amount can be exceeded quickly, resulting in an individual income tax obligation as well as reporting and withholding obligations for the company.

However, under some circumstances, relief may be available to a nonresident alien from a country with which the United States has an income tax treaty. Among other purposes, tax treaties serve to simplify the tax obligations of residents of one country who engage in business in the other contracting country. Effectively, the treaties generally provide that tax for income related to employment will only be owed to the country in which the person resides if certain conditions are met.

Every tax treaty is different and requires individual analysis. However, though it is necessary to review the provisions of the relevant treaty given the variation among the conditions, there is

consistency among most treaties in the treatment of compensation received by a business traveler for services performed in the United States.

There are typically three conditions that need to be satisfied for the treaty relief to apply. First, the nonresident alien must be present in the United States for less than a specified threshold. Commonly, this day threshold requires a nonresident alien not to exceed 183 days in a rolling 12-month period.[2] Second, treaties often require that the cost of remuneration paid to a nonresident alien be borne by an employer that is not resident in the US. Finally, for treaty relief to be available, the remuneration paid to a business traveler cannot be borne by a permanent establishment that the employer has in the US.

Though subject to some variation, income tax treaties generally define a permanent establishment to include a fixed place of business through which a foreign enterprise carries on its business.[3] In examining whether business travelers may create a permanent establishment, certain business traveler activities pose a higher likelihood of being viewed as a permanent establishment than others.

For example, an executive concluding contracts and negotiating transactions on the company's behalf in a foreign country would pose a high risk of creating permanent establishment in that country. Though not an exhaustive list, certain key considerations should be examined to determine whether a permanent establishment has been set up; these include whether there is a fixed place of business, whether employees are receiving commissions or are in revenue-generating roles, and whether contracts are negotiated or concluded by the employee in the host country. As discussed above, the existence of a permanent establishment in a business traveler's destination country will render the income tax treaty's relief inapplicable.

Social Security Taxes

Though income tax treaties may provide for relief from income tax, they do not provide for relief from Federal Insurance Contributions Act (FICA) taxes; namely, social security (old-age, survivors, and disability insurance) and Medicare (hospital insurance). To the extent a business traveler earns wages for services performed in the United States, such amounts are subject to FICA tax with no *de minimis* threshold. That is to say, a business traveler and his or her employer owes FICA taxes from day one, dollar one unless a separate social security treaty is in place.

Social security treaties are commonly referred to as totalization agreements and the United States has entered into such agreements with several countries to avoid double taxation with respect

to FICA taxes.[4] To avail oneself to the relief provided by the totalization agreements, a business traveler must obtain a Certificate of Coverage from the traveler's home country and present that document to the United States employer.[5]

State Taxes

Business travelers in the United States – whether individuals traveling into the US from a foreign country or local US residents traveling interstate – need to be aware of state income tax issues. For inbound international travelers, whether they are subject to state income tax is dependent upon whether a tax treaty is available to provide relief from federal income tax and whether the destination state recognizes the treaty relief. Some states honor the provisions of tax treaties and others do not.[6] Although states are not permitted to enter into agreements with nations, many states use federal taxable income as the starting point for determining state income tax liability. To the extent a state uses federal taxable income as the starting point and treaty relief is available, a business traveler will not have a state income tax liability.

It should also be noted that US resident business travelers may have additional nonresident state income tax obligations. Unlike international travelers, and other than a handful of states with reciprocal income tax agreements, domestic business travelers find no relief from income tax treaties. Rather, each state is empowered to enact its own threshold on when a nonresident business traveler may be obligated to file a tax return and when that traveler's employer may have a withholding and reporting obligation. In many states taxation will occur from the first day of presence in that state.

Efforts have been made by members of Congress to simplify these rules by implementing a 30-day threshold for all states, but to date these attempts have been unsuccessful and it remains up to each state to set their own rules.[7]

Are A Business Traveler's Travel Expense Reimbursements Taxable?

In general, expenses incurred by business travelers (*e.g.*, airfare, hotels, meals while traveling) are considered to be deductible business expenses and thus are not considered taxable income to the employee when the employee is working "away from home".[8] However, the determination of whether an employee is "away from home" is dependent upon whether the destination is considered a temporary, rather than non-temporary, work location. To the extent the destination is considered a non-temporary work location, expenses incurred in traveling there would be considered nondeductible commuting expenses.

A temporary work location is a location at which the employee works or performs services on a temporary basis. If employment at a work location is realistically expected to last (and does in fact last) for one year or less, the employment is temporary in the absence of facts and circumstances indicating otherwise. If employment at a work location is realistically expected to last for more than one year, the employment is not temporary, regardless of whether it actually exceeds one year.[9] Going back to our example of the business traveler from XYZ UK Limited, the US would be considered to be a temporary work location because the work was only expected to last two weeks.

In addition to the temporary and non-temporary rules, the IRS has issued guidance that seeks to assess whether an employee's performance of services at a location is so infrequent or sporadic that the location should be treated as though it is temporary even if there is a realistic expectation of working at that location for more than one year.[10]

If there is an initial realistic expectation that an employee will perform services at a work location for a period exceeding one year, but for no more than 35 workdays during each of the calendar years within that period, then employment at that location may be treated as temporary. Even if our hypothetical employee from XYZ UK Limited was scheduled to continue to travel to the US periodically for the next few years, the travel expenses could still be considered nontaxable if each year the employee will be in the US for fewer than 35 days.

What Is Required To File A US tax Return?

All individuals filing a tax return must have a US tax identification number (TIN).[11] Most US citizens and residents use their Social Security Number as their TIN. However, business travelers to the US are not always eligible to obtain a Social Security Number, dependent on the type of visa used to travel, and must instead obtain an Individual Taxpayer Identification Number (ITIN). The process to obtain an ITIN has become increasingly difficult over the past few years as the IRS and Congress have attempted to curb perceived abuse of the system via fraudulent applications. These attempts have made the process more burdensome for business travelers to comply with the requirement to file a US return.

An ITIN application must include supporting documentation to verify the individual's identity and residency status to the IRS and there are a variety of methods through which this verification may be achieved. The first two options are for ITIN applicants to apply in-person at an IRS center or provide a copy of their passport which has been certified by the issue agency.

Generally the certified copy is issued by the passport authorities in the individual's home country or a consulate which that country has in the US. A third option is to utilize the services of various Certified Acceptance Agents (CAAs), which greatly simplifies the application process by allowing the CAA to review the passport without the need to obtain a certified copy. Many accounting firms and other financial service providers have obtained CAA status to assist their clients. However, legislation passed in 2016 removed this third option for applicants who reside overseas.[12] Most business travelers are now required to apply for an ITIN in-person at an IRS center or via mail, including a certified copy of their passport.

Why Should Employers Take Action Now?

Tax authorities both at the Federal and certain state levels are targeting business travelers and their employers due both to the high level of noncompliance and to raise additional revenue. By leveraging corporate data available during routine audits, such as travel records and expense reports, the tax agents are identifying nonresident business travelers within their borders. Of particular interest to companies with business travelers inbound to the United States, the IRS Foreign Payments Practice group is focused on enforcing the withholding and information reporting rules and regulations pertaining to nonresident aliens and foreign entities. With increased communication and coordination between immigration and tax authorities, individual business travelers are also facing heightened enforcement.

As important, employers that proactively manage the tax consequences of business travel to the United States can frequently reduce the tax burden. As discussed above, there are tools that employers and employees can use to reduce state, Federal, and social security taxes – if they plan in advance.

Due to enhanced enforcement efforts facing both employees and employers, now is the time to take the next steps towards compliance and cost reduction.

Endnotes

1 IRC § 861(a)(3) excludes from the definition of US-sourced income any compensation paid to a nonresident alien for performance of services for a non-US company if the individual is present in the US for fewer than 90 days and the total compensation for that period does not exceed USD3,000 in aggregate.

2 Older treaties may refer to 183 days in a calendar or fiscal year, rather than the rolling 12-month period.

3 *See*, *e.g.*, United States–United Kingdom Income Tax Convention, Article 5, Permanent Establishment (defining the term permanent establishment as well as specific activities that are excluded).

[4] IRC § 3101(c) provides that "wages received by or paid to an individual shall be exempt from [FICA taxes] to the extent that such wages are subject under such agreement exclusively to the laws applicable to the social security system of such foreign country." IRC § 3111(c) provides similar relief for employers. *See also* https://www.irs.gov/individuals/international-taxpayers/totalization-agreements for listing of current countries with which the United States has a totalization agreement.

[5] Rev. Proc. 80-56; 1980-2 C.B. 851.

[6] For example, California does not provide an exclusion for income excluded at the federal level due to an income tax treaty, but New York does recognize treaty relief.

[7] On March 22, 2017 the Judiciary Committee of the US House of Representatives approved H.R. 1393, the Mobile Workforce State Income Tax Simplification Act of 2017, which would restrict states from imposing income tax on nonresidents, unless the individual works in that state for more than 30 days during the year. Similar versions of this legislation passed the full House in May 2012 and again in September 2016, but ultimately were not brought to a vote in the Senate and were not enacted. A floor vote on the current House bill has not yet been scheduled.

[8] IRC § 162(a)(2); *see also* Treas. Reg. §1.162-2.

[9] Rev. Rul. 93-86, 1993-2 C.B. 71.

[10] Chief Counsel Memorandum 200026025.

[11] IRC § 6109(a).

[12] PATH Act, P.L. 114-113, 12/18/2015, § 203, which amended IRC § 6109 by adding IRC § 6109(i)(1), limiting the use of a CAA to taxpayers who reside in the US.

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Russian Finance Ministry Clarifies Use Of The Look-Through Approach In Relation To Dividend Payments

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The actual recipient rules introduced by the deoffshorization amendments to tax law have been in effect in Russia since January 1, 2015.

The rules do not allow lower withholding tax rates provided for in Russia's tax treaties to be applied where a foreign company receiving income is an intermediate ("conduit") entity.

A recently published letter [1] from the Tax and Customs Tariff Policy Department of the Russian Finance Ministry presents clarifications regarding the application of the "look-through approach" in relation to dividend payments. In the letter, the Ministry considers a situation in which the actual recipient of dividends is a foreign company whose participation in the capital of the Russian company paying the dividends is not direct but indirect (*e.g.*, structured via a series of intermediate holding companies).

To the disappointment of taxpayers, the Ministry took the view that the application of a lower tax rate for dividends was conditional on the actual recipient having made a direct contribution to the Russian company's capital. In many cases, this approach would prevent a lower withholding tax rate from being applied under the look-through approach by virtue of the fact that a foreign shareholder made its investment in a Russian company not directly, but through intermediate foreign companies which are not the actual recipients of the dividends.

The Ministry's letter is concerned with the Russian–Spanish tax treaty, but many other Russian tax treaties contain a similar investment criterion. Furthermore, a similar approach might also be taken in relation to the ownership interest criterion, which also figures in a number of treaties.

The letter therefore has considerable importance from the point of view of the development of practice in the application of the actual recipient rules.

Below we take a more detailed look at the Ministry's clarification.

Applicable Law

The actual recipient rules introduced in the Tax Code with effect from January 1, 2015 [2] establish a set of criteria which a recipient of income must meet in order to qualify for benefits under Russian tax treaties.

The core principle of the look-through approach consists in applying tax treaties not to the immediate recipient of income, but to the final recipient which has an actual right to that income. [3]

In order for the look-through approach to be applied to dividends, for example, the following conditions must be met: [4]

- The entity to which the payment is made must acknowledge that it does not have an actual right to the income;
- The entity which has an actual right to the income must hold a direct and/or indirect interest in the Russian company paying the dividends;
- The entity which has an actual right to the income must provide the following documents to the tax agent before the date on which the income is paid:
  - Confirmation of residence of a state with which Russia has an international tax treaty, certified by a competent authority of the relevant foreign state (tax residence certificate);
  - Confirmation that the company has an actual right to receive the income in question. [5]

The Finance Ministry's Clarification

In the recent letter, the Finance Ministry examines a situation in which the actual recipient of dividend income paid by a Russian company was a Spanish tax-resident company.

The tax treaty between Russia and Spain [6] provides for a lower withholding tax rate of 5 percent to be applied in relation to dividends provided that:

- The person possessing an actual right to the dividends is a company which has invested in the capital of the company paying the dividends at least EUR100,000 (USD107,919) or the equivalent amount in any other currency; and

- The dividends in question are exempt from tax in the other contracting state.

If only one of these conditions is met, the applicable rate is 10 percent.

The Ministry asserts that in order to qualify for the 5 percent rate, a Spanish tax resident which is the actual recipient of dividends must have invested at least EUR100,000 *directly* in the capital of the Russian company paying the dividends. In the situation described, therefore, under the look-though approach the Russian tax agent would have to withhold tax at the rate of 10 percent.

In our view, however, there are arguments to support the taxpayer's position that the lowest tax rate is applicable, since the look-though approach as such is an expression of the substance-over-form principle, and using it as a basis for applying a selectively formal approach to individual criteria is questionable.

Conclusions

Practice in regard to the application of the actual recipient concept is constantly developing. [7] In addition to the difficulties over the application of the look-through approach, there are numerous other issues that are not satisfactorily dealt with at the legislative level.

It is therefore advisable for companies which pay dividends, royalties and other income from Russia and apply lower withholding tax rates:

- To analyze existing structures and assess their susceptibility to the "actual right to income" concept;
- To gather evidence (documents, reports, transaction records) that foreign recipients of income are the actual owners of the income, so as to be in a good position to defend the application of lower withholding tax rates if questions arise during an audit;
- If necessary, to carry out restructuring in order to minimize future risk;
- To request foreign recipients of income to provide documentary confirmation of their status as the actual recipients of income. Clause 1 of Article 312 of the Tax Code now makes it a requirement for such confirmation to be obtained before income is paid.

Endnotes

1 Letter No. 03-08-05/73316 of the Tax and Customs Tariff Policy Department of the Ministry of Finance of December 7, 2016.

2 New versions of Articles 7 and 312 of the Tax Code.

3 Clause 4 of Article 7 of the Tax Code.

[4] Clauses 1 to 1.4 of Article 312 of the Tax Code.

[5] The form of the confirmation is not prescribed in law. For advice on what it should contain, *see*, *e.g.*, Letter No. 03-08-05/78852 of the Ministry of Finance of December 28, 2016.

[6] Convention between the Government of the Russian Federation and the Government of the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income and Capital, dated December 16, 1998.

[7] *See*, *e.g.*, http://www.ey.com/Publication/vwLUAssets/EY-Tax-Alert-28-March-2016-Eng/$FILE/EY-Tax-Alert-28-March-2016-Eng.pdf, http://www.ey.com/Publication/vwLUAssets/ey-tax-alert-20-july-2016-eng/$FILE/ey-tax-alert-20-july-2016-eng.pdf, and http://www.ey.com/Publication/vwLUAssets/EY-Tax-Alert-3-November-2016-Eng/$File/EY-Tax-Alert-3-November-2016-Eng.pdf and http://www.ey.com/Publication/vwLUAssets/EY-Tax-Alert-16-February-2017-Eng/$FILE/EY-Tax-Alert-16-February-2017-Eng.pdf

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Diverted Profits Taxes – Slow To Catch On

by Stuart Gray, Senior Editor,
Global Tax Weekly

The United Kingdom pioneered the diverted profits tax (DPT), a somewhat novel response to tax base erosion and profit shifting. It is an idea that has been slow to catch on, however.

This article summarizes the UK DPT requirements, looks at proposals for a similar tax in Australia, and considers the merits or otherwise of this approach to tackling BEPS.

The UK Diverted Profits Tax

The DPT, which took effect in April 2015 as part of the 2015 Finance Act,[1] is intended to counter aggressive tax avoidance by multinational companies. It is charged at a rate of 25 percent (compared with a corporate tax rate of 20 percent (19 percent from April 1, 2017)) on all profits "artificially" diverted from the UK. It is a separate tax to corporation tax, and as such cannot be set off against corporate tax liabilities.

The DPT operates through two basic rules.

The first rule counteracts arrangements that exploit permanent establishment rules. In particular, the DPT applies in cases where a person is carrying on activity in the UK in connection with supplies of goods and services by a non-UK resident company to customers in the UK, provided that the detailed conditions are met.

The second rule intends to prevent tax advantages obtained through the use of transactions or entities that lack economic substance. The primary function is to counteract arrangements that exploit tax differentials and will apply where the detailed conditions, including those on an "effective tax mismatch outcome," are met.

Multinationals are required to inform HM Revenue & Customs (HMRC) if they potentially fall within the scope of the DPT. The legislation provides that, where a designated HMRC officer

determines that the DPT should apply, a preliminary notice would be issued explaining, among other things, the reasons for the amount of the charge and the basis on which it has been calculated (including the details of the amount of the taxable diverted profits).

The recipient would then have 30 days to make representations. The designated HMRC officer may consider certain specified matters within a further 30-day period before either issuing a charging notice on the original or a revised amount, or confirming that no charge arises.

Where specific conditions are met and the designated HMRC officer considers that certain expenses otherwise deductible may be greater than they would have been at arm's length, the diverted profit charge will initially reflect a 30 percent disallowance of those expenses. The charging notice will require the payment of the DPT within 30 days. Penalties will apply for late payment.

Following the due date for payment, there is a 12-month review period during which the charge may be adjusted based upon evidence. At the end of the review period, the business has the opportunity to appeal against any resulting charge. The review period can be brought to a conclusion earlier with the agreement of both parties. There will be no postponement of the disputed tax during the review period or due to any subsequent appeal.

HMRC released updated guidance on the application of the DPT on November 30, 2015.[2]

The updated guidance is divided into five chapters. Chapter 1 provides an overview of the new regime, and Chapter 2 sets out key information about the application of the DPT legislation, including the detail of the conditions which must be met; examples of the situations to which it applies; and the computation of diverted profit.

Chapter 3 contains information about the ways in which taxpayers affected by the application of the DPT could "engage with HMRC in an open and transparent way."

Guidance about the computation of the tax, including the availability of credits and its interaction with other taxes, is contained in Chapter 4. This Chapter also includes information about notification, assessment and payment, including interest, penalties, and appeals.

Finally, Chapter 5 sets out the procedures that HMRC has to follow to impose a charge, including governance procedures.

HMRC advises that the guidance should be read in conjunction with the legislation, Explanatory Notes, and the Tax Information and Impact Note released on March 24, 2015.

The Australian Diverted Profits Tax

In a similar vein to the UK version of the tax, the Australian DPT – the legislation for which completed its passage through Parliament on March 27 and is now awaiting Royal Assent – would impose a penalty tax on profits that have been "artificially diverted" from Australia by multinationals. The DPT provisions are contained in two Bills: the Diverted Profits Tax Bill,[3] and the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017.[4] The tax will apply to multinationals with global income of more than AUD1bn (USD772m), and Australian income of more than AUD25m.

The Australian DPT will operate on the basis of three tests, as follows:

- **The AUD25m income test** – this test will apply if it is reasonable to conclude that, broadly, the sum of the assessable income, exempt income and non-assessable non-exempt income of the relevant taxpayer, the assessable income of any other associated entities that are members of the same global group and, if the DPT tax benefit relates to an amount not being included in assessable income, the amount of the DPT tax benefit, does not exceed AUD25m;
- **The sufficient foreign tax test** – this test will apply if, broadly, the increase in the foreign tax liabilities of foreign entities resulting from the scheme is 80 percent or more of the reduction in the Australian tax liability of the relevant taxpayer; or
- **The sufficient economic substance test** – this test will apply if, broadly, the profit made as a result of the scheme by the relevant taxpayer and by each entity that is an associate of the relevant taxpayer and entered into or carried out the scheme or any part of the scheme, or is otherwise connected with the scheme or any part of the scheme, reasonably reflects the economic substance of the entity's activities in connection with the scheme.

The legislation enables the Commissioner of Taxation to issue a DPT assessment to the relevant taxpayer, and impose tax on the amount of the diverted profit at a penalty rate of 40 percent.

Following the issuance of the notice of a DPT assessment, the taxpayer will be able to provide the Commissioner with further information disclosing reasons why the DPT assessment should be reduced (in part or in full) during the period of review (generally 12 months after notice is given of the DPT assessment).

If, at the end of that period of review, the relevant taxpayer is dissatisfied with the DPT assessment or the amended DPT assessment, the taxpayer will have 60 days to challenge the assessment by making an appeal to the Federal Court of Australia. However, the taxpayer will generally be restricted to adducing evidence that was provided to the Commissioner before the end of the period of review.

The DPT is being inserted into Part IVA of the Income Tax Assessment Act 1936. Part IVA (sections 177A to 177G), which applies to schemes to reduce income tax, was amended in 2013 by the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013.[5]

The DPT, like the multinational anti-avoidance law, expands the scope of Part IVA and is still focused on tax avoidance arrangements that are of an artificial or contrived nature. According to the explanatory memorandum to the Diverted Profit Tax Bill 2017, although the DPT is not a provision of last resort, consistent with the operation of Part IVA, it is expected that it will be applied only in very limited circumstances. It is intended that the Commissioner would apply the DPT only after he or she has given consideration to the operation of the ordinary provisions in the income tax law.

The DPT will not apply to managed investment trusts or similar foreign entities, sovereign wealth funds, and foreign pension funds. These entities have been excluded as they are low risk from an integrity perspective, are widely held, and undertake passive activities. This exclusion also ensures that such entities do not face an unnecessary compliance burden as a result of the introduction of the DPT.

Weighing Up The DPTs

Both governments have justified their respective DPTs on the basis that they will make it significantly more difficult for multinational companies to use artificial arrangements with the sole intention of avoiding tax.

"We will make sure big multinational business pay their fair share," explained the then UK Chancellor of the Exchequer George Osborne when introducing the measure in 2014. "Some of the largest companies in the world, including those in the tech sector, use elaborate structures to avoid paying taxes. That's not fair to other British firms, it's not fair to the British people either, today we're putting a stop to it."

"By their nature, we are dealing with highly contrived tax arrangements that sometimes cover three or four different sovereign jurisdictions," Osborne told the House of Commons Treasury Committee in the following year. "By their nature, these are very complicated tax arrangements. … I am confident that we will be able to tax genuine economic activity that happens in the UK, do it in a way that the UK remains one of the most attractive places in the world to bring your investment, to set up your tech business or other business and prosper."

Likewise, in a statement issued at the time of the introduction of the Diverted Profits Tax Bill 2017, Australian Treasurer Scott Morrison said the tax would prevent multinationals shifting profits made in Australia offshore and raise AUD100m in revenue per year from 2018/19.

"It provides a powerful new tool to the Australian Taxation Office (ATO) to tackle contrived arrangements and uncooperative taxpayers, and will reinforce Australia's position as having some of the toughest laws in the world to combat multinational tax avoidance," he said. "This represents a significant step as the Turnbull Government continues to deliver on its commitment to ensure the integrity of our tax system."

Morrison assured taxpayers that the Australian Government "has consulted extensively to ensure that the legislation appropriately targets multinational tax avoidance."

However, the DPTs have attracted criticism from businesses, legislators, and tax experts for a number of reasons, with concerns focusing on lack of consultation, complexity, and international incompatibility.

As part of its report on the measures announced in the 2014 Autumn Statement, the UK Treasury Committee called the tax unwieldy and potentially harmful to international efforts to combat base erosion and profit shifting under the banner of the OECD, particularly because the UK Government had acted to introduce the tax before the conclusion of the OECD's work on the BEPS initiative. The Committee was concerned this might "destabilize the international effort." It also criticized the legislation as being "long and highly complex [and] likely to be a source of uncertainty." [6]

Likewise, in its submission to the Committee, the Institute of Chartered Accountants of England and Wales (ICAEW) concurred, describing the DPT legislation as "highly complicated" and potentially incompatible with the more than 120 tax treaties the UK has with other jurisdictions:

> "The target of this new legislation appears to overlap with the OECD BEPS Action Plan. The overall intention of BEPS is to align taxation with the location where economic activities take place and where value is created. It is also a key objective of BEPS that the … countries involved should act in concert and introduce the required measures in a coordinated way."

The Chartered Institute of Taxation largely agreed, noting that the legislation had been drafted in a "very unclear manner," especially with regard to the tax's potential scope:

> "We would not welcome a tax which might be in conflict with internationally agreed principles and which gives businesses no opportunity to modify their approaches in line with those new principles."

The International Chamber of Commerce also warned the UK Government that the DPT would be troublesome for taxpayers and the tax authority to administer, and would very likely undermine the BEPS project:

> "We've seen a number of other governments put forward measures recently that cut-across the BEPS project. The net effect is significant uncertainty for business and increased double taxation risks. There is a real concern within the international business community that this will trigger a raft of tax disputes that the international system is not at all equipped to deal with."

In the UK, the feeling that the legislation was rushed into place in time for the 2015 general election is widespread in the tax and business community, with the Institute of Directors having accused the Government of ramming the measure through "for short-term political reasons and against the Government's own rules on setting business taxes." And these criticisms have been echoed on the other side of the world regarding Australia's incoming DPT.

Chartered Accountants Australia and New Zealand, for example, has said the DPT will make the country a more uncertain place to do business. Its head of tax, Michael Croker, observed: [7]

> "Businesses need certainty and despite what politicians say, the law doesn't levy tax based on the concept of paying a 'fair share'.
>
> In the eyes of the international business community, Australia can ill-afford to be seen as a place where the ascertainment of tax payable only becomes clear following discussions with the ATO about the inbound structure and related-party transactions."

In a recent critique of the measure, the Minerals Council of Australia said the Government had not learned from the UK's experience with its failure to subject the proposal to adequate scrutiny. The Council stated: [8]

> "There is wide agreement amongst Australia's most respected and knowledgeable tax experts that the legislation, as drafted, is badly flawed. The legislation will impose heavy compliance burdens and uncertainty on businesses investing in Australia and risks damage to Australia's reputation as a place to invest."

The Council is also of the opinion that the Australian DPT represents a departure from the OECD's BEPS recommendations issued in October 2015.

It is certainly noticeable that few other countries have followed the UK's and Australia's lead by attempting to implement similar taxes. And this suggests they too can see the flaws pointed out by businesses and tax professionals.

So far, only France and New Zealand have given serious consideration to introducing a DPT. However, the French Government's draft proposals were struck down by the country's constitutional court in December 2016 on the grounds that the law was overly vague and gave the tax authority too much discretion in a company tax audit. [9] Meanwhile, the New Zealand Cabinet has said that such a measure is no longer its "preferred option" for tackling BEPS, with the Government now seeking to strengthen existing transfer pricing and permanent establishment rules instead.

Significantly, the New Zealand Cabinet Paper on the issue of strengthening international anti-avoidance rules took account of the UK DPT legislation and the Australian legislative proposals and concluded that a similar measure "could impact on foreign investor's perceptions of the predictability and fairness of New Zealand's tax system for foreign investment." The Paper goes on to state: [10]

> "As a separate tax from our general income tax it may produce unintended adverse consequences for taxpayers – especially with regard to normal grouping of tax attributes (for example income tax losses would not be able to be set off against diverted profits).
> A DPT may also have an unintentional negative impact on compliant taxpayers. The more we get into imposing arbitrary taxes the greater the risk of other countries doing the same to our exporters. Overall, a DPT chips away at the consistency, neutrality, and relative simplicity of our tax system from a global perspective.

> Finally, the DPTs that have been proposed in Australia and enacted in the UK respond to particular problems with the application of their own income tax rules to multinationals. While a DPT may be appropriate for the issues Australia and the UK face, it seems more straightforward for us to fix New Zealand's problems with our income tax rules rather than implement a new tax."

Conclusion

It remains to be seen if the UK and Australian governments are proved right and DPTs become an effective means of preventing the shifting of profits to low-tax jurisdictions. There are, however, plenty of critics who think otherwise, and their concerns are manifold.

They have cautioned their respective governments that DPTs are complex, too wide in scope, too ambiguous, and potentially conflict with the wider aims of the BEPS project. What's more, such taxes could lead to more instances of double taxation and disputes between taxpayers and tax authorities, it has been argued. The possibility remains that other countries will follow suit, but the fact that so many have not yet done so suggests that they too believe that DPTs are not an ideal approach to countering tax avoidance.

Endnotes

1 http://www.legislation.gov.uk/ukpga/2015/11/part/3/enacted

2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480318/Diverted_Profits_Tax.pdf

3 http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbills%2Fr5804_first-reps%2F0000%22;rec=0

4 http://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r5805_aspassed/toc_pdf/17010b01.pdf;fileType=application%2Fpdf, at Schedule 1.

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9 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).

10 http://taxpolicy.ird.govt.nz/publications/2016-other-cabinet-paper-transfer-pricing/cabinet-paper#uk-australia-dpt, at paras 18 and 19.

Liability For Trust Fund Taxes

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Introduction

As a rule, workers look forward to payday, even if their meager restitution isn't as much as they would like it to be. Visions of sugarplums dance in their heads, or at least visions of one less bill emblazoned with the dreaded "Past Due, Please Remit" stamp.

As a rule, employers dread payday. Even if there is enough money in the account to cover payroll, and that is often a big "if," payday is an immense compliance burden. The US Department of Labor has rule upon rule regarding wages paid to workers (*i.e.*, is the worker exempt, nonexempt, an independent contractor, or an intern). Furthermore, judges, lawmakers and bureaucrats change these rules constantly and sometimes even cancel out one another.

The Internal Revenue Service (IRS, or Service) has an entirely different stack of rules [1] on this subject, and it is important to not only understand employers' rights and responsibilities in this area as financial professionals, but also to be able to communicate these principles in a clear and concise manner, because the penalties for noncompliance are significant, and we all know who employers will try to blame if things go sideways.

Trust Fund Taxes

Although source withholding seems to be the lynchpin for the entire income tax system, this tool is a relatively new invention. The first income tax did not include such a provision and was difficult to collect, which is probably the main reason that no one in Washington was terribly upset when the Supreme Court invalidated the income tax in 1895, because it did not apportion taxes evenly among the states as required by Article I, Section 8.

After lawmakers fixed this minor technicality with the Sixteenth Amendment in 1913 and then enacted a modest income tax almost before the ink was dry, another 30 years passed before

Congress passed the Current Tax Payment Act of 1943. Income taxes skyrocketed to help finance World War II, and source withholding essentially meant that the IRS could close its collection arm and focus on enforcement. At the time, the Treasury Department hailed the law as a way to collect revenue more easily and raise future taxes more surreptitiously, as unsuspecting taxpayers would see their tax liabilities as lines on forms as opposed to greenbacks from their pockets.

The phrase "trust fund" is a bit of a misnomer, as there is no requirement to place withheld taxes in a different account or segregate them in any way, because it is still the employer's money until the tax bill arrives. As a result, some employers are tempted to use this trust fund money to help them get through a rough patch or two. Nevertheless, the phrase also denotes a special responsibility which, according to Judge Benjamin Cardozo, is "stricter than the morals of the market place. Not honesty alone, but the punctilio [2] of an honor the most sensitive, is the standard of behavior."

The Trust Fund Recovery Penalty (TFRP)

The nasty TFRP usually means personal liability, even if the entity that wrote the paycheck is a corporation, an LLC, a partnership, or an agency. For penalties to attach, the Service must establish a "willful" failure to pay, and in this context, that means the employer paid any other vendors aside from the IRS; the Service must also prove that the employer had a duty to collect and account for the tax.

It's important to distinguish between trust fund (employee income and FICA taxes) and non-trust fund taxes (employer FICA taxes), as the penalty applies to the former but not the latter. The TFRP is actually only an additional collection tool as opposed to a "penalty" that involves additional payments. That comes later.

Liability Issues

According to Section 6672, any person who must "collect, truthfully account for, *and* pay over any tax imposed" is subject to the TFRP. Companies used to argue that they were not liable because they did not have a responsibility in all three of these areas. The Supreme Court closed this loophole in *United States v. Sotelo* [3] by holding that "and" really means "or" in this statute.

That being said, a liability issue remains, *viz*, who (or what) is a responsible person?

In labor law, although there is some uncertainty, an employer is usually an entity that exercises control over the workers. That same analysis applies in this context, as the IRS determines who

has both policy control and practical control over the organization's purse strings. IRS Policy Statement P-5-60 offers some additional guidance. The penalty normally does not apply to persons who perform "ministerial acts without exercising independent judgment"; rather, responsibility is a matter of "status, duty and authority."

As normally happens in these situations, courts have established a non-exhaustive list of factors to consider, including:

- Ownership stake or operating interest;
- Day-to-day management responsibilities;
- Ability to hire and fire; and
- Decision-making power over expense matters.

A person does not need to be an officer or director to be a "responsible person," since the test is extremely broad and rather vague. However, non-officers rarely have the requisite amount of authority. As one court succinctly put it, anyone who "could have impeded the flow of business to the extent necessary to prevent the corporation from squandering the taxes" could be liable. Ouch.

The government must prove willfulness, and once again, this term has a very specific meaning in this context. For TFRP purposes, willfulness basically means ignoring a legal duty, *i.e.*, the responsibility to withhold money, give an accounting, and pay taxes. Willful blindness isn't normally a defense, because the jury may also consider evidence of dogged indifference as willfulness.

In sum, there are few controls at the front end of the trust fund process, as employers need not follow any specific protocol in setting aside employee taxes. However, Judgment Day cometh soon, and the IRS will almost certainly hold violators strictly and painfully accountable for any shortfall.

Delinquency And Collections Procedure

The Service only pursues a TFRP if the initial collection efforts against the employer fail, so unfortunately for the defendant, the revenue agent attached to the prosecution is already out for blood.

The cage match begins with a thorough investigation, as the IRS looks to identify anyone with check signing authority, as outlined above. Then, the Service joins any defendant who has assets that can be seized. These targets then basically receive 30-day letters, like the ones the government uses in gift and estate tax matters. If the person does not appeal, or the IRS Appeals Office sides with the auditor (and we can fairly guess how often that happens), the Service assesses the taxes and penalties.

The Service can use almost anything in its toolbox in TFRP collections matters, including:

- IRS summons,
- Bank account levy, or
- Lien.

Sometimes, there are statute of limitations issues involved.

Possible Defenses

Once the IRS assesses the amount due and files a lien, Collection Due Process (CDP)[4] kicks in. Given the lack of judicial remedies in the delinquency/collections process, adversely affected taxpayers may be able to invoke the CDP, get their day in court, and challenge the merits of the assessment.

The bad news is that there is no jury and the judge is likely to be a generalist, and litigants only get limited discovery opportunities in tax court. The good news is that the government cannot run up legal fees by pulling more defendants into the litigation and the IRS cannot pursue any collections activities until the CDP completely runs its course.

Most TFRP cases involve employers who put their hands into the proverbial cookie jars to cover a cash flow shortage. If that's the case, and the client's business has picked back up, it may be best to work out a deal with the IRS for an installment payment plan. Additionally, if the client has assets, pay down the taxes before paying other delinquent third-party creditors; be sure that these payments are dedicated to the principal, because the IRS normally applies money to the penalties and interest first.

Clients are always scared when a friendly neighborhood G-man shows up at the door and begins asking questions, and their fear is justified. However, if the client is forthcoming and dedicated to resolving the issues, TFRP matters are eminently manageable. Good night, and good luck.[5]

Endnotes

1 https://www.irs.gov/publications/p505/ch01.html.

2 https://www.nycourts.gov/reporter/archives/meinhard_salmon.htm.

3 https://www.law.cornell.edu/supremecourt/text/436/268.

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Topical News Briefing: Raising The Stakes

by the Global Tax Weekly Editorial Team

Regulating and taxing the gambling industry has long been a goal of governments all over the world. But it has recently become something of a challenging one.

Before the advent of mass telecommunication, regulating gambling was a fairly routine task for the authorities. This is because such activities largely took place in physical venues like casinos, betting shops, and at racecourses.

Then along came telephone betting and suddenly it was possible to place a bet on a race in another country, using a bookmaker based in a third jurisdiction.

Borders have been blurred comprehensively by the internet, which has brought gambling and gaming to a mass, global market. Now, in theory, individuals can use their phones, tablets or laptops to place a bet anywhere in the world, with a company based in another country, on a sporting event in a third, through a server based in a fourth.

In practice, the market doesn't operate as seamlessly as this. Some countries have moved to ban all or certain forms of online gambling offered to its citizens from offshore – the US being one notable example – while others have attempted to place heavy restrictions on the e-gambling sector.

Other jurisdictions have stretched the boundaries of their own tax regimes with innovative new solutions to ensure that the industry pays what is due in tax. One such is the UK, which introduced a point-of-consumption tax in 2014, under which an online gambling operator is liable to pay a 15 percent tax on profits derived from UK-based customers, irrespective of where the company itself is located.

Indeed, many jurisdictions have woken up to the fact that legitimizing certain activities they consider undesirable is beneficial for a number of reasons. First, it allows these activities to be controlled, regulatory boundaries to be set, and, in the case of gambling, vulnerable individuals to be protected. Second, it allows these activities to be taxed. And in the gambling sector, numerous countries have taken the opportunity to do so in recent times.

But, in an industry where providers are highly mobile, governments and lawmakers face a delicate balance when it comes to taxing e-gaming firms, as they are in a position where withdrawing from one market and offering their services elsewhere is relatively easy.

We have seen plenty of examples recently of where countries appear to be getting this balance wrong.

Going back to mid-2015, we saw a number of online gaming providers exit the Portuguese market in response to the introduction of a new gambling regime, under which operators faced a tax of up to 30 percent of gross revenues.

Most recently, several prominent bookmakers and e-gaming companies have announced plans to withdraw from the Polish market ahead of a 12 percent tax on sports betting turnover, to be introduced on April 1, 2017.

Between these developments, industry disquiet has been expressed about the Dutch Remote Gambling Bill, approved in 2016, which includes a 29 percent tax on gross gaming revenues.

And several prominent bookmakers and remote gaming firms have responded to changes in UK tax legislation in the past by moving the bulk of their operations offshore, particularly to Gibraltar.

When it comes to taxation in the borderless world of the digital economy, of which remote gambling is a significant part, countries are finding that a collaborative approach is often better than trying to find unilateral solutions. Perhaps much more international cooperation is required to ensure the online gambling industry is taxed appropriately. However, on the evidence of recent developments, countries are continuing to go it alone, and not altogether successfully.

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Gross Withholding Taxes: Is The CJEU Back On Track With Regard To Deductible Expenses?

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1. Introduction

The Court of Justice of the European Union (CJEU) has handed down a massive body of case law on the question of whether a withholding tax on gross income is consistent with European Union (EU) law, especially with the fundamental freedoms.[1] The Court does not allow gross withholding taxes levied from non-residents if Members States tax their residents on their net income with the result that residents pay less taxes than non-residents on the same class of income. Key to this comparison of tax burdens of non-residents and residents is what is the tax base of residents to be taken into account, because the tax base multiplied by the tax rate results in the tax burden, leaving aside potential tax credits to be taken into account when calculating the ultimate non-resident's respectively resident's tax burden.

The research questions of this editorial are:

(1) What deductible expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the

tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties?

(2) Is the CJEU consistent in its decisions concerning what deductible expenses must be taken into account in order to calculate the net income of a resident?

The context of an editorial does not allow a very detailed answering of these questions. After setting a benchmark to assess the Court's case law in section 2, the author will address at high level settled case law which was handed down before the *Société Générale* case was decided.[2] This will be done in section 3. Subsequently, this ruling will be separately addressed in section 4, because this ruling dealing with a gross dividend withholding tax seems to be a deviation from the Court's case law. In section 5, the question will be dealt with of whether the Court in its *Pensioenfonds Metaal en Techniek* (also known as *PMT*) decision returned to its settled case law.[3] In section 6, the *Brisal* case will be discussed and the potential impact of this ruling on dividend income and royalties.[4] Section 7 draws the main conclusions.

2. Benchmark To Assess The Court's Case Law

In order to assess whether the tax burden of non-residents subject to a withholding tax on gross income, such as wages, dividends, interest, royalties, is not worse than the tax burden of residents taxed on the net income of such classes of income, an extended comparison must be made. The *actual* effective tax rate of non-residents and residents must be compared in order to assess whether the tax treatment of non-residents constitutes a discrimination or a discriminatory restriction.[5] This is only possible if a full comparison is made of the tax positions of both.

Only when the extended comparison is applied, a level playing field is created. A non-resident must be in the same competitive position as a resident. The extended comparison will also satisfy international tax neutrality, because the relation between taxes (burdens) and public goods (benefits) will not be disturbed to the disadvantage of a transnational situation. If the result is such that the tax burden of a resident is lower than that of a non-resident, a resident pays less for the public goods than a non-resident pays. The extended comparison also respects capital and labor import neutrality (CLIN), because non-residents and residents will carry the same effective tax burden in the source state with regard to the concerned class of income.

Furthermore, the non-resident's and resident's ability to pay will be measured in the same manner under the extended comparison. It satisfies the principle of equal treatment. Taxation on a gross basis might easily lead to over taxation, *i.e.*, taxation on more than the increase of wealth,

thus on more than the increase of the ability to pay. The extended comparison is also in line with an origin-state-based taxation, *i.e.*, income should be taxed only in the state where that income has been generated. This is because the public facilities provided by that state have contributed to the operation of the income-producing activities (direct benefit principle). In substance, the direct benefit principle is part of the ability-to-pay principle. The state where the income has been created, contributes to a person's wealth, which gives him the ability to pay taxes. In this context, income must be the net income, *i.e.*, the gross class of income minus the expenses attributable to that class of income. Only then, a state taxes a person's ability which has been created in that state.

In conclusion, the extended comparison contributes to creating a level playing field, establishing international tax neutrality, CLIN and satisfies the ability-to-pay principle and an origin-state-based and therefore contributes to the establishment of the internal market.[6]

3. Settled Case Law Up To *Société Générale*

The extended comparison is also settled case law.[7] This may not come as a surprise, because the CJEU is the most important protector of the development of the internal market, at least in the field of direct taxation.[8] In this context, the following cases may be mentioned as examples: *Biehl*, *Gerritse*, *Bouanich*, Case 284/09 (*Commission v. Germany*), and Case 342/10 (*Commission v. Finland*).[9] In the *Bouanich* case, the Court argues:

> 52 With regard to tax treatment under the Franco-Swedish agreement, it should be recalled that a *non-resident shareholder* such as Ms Bouanich is permitted, under that agreement, as interpreted in the light of the commentaries on the OECD Model Tax Convention, *to deduct the nominal value of the shares* from the taxable amount payable on the occasion of a repurchase of those shares. The *remaining amount* is then taxed *at the rate of 15 percent.*
>
> 53 In view of the fact that *resident shareholders* are taxed at the *rate of 30 percent* on share repurchase *payments after deduction of the cost of acquisition*, it must be ascertained *whether those shareholders are treated more favorably than non-resident shareholders*. In order to do this, it is necessary to know the cost of acquisition of those shares as well as their nominal value. […]
>
> 55 It is *therefore a matter for the national court* to determine in the proceedings before it whether the fact that *non-resident shareholders* are permitted to deduct the nominal

> value and are liable to a maximum tax rate of 15 percent *amounts to treatment that is no less favorable than that afforded to resident shareholders*, who have the right to deduct the cost of acquisition and are taxed at a rate of 30 percent.
>
> 56 The answer to the second question must therefore be that Articles 56 EC and 58 EC must be interpreted as *precluding national legislation* which derives from a double taxation agreement, such as the Franco-Swedish agreement, which *fixes a lower ceiling on the taxation of dividends for non-resident shareholders than for resident shareholders*, and, by interpreting that agreement in the light of the OECD's commentaries on its applicable model convention, permits the nominal value of such shares to be deducted from the share repurchase payment, except where, under *such national legislation*, *non-resident shareholders are not treated less favorably than resident shareholders. It is for the national court* to determine whether that is the case in the specific circumstances of the main proceedings.

In a number of cases, the Court holds that "economically connected business expenses" are expenses that are directly linked to the economic activity that generated the taxable income. One of them is the *Scorpio* case:

> In order to provide the referring court with a useful answer, the concept of "*economically connected business expenses*" must therefore be understood as referring to *expenses that are directly linked*, within the meaning of the line of case-law starting with *Gerritse*, *to the economic activity that generated the taxable income.*[10]

This rule has been affirmed in respect of dividend income in Case C-342/10 (*Commission v. Finland*):

> 25 The Commission observes that *resident* pension funds, although as regards the *dividends which they have received*, subject to a rate of taxation of 19.5 percent, *are in effect authorized to deduct tax*, on the basis of Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, *the amounts reserved in order to meet their obligations as regards pensions*, which, *in fact*, gives rise to a *tax exemption for those dividends.*
>
> 26 However, the dividends received by the *non-resident* pension funds are subject to a rate of tax of at least 15 percent in accordance with the double taxation conventions or a rate of tax of 19.5 percent in accordance with national tax legislation, *without the possibility* of their being granted by the Republic of Finland *the right to deduct tax from*

> *the amounts in reserve*, *whereas the legislation of that Member State regards those amounts as expenses directly related to the income concerned.*[11]

The author believes that this rule does not mean that only direct expenses related to dividend income should be taken into account and not indirect expenses. In this context, the author points to, *e.g.*, the *Schröder* case, in which the direct expenses were only mentioned as an example of expenses which could be taken into account:

> 40 However, the Court has held, in relation to *expenses*, *such as business expenses which are directly linked to an activity* which has generated taxable income in a Member State, that residents and non-residents of that State are *in a comparable situation*, with the result that *legislation of that State which denies non-residents*, in matters of taxation, *the right to deduct such expenses*, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality.[12]

In fact, the *Scorpio* case itself gives the rule that the CJEU's case law does not limit deduction of (business) expenses to only direct expenses. What it does rule is that at the retention of tax at source, reported direct expenses must be taken into account. However, in a refund procedure, expenses that were not directly linked to the economic activity that generated the taxable income can be taken into account:

> 50 By this question, which is linked to the preceding one, the Bundesfinanzhof essentially asks whether Articles 59 and 60 of the EEC Treaty must be interpreted as not precluding national legislation under which only the *business expenses directly linked to activities* in the Member State in which the service is provided, which the service provider established in another Member State *has reported* to the payment debtor, *are deducted in the procedure for retention at source*, and *any further business expenses* can be taken into account in a subsequent *refund procedure.*
>
> 51 This question must be answered in the light of the considerations on the previous question and bearing in mind the fact that the Court does not have the material to make a comparison between the situations of resident and non-resident providers of services. While the expenses which the provider of services *has reported to his debtor* must be deducted in the procedure for *the retention of tax at source*, Articles 59 and 60

> of the EEC Treaty do not preclude the taking into account if appropriate of *expenses that are not directly linked*, within the meaning of the *Gerritse* line of case-law, *to the economic activity that generated the taxable income*, in a subsequent *refund procedure.*[13]

The author has held earlier that it might be true that the compliance costs for a taxpayer might exceed the benefits of a net income taxation compared to a gross income taxation.[14] Therefore, in the context of a cost-benefit analysis, the CJEU might find it appropriate and proportional to give the taxpayer an option to be taxed on a net basis, but that a net basis taxation would not be mandatory. In this way the taxpayer could opt for a gross base taxation only, for whatever reason. In this respect an analogy might be drawn with the Court's case law regarding exit and final settlement taxes.[15] The Netherlands has included such an option in respect of short-term contracted sportsmen and artists.[16] The author held that he would welcome such a development of the Court's case law for practical reasons.

Actually, the Court has developed its case law in this direction as is evidenced by the *Brisal* decision in which the Portuguese withholding tax on gross interest income was under discussion.[17] The Court allows the option to be taxed on a net basis to the taxpayer, but such a taxation is not mandatory. If the taxpayer chooses to be taxed on the gross interest amount with a withholding tax, that is fine as well:

> 42 Next, the *additional administrative burden* which may fall on the recipient of the service, where the latter must enter into the accounts the business expenses which the service provider seeks to deduct, exists only in a system which provides that that deduction must be made before withholding tax is applied and may therefore *be avoided in the case where the service provider is authorized to claim its right to deduction directly from the authorities once IRC has been levied.* In such a case, the right to deduct will take the form of a *reimbursement* of a fraction of the tax withheld at source.
>
> 43 Finally, *it is for the service provider to decide* whether it is appropriate to invest resources in drawing up and translating documents intended to demonstrate the genuineness and the actual amount of the business expenses which it seeks to deduct.

4. The Exception Of *Société Générale* With Regard To Dividends

Société Générale not only incurred direct expenses in respect of the portfolio shareholdings, such as interest expenses on loans taken up to acquire these shareholdings, but also indirect expenses

such as, in the case of hedging, negative exchange and transaction results from other shares and positions than those from which the dividends arose, but which were connected with those dividends. The Dutch Supreme Court raised the question of whether all expenses which, in an economic sense, were connected with the shares from which the dividends arose had to be taken into account when calculating and comparing the effective tax rates.

Under the CITA 1969, residents are taxed on their *net income*, *i.e.*, income after deduction of direct and indirect business expenses causally linked to the income.[18] The author believes that this causal link is essentially to what the CJEU also refers to in its settled case law, since, as follows from the *Scorpio* decision, it allows non-residents to take into account direct and indirect expenses linked to the economic activity that generated the taxable income if residents may do this when calculating their taxable base.[19] Under the DWHTA 1965, no expenses were taken into account at all.[20] The taxable base was the gross dividend. Whereas resident portfolio shareholders can take into account direct and indirect business expenses causally linked to the income, non-resident portfolio shareholders could not. For them, the dividend withholding tax (DWHT) was a final tax. Therefore, in order to establish equal tax treatment of both resident and non-resident portfolio shareholders, non-resident shareholders should also be entitled to take into account direct and indirect business expenses causally linked to the dividends concerned. Such a treatment would contribute to removing the discriminatory treatment or restriction of non-resident portfolio shareholders.

Furthermore, it must be noted that the Dutch Supreme Court has decided that "costs" are current expenses and that in respect of interest income received the interest paid on loans taken up to finance the acquisition of debt claims receivables qualify as current expenses.[21] As a consequence, the interest paid is deductible as costs from the interest received. By analogy, under Dutch tax law, interest paid on loans taken up to finance the acquisition of shares are deductible as expenses from dividends received as well. It is rather curious that the Dutch Supreme Court did not take this decision into account when asking the preliminary questions.[22] One could even argue that, based on this decision, the Court itself could have decided the case in respect of deductible interest expenses without asking preliminary questions.[23]

Considering the CJEU's settled case law and the Dutch tax system, the answer of the CJEU in the *Société Générale* case is surprising and does not match with its previous case law and the Dutch tax system with regard to deductible expenses linked with dividends. Instead of an extended comparison of the situations of residents and non-residents, in substance, the Court develops its own

taxable base, as it decides that, based on European law, only expenses which are directly linked to the actual *payment* of the dividends must be taken into account for the purposes of comparing the tax burdens of resident and non-resident companies. These expenses do not include, for example, interest expenses concerning ownership of the shares *per se*, whereas such expenses are deductible as expenses from dividends received when calculating the taxable base of residents. The CJEU argues (italics added):

> 57 In that regard, it is settled case-law of the Court, in relation to *expenses such as business expenses which are directly linked to an activity that has generated taxable income* in a Member State, that residents and non-residents of that State are in *a comparable situation*, with the result that legislation of that State which denies non-residents, in matters of taxation, the right to deduct such expenses, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality (judgment in *Schröder*, C-450/09, EU:C:2011:198, paragraph 40 and the case-law cited).
>
> 58 In particular, as regards income received in the form of *dividends*, *such a link* exists *only* if *those expenses*, which may in some circumstances be directly linked to a sum paid in connection with a securities transaction, are *directly linked to the actual payment of that income* (see, to that effect, judgment in *Commission v. Germany*, C-600/10, EU:C:2012:737, paragraph 20).
>
> 59 It follows that *only* expenses which are *directly linked to the actual payment of the dividends* must be taken into account for the purposes of *comparing* the tax burden of companies.
>
> 60 The expenses identified by the referring court in its reference for a preliminary ruling in Case C-17/14 do *not* have such a link. As regards, first, *the deduction of the dividend included in the purchase price of the shares*, it is apparent from the documents before the Court that the purpose of that deduction is to establish the actual purchase price of the shares. That deduction does *not*, therefore, concern expenses which are directly linked to the actual payment of the dividends arising from those shares. Secondly, the *financing costs* also mentioned by the referring court *concern ownership of the shares per se*, and therefore they are also *not* directly linked to *the actual payment* of the dividends arising from those shares.[24]

Thus, the Court did not decide that it is for the national court to determine, based on its national law, whether non-resident shareholders are not treated less favorably than resident shareholders. Such a decision would have been in line with its settled case law as discussed above and with its also settled case law that determining the taxable base is a competence of the Member States as long as no harmonization at European level has taken place. See, for example, the *X Holding* case:

> It must be borne in mind that, according to settled case-law, although *direct taxation is a matter within the competence of the Member States*, they must none the less exercise that competence in a manner consistent with Community law (see, *inter alia*, *Marks & Spencer*, paragraph 29, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 36, and Case C-182/08 *Glaxo Wellcome* [2009] ECR I-0000, paragraph 34).[25]

The Court applied a limited comparison based on its self-developed standard instead of the regular extended comparison based on national tax law of the Member State concerned. What expenses are directly linked to an activity that has generated taxable income in the Netherlands, in this case dividends, is determined by Dutch national tax law and not by European law.

Therefore, the author believes that the *Société Générale* decision does not contribute to creating a level playing field, establishing international tax neutrality, CLIN and does not satisfy the ability-to-pay principle and an origin-state-based. In conclusion, the decision does not contribute to the establishment of the internal market.

5. Back On Track In *PMT* With Regard To Dividends?

However, one may wonder whether the *Société Générale* decision may be considered an incident and that the CJEU is on its way back to its settled case law. Maybe a first indication can be found in the *PMT* decision.[26] This case dealt with Swedish dividend withholding tax on gross dividends received by the Netherlands resident PMT. Point 64 of the decision provides support for the idea that the Court is returning back to its settled case law as handed down before the *Société Générale* decision. The wording of this point is more in line with that case law:

> That being noted, it is important, moreover, to observe that, if the application of two different taxation methods to resident and non-resident pension funds is in this instance justified by the difference in situation of these two categories of taxpayers, the Court has previously held that, in relation to professional *expenses directly linked to an*

> *activity that has generated taxable income* in a Member State, residents and non-residents of that State are in a *comparable* situation (judgment of September 17, 2015, *Miljoen and Others*, C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraph 57).

Nevertheless, the ultimate decision seems to be more in line with the *Société Générale* decision. However, this could be the result of PMT's relevant actions and procedure. As it seems to be, it has only asked for taking into account expenses directly connected to the *receipt* of dividends and not for taking into account other expenses indirectly but causally linked to the dividends received. Therefore, the Court could limit its decision to expenses directly connected to the *receipt* of dividend:

> It is, therefore, *for the referring court to determine* whether the taxation method applied to resident pension funds, by means of the calculation of the tax base of those funds and, in particular, the inclusion of their liabilities in the calculation of the capital base, allows for the taking into account of any professional *expenses directly connected to the receipt of dividends*, *as PMT appears to claim.* If that were the case, it should also be admissible to take into consideration such expenses in respect of non-resident pension funds.[27]

However, it must be emphasized that the Court, different from the *Société Générale* decision in which it decides itself as to what has to be included and what not as expenses directly linked to the actual payment of the dividends arising from the concerned shares, decided in the *PMT* case that it is for the national court to determine this.

Furthermore, it should also be emphasized that in the *Société Générale* decision, financing costs concerning ownership of the shares *per se* are not considered to be directly linked to the actual payment of the dividends arising from those shares, whereas in the *PMT* decision, in the context of expenses *directly* connected to the *receipt* of dividends, the Court allows to take into account for making a comparison between resident and non-resident pension funds, that resident pension funds include their liabilities in the calculation of their taxable base. It can be argued that, at least to a certain extent, financial costs concerning ownership of the shares *per se* are considered to be directly linked to the actual payment of the dividends arising from the shares held by PMT, indeed. Anyway, according to the author, the Court does not allow to tax resident pension funds on a net taxable base and non-resident pension funds on a gross taxable base, even when the taxation methods differ and that difference is justified because of the different goals of the distinctive taxation methods, if the net taxation of resident pension funds is also meant to take into account any

professional expenses directly connected to the receipt of dividends. If the Swedish court establishes that this is the case, then, in the context of comparing the effective tax burdens of resident and non-resident pension funds, that court must also allow non-resident pension funds to take into account such expenses.[28]

Reading the *PMT* decision in this way, this decision is already departing from the *Société Générale* decision. The Court seems to pave the way to return to its settled case law, which move is more than welcome.

6. Back On Track In *Brisal*

This idea that the CJEU is getting back on track is further fuelled by the *Brisal* decision.[29] This case was handed down after the *PMT* decision. In this case, the Court decides that the Portuguese withholding tax on gross interest paid by the Portuguese resident company Brisal to the Irish resident bank KBC Finance Ireland is inconsistent with freedom to provide services. Portuguese resident financial institutions have the right to deduct in respect of interest income received business expenses directly related to the activity in question, whereas non-resident financial institutions are not. It is for the Portuguese national court to assess, on the basis of its national law, which business expenses may be regarded as being directly related to the activity that has generated taxable income in Portugal:

> 44 With regard to the third aspect of the request for a preliminary ruling, that is to say, *how to determine the business expenses directly related to interest income* arising from a financial loan agreement such as that at issue in the main proceedings, it must be recalled that the Court has held that a Member State which grants residents the opportunity *to deduct such expenses* may not, in principle, preclude the deduction of *those same expenses* for non-residents […]
>
> 45 It follows that, as regards the account to be taken of those expenses, non-residents *must*, in principle, *be treated in the same way* as residents and must be able *to deduct the same expenses* as those which residents are allowed to deduct.
>
> 46 Furthermore, it is clear from the case-law of the Court that *business expenses directly related to the income received* in the Member State in which the activity is pursued must be understood as *expenses occasioned by the activity in question*, and therefore *necessary for pursuing that activity* […]

> 47 With regard to the service at issue in the main proceedings, that is to say, the granting of a loan, it must be noted that the performance of that service necessarily gives rise to *business expenses* such as, for example, *travel and accommodation expenses, and legal or tax advice*, for which it is relatively easy both to establish the *direct link* with *the loan* in question and to prove the actual amount involved. Since taxpayers with limited liability must be able to enjoy the same treatment as taxpayers with unlimited liability, they must be granted, as regards those expenses, *the same opportunities to make deductions*, whilst being subject to the same requirements as regards, in particular, the burden of proof.
>
> 48 It is important to add that the pursuit of that activity *also occasions financing costs* which must, in principle, be regarded as *necessary* to the pursuit of that activity, but in respect of which it may prove more difficult to establish a direct link with a given loan or the actual amount involved. The same is true, as the Advocate General stated in point 39 of her Opinion, as regards the *fraction of the general expenses* of the financial institution which may be regarded as *necessary* for the granting of a particular loan. […]
>
> 52 *It is for the referring court*, before which the dispute has been brought and which must assume responsibility for the subsequent judicial decision, to determine in the main proceedings, first, *which of the expenses claimed* by KBC may be regarded as business expenses directly related to the financial activity in question *for the purposes of national legislation*, and secondly, *what is the fraction of the general expenses* which may be regarded as *directly related* to that activity […]
>
> 53 In that regard, it is appropriate to add that, *unless national legislation authorizes* resident financial institutions to use, in the calculation of the financing costs incurred, interest rates such as those mentioned by the referring court in its third question for a preliminary ruling, that court cannot take those rates into account in a situation such as that at issue in the main proceedings.

With the *Brisal* decision, the Court is back on its track with regard to the deduction of expenses when comparing the situation of non-residents with residents: for comparing their effective tax burdens in respect of a class of income, they are entitled to the same deductions, *i.e.*, the deductions to which residents are entitled, non-residents are entitled as well. The author welcomes this

decision, because it contributes to creating a level playing field, establishing international tax neutrality, CLIN and it satisfies the ability-to-pay principle and an origin-state-based. The decision contributes to the establishment of the internal market.

However, it is surprising that the Court does not refer at all to its *Société Générale* decision, although this decision has been heavily criticized.[30] It is even more remarkable, because also Advocate General Kokott was very critical.[31] She even tried to provide the Court with an escape by referring to the distinction made for value-added tax (VAT) purposes between holding shares which does not constitute an economic activity for VAT purposes and granting loans which is an economic activity. However, the author does not believe that this distinction can really be an escape, because in respect of the free movement of capital, it is settled case law that no economic activity is required.[32] Indeed, it was exactly that freedom which has been applied in the *Société Générale* decision. The reason why the CJEU did not address the *Société Générale* decision is unclear. Is the *Brisal* decision another step of further departing from this unfortunate decision?

The *Brisal* decision may have a wide impact. The decision may be a good reason to take a similar case as the *Société Générale* case again to the CJEU. Furthermore, gross withholding taxes are also frequently levied on royalties. The same approach as in the *Brisal* case should be applied in this context.[33] If a non-resident of a Member State does not have the right to deduct expenses which are directly linked to granting a license which generates taxable income in that Member State, whilst a resident of that Member State has such a right with the result that residents pay less taxes than non-residents on royalties, such a different treatment constitutes a discrimination or a discriminatory restriction which can only be saved from a European law perspective if that different treatment can be justified by a rule of reason.

7. Conclusions

The research questions of this editorial are:

(1) What deductible expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties?
(2) Is the CJEU consistent in its decisions concerning what deductible expenses must be taken into account in order to calculate the net income of a resident?

To answer the second question first: The CJEU's case law concerning what deductible expenses must be taken into account in order to calculate the net income of a resident is consistent with the exception of the *Société Générale* decision. The *PMT* and *Brisal* decisions indicate that the Court is departing from this unfortunate decision. At least, these decisions may be good reasons to take a similar case as the *Société Générale* case again to the CJEU. Then, it can demonstrate that it is back on track with regard to deductible expenses.

In respect of the first question, the answer is that the national tax laws of the Member State concerned determine what expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties. It is for the national courts of that Member State to make this assessment. If national tax legislation gives the right to residents to deduct direct and indirect expenses causally linked with the class of income concerned, it must give non-residents the option to claim the same deductions if as a result of these deductions residents pay less taxes than non-residents on the same class of income.

With the exception of the *Société Générale* decision and possibly the *PMT* decision, the CJEU's case law with regard to deductible expenses contributes to creating a level playing field, establishing international tax neutrality and CLIN. It also satisfies the ability-to-pay principle and an origin-state-based. Thus, this case law contributes to the establishment of the internal market.

Endnotes

1 *See* extensively, *e.g.*, Karin Simander, "Withholding Taxes and the Fundamental Freedoms," *EUCOTAX Series on European Taxation*, Volume 38 (Kluwer Law International: Alphen aan de Rijn, The Netherlands 2013); Eric C.C.M. Kemmeren, "The Netherlands: What Are the Right Comparators Under Article 63 TFEU When Assessing a Dividend Withholding Tax Refund Claim? – Cases C-10/14 (Miljoen), C-14/14 (X), and C-17/14 (Société Générale)," in *ECJ-Recent Developments in Direct Taxation 2014*, *Series on International Tax Law*, Vol. 91, 121–168 (Michael Lang *et al.* eds, Linde Verlag Wien: Wien, Österreich, 2014); Karin Spindler-Simader, "Dividend Withholding Taxes after Miljoen, X and Société Générale," 25 *EC Tax Rev.* 70–76 (2016); and B.M. van der Werf, "The Effective Tax Burden Analysis After Société Générale, PMT and Brisal," 18(4) *Derivatives & Fin. Instruments* (2016).

2 CJEU, September 17, 2015, Case C-17/14 (*Société Générale*).

3 CJEU, June 2, 2016, Case C-252/14 (*PMT*).

4 CJEU, July 13, 2016, Case C-18/15 (*Brisal*).

5 *See also*, *e.g.*, Kemmeren, *supra* note 1, at 138–141.

[6] *See* for further details on these benchmarks, *e.g.*, Eric C.C.M. Kemmeren, *Principle of Origin in Tax Conventions, A Rethinking of Models*, Dissertation PhD thesis, Tilburg University 35 *et seq*., 177 *et seq.,* and 340–350 (E.C.C.M. Kemmeren/Pijnenburg vormgevers/uitgevers 2001), https://www.tilburguniversity.edu/nl/webwijs/show/kemmeren_nl.htm; Eric C.C.M. Kemmeren & Daniël S. Smit, "Taxation of EU-Non-Resident Companies Under the CCCTB System: Analysis and Suggestions for Improvement," in *Corporate Income Taxation in Europe, The Common Consolidated Corporate Tax Base (CCCTB) and Third Countries*, 51 *et seq.* (M. Lang *et al.* eds, Edward Elgar Publishing, 2013); and Eric C.C.M. Kemmeren, "Legitimacy of Tax Claims of Developing Countries on Interest and Royalties of MNEs," in *Practical Problems in European and International Tax Law, Essays in Honour of Manfred Mössner*, 163 *et seq.* (Heike Jochum *et al.* eds, IBFD: Amsterdam, 2016).

[7] *See also*, *e.g.*, Kemmeren, *supra* note 1, at 138–141.

[8] *See also*, *e.g.*, Axel Cordewener, "The Prohibitions of Discrimination and Restriction Within the Framework of the Fully Integrated Internal Market," in *EU Freedoms and Taxation*, 2 *EATLP International Tax Series*, 51 *et seq.* (Frans Vanistendael ed., Amsterdam, The Netherlands: IBFD, 2006); and Eric C.C.M. Kemmeren, "The Internal Market Approach Should Prevail over the Single Country Approach," in *A Vision on Taxes Within and Beyond European Borders, Festschrift in Honor of Professor Dr. Frans Vanistendael*, 560–561 (Luc Hinnekens & Philippe Hinnekens eds, The Hague, The Netherlands: Kluwer Law International, 2008).

[9] *See* CJEU, May 8, 1990, C-175/88 (*Biehl*), paras 14 and 16; CJEU, June 12, 2003, C-234/01 (*Gerritse*), paras 47 and 52–54; CJEU, January 19, 2006, C-265/04 (*Bouanich*), paras 3–7, 44, 52–53, and 55–56; CJEU, October 20, 2011, C-284/09 (*Commission/Germany*), paras 49, 51, and 53–58; and CJEU, November 8, 2012, C-342/10 (*Commission/Finnland*), paras 24–26, 29, 31–32, 34 and 44.

[10] *See* CJEU, October 3, 2006, C-290/04 (*Scorpio*), para. 44.

[11] *See* CJEU, November 8, 2012, C-342/10 (*Commission/Finland*), paras 25–26.

[12] *See* CJEU, March 31, 2011, Case C-450/09 (*Schröder*), paras 40.

[13] *See* CJEU, October 3, 2006, C-290/04 (*Scorpio*), paras 50–51.

[14] *See* Kemmeren, *supra* note 1, at 151–152.

[15] *See*, *e.g.*, CJEU, November 29, 2011, C-371/10 (*National Grid Indus BV*); CJEU, July 12, 2012, C-269/09 (*Commission/Spain*); CJEU, September 6, 2012, C-380/11 (*DI.VI.*); CJEU, September 6, 2012, C-38/10 (*Commission/Portugal*); CJEU, January 31, 2013, C-301/1 (*Commission/The Netherlands*); CJEU, April 25, 2013, C-64/11 (*Commission/Spain*); CJEU July 18, 2013, C-261/11 (*Commission/Denmark*); CJEU, January 23, 2014, C-164/12 (*DMC*).

[16] *See* Art. 9.4(3)(b) *Wet inkomstenbelasting 2001* (Personal Income Tax Act 2001 (PITA 2001)).

[17] *Supra*, note 4, paras 42–43.

[18] *See* Arts 7-15a *Wet op de vennootschapsbelasting 1969* (Corporate Income Tax Act 1969 (CITA 1969)). Based on these provisions, certain expenses are not deductible, but these non-deductible expenses

are not relevant for this case. *See* for a more detailed discussion, *e.g.*, E.C.C.M. Kemmeren and O.L.J. Nuijten, *Renpaarden rijden Cessna's niet in de wielen en leiden niet tot een spooktocht*, 739–747 (Weekblad Fiscaal Recht, 2003).

[19] *Supra*, note 13, paras 50–51.

[20] *Wet op de dividendbelasting 1965* (Dividend Withholding Tax Act 1965 (DWHTA 1965)). As of January 1, 2017, Art. 10a DWHTA 1965 provides a refund procedure through which a taxpayer can claim a net base taxation in line with, *inter alia*, the *Société Générale* decision.

[21] *See Hoge Raad* (HR; Dutch Supreme Court), June 17, 2011, No. 10/00076, *Beslissingen in belastingzaken Nederlandse Belastingrechtspraak* (*BNB*) 2012/23.

[22] *See* HR, December 20, 2013, No. 12/03235, *BNB* 2014/64.

[23] It should also be noted that the Dutch Supreme Court also neglected HR BNB 2012/23 in its final decision in the *Société Générale* case. *See* HR March 4, 2016, No. 12/03235, *BNB* 2016/88. This may be a good reason to take a similar case as the *Société Générale* case again to Dutch Supreme Court.

[24] *Supra*, note 2, paras 57–60.

[25] *See* CJEU, February 25, 2010, Case C-337/08 (*X Holding*), para. 16. *See also*, *e.g.*, CJEU, May 26, 2016, Case C-48/15 (*NN (L)*), para. 43.

[26] *See* CJEU, June 2, 2016, Case C 252/14 (*PMT*).

[27] *Id*, para. 65.

[28] *See* for a different opinion, *e.g.*, Daniël S. Smit, *International Income Allocation under EU Tax Law: Tinker, Tailor, Soldier, Sailor*, Tilburg University, Tilburg 2016, p. 17, who holds that the CJEU is blending two elements of two different systems and, subsequently, that it uses that blend as a new benchmark. According to Smit, the CJEU creates a new international income allocation rule.

[29] *Supra*, note 4, paras 43–54.

[30] *See*, *e.g.*, Rens Paternotte in his annotation to *Société Générale* (*supra*, note 2), H&I 2015/343; Spindler-Simader, *supra*, note 1; Dutch Advocate General Wattel in his opinion of December 23, 2015, No. 12/03235, *BNB* 2016/88, paras 3.6–3.12; P.G.H. Albert in his annotation to *BNB* 2016/88; H. Vermeulen, *Over outbound dividend, kostentoerekening en inningskosten. Het mysterie in de zaak Société Générale*, NTFR 2016/1515; and van der Werf, *supra*, note 1.

[31] *See* Advocate General in her opinion of *Brisal* (*supra*, note 4), paras 31–36.

[32] *See*, *e.g.*, CJEU, December 11, 2003, Case C-364/01 (*Erven Barbier*), paras 56–63; CJEU (*Stauffer*), paras 18–24; and CJEU (*Welte*), paras 31–39.

[33] Compare also, *e.g.*, van der Werf, *supra* note 1.

Topical News Briefing: Brexit – Will There Be Devil In The Detail?

by the Global Tax Weekly Editorial Team

After many long months of uncertainly since Britain's momentous vote to leave the EU, the outlines of the UK's future trading relationship with the EU is at last beginning to take shape.

The UK Government's preference for a "hard Brexit" means we can now stop speculating too much about whether the country will continue as a member of the Single Market, or merely have access to it – like other non-EU countries – probably on less preferential terms than it gets at present.

Furthermore, the EU itself seems to have adopted a more conciliatory tone towards the UK since the Government came to the realization that it couldn't have its cake and eat it (*i.e.*, all the benefits of EU membership, but none of the drawbacks – as leave campaigners saw them – like free movement of people and billions in annual contributions to the EU budget). This was evidenced in remarks made by EU chief Brexit negotiator Michael Barnier in a recent speech, when he said the EU27 wants to reach a deal with the UK on its "orderly withdrawal" that prepares "the way for a new partnership."

So, with the UK finally triggering Article 50 and setting the ball rolling on its negotiations with the EU, some progress is at last being made towards the final Brexit settlement.

However, we are still not much further forward towards knowing how Brexit will change the UK's legal landscape, especially in the area of tax, and the answers are unlikely to emerge from the fog of confusion until well into the negotiating process.

While member states are largely free to set their own tax systems as they wish, there will nevertheless be major implications for certain taxes when a country chooses to leave the EU, particularly with regards to value-added tax and intra-company withholding taxes.

Currently, VAT is the only tax substantially harmonized at EU level, and businesses will hope that compliance requirements for UK-based companies will continue to be broadly in line with those currently in place, to ease the burden of trading with the EU. Other changes may be necessary,

as UK goods and services may no longer be treated as intra-community supplies or acquisitions.

Once Brexit is achieved, the Parent-Subsidiary and Interest and Royalties directives would also no longer apply in the UK. And this is significant for multinational groups because these laws are designed to ensure that intra-EU dividend distributions and payments of interest and royalties between certain companies of the same group are not doubly taxed.

Perhaps one of the most crucial issues, however, is the legal status in the UK of the huge volume of tax jurisprudence issued by the European courts over the years. Obviously, if the UK comes out of the EU, it would no longer have to abide by future rulings, but it remains to be seen the extent to which existing case law remains applicable.

There are also other ramifications for UK tax policy as a result of a Brexit. For example, it is to be assumed that the UK would no longer have to abide by UK state aid rules, allowing the Government much more freedom to provide support to certain industries or geographical areas in the form of tax incentives or subsidies.

In terms of tax issues with wider international significance, the UK would also be free to take its own position on the OECD's BEPS project, independent of the Directives issued by the European Commission, although it would still be accountable to the international community.

And presumably, now it is fairly certain that the UK is leaving the EU, it would also no longer be obligated to take part in any further projects intended to harmonize tax rules at EU level, notably the proposed common consolidated corporate tax base, which is high on the European Commission's agenda.

So, while investors and taxpayers may welcome the fact that light has been shed on Britain's broad Brexit strategy, they still face an agonizing wait on many of the small but crucial details that will shape its post-settlement tax and legal framework.

Trump Looks To Tax Reform Following Health Care Act Failure

US President Donald Trump has announced his intention to move onto tax reform immediately, following the decision to pull the American Health Care Act (AHCA).

At a press conference on Friday, Paul Ryan, Speaker of the US House of Representatives, cited a lack of support for the AHCA among some Republicans for a vote on the Act to succeed, conceding that Obamacare "is going to remain the law of the land."

This setback for the Trump Administration means that the various taxes that would have been repealed under the AHCA will remain in place.

Shortly after Ryan's announcement, Trump said: "We'll be going right now for tax reform, which we could have done earlier."

Based on the Republican party's blueprint released in June last year, it is likely that the tax reform package to be put forward will include a proposal for a Border Adjustment Tax (BAT), simplification of the individual income tax regime and potentially a cut to the top tax rate, the repeal of the Estate Tax, and a reduction to the corporate tax rate of 20 percent.

US Begins Process Required To Renegotiate NAFTA

The White House is preparing to issue the notification to Congress that it will renegotiate the North American Free Trade Agreement (NAFTA).

Commerce Secretary Wilbur Ross has reportedly met with the House Advisory Group on Negotiations, paving the way for the Administration to notify Congress that it will launch renegotiations within three months.

President Donald Trump has indicated he would consider pulling out of NAFTA if his counterparts are unwilling to renegotiate the agreement. Withdrawing from NAFTA would require six months' notice.

Mexico commenced its own three-month consultation process in February.

US Tax Reform Timetable Uncertain, Spicer Says

White House Press Secretary Sean Spicer has discussed the timetable for US tax reform.

His comments follow the setback to US President Trump's plans following the decision to pull the American Health Care Act (AHCA) prior to a vote.

Speaking on March 27, Spicer was asked about Treasury Secretary Steven Mnuchin's comments that tax reform could proceed in August. Spicer cited the large number of stakeholders that would be involved in the process as potentially constraining that deadline.

He said: "I know that Secretary Mnuchin has talked about August as a target date. And I think it depends. I mean, as you point out, these are big things. There's a lot of groups that are going to want a ton of input because of the very nature that it's been 30 years. But I think part of this is going to be dependent on … the degree to which we can come to consensus on a lot of big issues. But I know that we have a goal and it will depend on a lot of these issues, both on the corporate side and on the individual side, how that process evolves."

With health care reform shelved, Trump has said that tax reform is now a priority.

However, business leaders are skeptical that US tax reform can be achieved quickly. In a recent KPMG survey, more than half of respondents (53 percent) predicted that significant business tax reform will not arrive until 2018. Only 16 percent of more than 1,000 respondents polled during a recent webcast expect tax reform to be achieved in 2017, while 11 percent do not expect reform until 2019, and 21 percent said they are unsure of when tax reform might be achieved.

Canadian Budget Focuses On 'Tax Fairness'

The tax measures contained in Canadian Finance Minister Bill Morneau's second Budget are focused on closing loopholes, cracking down on tax evasion, and improving tax reliefs for the "middle class."

Morneau delivered the Budget on March 22. In his speech, he said: "Going forward, we will close loopholes that result in unfair tax advantages for some at the expense of others. We will eliminate inefficient tax measures, especially those that disproportionately benefit the wealthy. And we will work with the provinces and territories to crack down on those who hide their identity to avoid paying taxes."

According to Budget documents, the Government intends to take the following actions to close loopholes in the tax system:

- Prevent the avoidance or deferral of income tax through the use of offsetting derivative positions in straddle transactions;
- Clarify the intended meaning of "factual control" under the Income Tax Act for the purpose of determining who has control of a corporation, in order to prevent inappropriate access to support such as the small business tax rate and the enhanced refundable Scientific Research and Experimental Development Tax Credit for small businesses;
- Prevent the avoidance of tax on income from the insurance of Canadian risks, by extending the foreign-affiliate base erosion rules to foreign branches of Canadian life insurers; and
- Extend to the Registered Education Savings Plans and Registered Disability Savings Plans anti-avoidance rules similar to those currently applicable in connection with Tax-Free Savings Accounts and Registered Retirement Savings Plans.

The Government will also further review the use of tax planning strategies involving private corporations that inappropriately reduce the personal taxes of high-income earners. It will at the same time consider whether there are features of the current income tax system that have an inappropriate, adverse impact on genuine business transactions involving family members.

The Government will release a paper in the coming months that will set out the nature of these issues in more detail, along with a range of proposed policy responses.

In addition, an extra CAD523.9m (USD393m) will be invested over five years in activities designed to prevent tax evasion and improve tax compliance. The funding will enable the Canada Revenue Agency to: increase

its verification activities; hire additional auditors and specialists with a focus on the underground economy; develop robust business intelligence infrastructure and risk assessment systems to target high-risk international tax and abusive tax avoidance cases; and improve the quality of investigative work that targets criminal tax evaders.

The Government expects to raise CAD2.5bn from the anti-evasion measures outlined in the Budget.

The federal Government will collaborate with the provinces and territories on a national strategy "to strengthen the transparency of legal persons and legal arrangements and improve the availability of beneficial ownership information." It is also currently examining how the tax reporting requirements for trusts can be enhanced, to improve the collection of beneficial ownership information.

Another key tax-related focus of the Budget is the elimination of tax measures that have a limited impact, have had low take-up, or duplicate other forms of federal support. The Budget proposes to:

- Eliminate the Public Transit Tax Credit, effective in respect of transit use occurring after June 30, 2017;
- Repeal the Good and Services Tax (GST)/Harmonized Sales Tax (HST) rebate payable to non-resident tourists and non-resident tour operators in respect of the accommodation portion of tour packages;
- Eliminate the surtax on domestic tobacco manufacturers;
- Repeal the 25 percent Investment Tax Credit for Child Care Spaces;
- Repeal the additional deduction available to corporations that donate medicine to eligible registered charities; and
- Allow the First-Time Donor's Super Credit to expire in 2017, as planned.

To improve consistency across the tax system, the Budget also proposes to eliminate the deduction in respect of employee home relocation loans, and remove the tax exemptions for non-accountable expense allowances paid to members of provincial and territorial legislative assemblies and to certain municipal office-holders.

With a view to updating the tax system to reflect the changing nature of the economy, the Budget will:

- Amend the definition of a taxi business under the Excise Tax Act, with a view to leveling the playing field and ensuring that ride-sharing businesses are subject to the same GST/HST rules as taxis;
- Eliminate the use of billed-basis accounting for income tax purposes by a limited group of professionals, to avoid giving these

professionals a deferral of tax that is not available to other taxpayers; and

- Eliminate the income tax exemption for insurers of farming and fishing property, which was introduced in 1954 to encourage the provision of insurance in rural districts.

On the personal tax front, the Budget proposes the following changes to the tax credit system:

- The range of courses eligible for the Tuition Tax Credit will be expanded to include occupational skills courses that are undertaken at a post-secondary institution in Canada;
- Individuals who require medical intervention in order to conceive a child will be eligible to claim the same expenses under the Medical Expense Tax Credit that would generally be eligible for individuals on account of medical infertility;
- The Government will introduce a new, non-refundable Canada Caregiver Credit, which will replace the existing Caregiver Credit, Infirm Dependant Credit, and Family Caregiver Tax Credit; and
- Nurse practitioners will be added to the list of medical practitioners that can certify the impacts of impairments for Disability Tax Credit applicants.

Uber Canada Concerned Over Ride-sharing Tax Reform

Uber Canada has said that changes to the goods and services tax (GST) rules for ride-sharing businesses will "hurt over a million Canadians who use ride-sharing to earn income and get around their cities."

The 2017 Budget included a proposal to amend the definition of a taxi business under the Excise Tax Act. The aim is to ensure that ride-sharing businesses are subject to the same GST/harmonized sales tax rules as taxis.

Responding to the announcement, Ian Black, Regional General Manager for Uber Canada, said there should be support for policies that "make sustainable transportation more affordable, not more expensive."

He argued: "Federal tax laws already offer small business owners a break on collecting sales tax, but unfairly exclude taxi drivers. The best way to support taxi drivers and level the playing field is to extend the same exemption to them."

Black said there should be meaningful consultation on the proposal and that Uber hopes to "work with the Government on smart solutions that support innovation."

April Cut-off For EU Financial Transactions Tax Negotiations

The EU member states taking part in the proposed EU financial transactions tax (FTT) will decide next month whether or not to proceed with the controversial tax, according to Austrian Finance Minister Hans Jörg Schelling.

Schelling appeared to suggest following the latest round of negotiations on the FTT that the talks would finally collapse at the next round, which is scheduled for May, if more countries decide to drop out.

"They must have made a decision by May," said Schelling, according to Euractive France. "If they do not approve it and decide to leave the group, the project is over."

Under the proposed FTT directive drafted by the Commission in 2011, the tax would be imposed on all transactions in financial instruments, with the exchange of shares and bonds taxed at a rate of 0.1 percent and derivative contracts at a rate of 0.01 percent.

However, the participating member states have found it difficult to arrive at a consensus on the technical details of the new directive, particularly around the issues of how the tax will apply to derivative trades, and to transactions made by pensions funds.

A total of 11 member states (Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia, and Slovakia) originally committed to the FTT under the enhanced cooperation legislative mechanism, which requires support from a minimum of nine member states and can be used when unanimity cannot be reached on EU-level initiatives.

The group was reduced to ten member states in 2015 when Estonia decided to pull out of the talks.

Belgium, which is a significant European financial center, is also understood to have reservations about the direction the negotiations are taking, while Slovenia is concerned that the tax will cost the country more to administer than it will receive in tax revenue. Slovakia is the other country said to be on the brink of leaving the negotiations.

This isn't the first time Schelling, who is chairing the negotiations, has issued such a warning. Last June, he said the FTT talks would dissolve if an agreement was not reached by September 2016.

Day Trading Transaction Tax Cut Expected Next Month In Taiwan

A planned cut in the existing day trading transaction tax in Taiwan from 0.3 percent to 0.15 percent is expected to tax place in April, according to reports in the national media.

The move is designed to improve the jurisdiction's attractiveness to investors and help Taiwan compete against other financial centers in the region, such as Hong Kong and Singapore.

A move to introduce a capital gains tax on share trading was scrapped at the end of 2015, due to concerns over a drop in trading.

According to a report from Channel NewsAsia, legislation implementing the cut has passed a first reading by the Legislative Yuan, and is expected to receive a second and third reading in April, with no problems anticipated.

It is planned that the tax cut will be in operation for one year. The tax cut may be extended, depending on whether it is effective in boosting share trading activity.

UK Begins 'Hard Brexit' Process

On March 29, 2017, UK Prime Minister Theresa May invoked Article 50 to launch the Brexit process.

"We are on the threshold of the most important negotiation for this country for a generation," said Brexit Secretary David Davis, prior to the Article being invoked.

Earlier this year, May 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."

She said while she wants the UK to remain part of the 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.

The triggering of Article 50 marks the beginning of a two-year negotiation process to reach agreement on the terms for Brexit.

Food Retailers Seek UK–EU Free Trade Agreement

The British Retail Consortium (BRC) and other food industry representative bodies have called on the UK Government to secure two-way tariff-free trade with the EU in Brexit discussions.

The BRC, the National Farmers Union of England and Wales (NFU), and the UK's Food and Drink Federation (FDF) have outlined their joint priorities for UK trade policy in a new statement.

They are calling on the Government to "adopt an approach that will ensure stability and continuity for agri-food and drink businesses" through a bilateral free trade agreement.

They are also calling on the UK to:

- Establish itself as an independent member of World Trade Organization, to provide continuity and predictability to firms by adopting the EU's current schedule of Most Favored Nation bound tariff rates;
- Secure the benefits for UK traders of existing EU preferential trade arrangements, including the UK's fair share of tariff rate quotas for agricultural imports; and

- Engage in formal trade negotiations with non-EU countries when the terms of the UK's future trading relations with the EU and other existing preferential trading partners are clear.

"We cannot operate in isolation," the joint statement said. "Our farmers need imported feed and inputs and they need access to other markets for their products, especially where demand for these in the UK is insufficient."

Having ruled out the possibility of the UK remaining part of the EU Single Market, UK Prime Minister Theresa 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," and for the UK to remain part of the customs union as an "associate member."

Hong Kong's New Chief Executive To Pursue Competitive Tax Regime

On March 26, Carrie Lam was elected Hong Kong's new chief executive, with a promise that she would pursue a "new tax policy direction" in the territory.

In her manifesto, Lam promised to maintain Hong Kong's simple tax regime and low tax rates, and to encourage research and development (R&D), which accounts for a small proportion of the territory's gross domestic product (GDP) relative to Hong Kong's regional peers.

She said Hong Kong should introduce additional tax breaks for R&D expenditure to ensure its regime is competitive with other territories. Additional tax deductions may also apply to spending on environmental protection initiatives, culture, arts, and design, she said, to promote the development of these industries.

Lam also promised a reduction in the tax burden for small, medium-sized, and startup enterprises. She said she would look to lower the tax rate from 16.5 percent to 10 percent on the first HKD2m (USD257,460) of a company's profits.

She said the territory would consult with stakeholders on any changes, and also seek to expand its double tax agreement network.

Irish Leadership Contender Sets Out Tax Cut Plans

Fine Gael leadership contender Leo Varadkar has described Ireland's high marginal income tax rate as "a real problem," and said that reforming tax and social insurance could help "attract and retain talented people."

Irish Prime Minister and Fine Gael leader Enda Kenny is due to step down but has yet to outline a timetable for his departure. In an opinion piece for *The Irish Independent*, Varadkar – widely regarded as one of the frontrunners to replace Kenny – set out his stall on personal income tax reform.

Varadkar contrasted Ireland's low corporate tax rate and the stability and predictability associated with the corporate tax regime with the complexity and high rates of the personal tax system. He noted that there are three personal tax charges – income tax, the Universal Social Charge (USC), and Pay Related Social Insurance (PRSI) – with "three different sets of thresholds and entry points, seven bands, and eight rates."

"The Government should never take more than 50 percent of any euro you own," he said, warning that high personal tax rates "make it harder to attract skilled, qualified, and talented people home from London and other countries, and it

is one of the push factors that causes our home-grown doctors, IT professionals, and others to take opportunities elsewhere."

"With Brexit, it's more important than ever that we bring these tax rates in line with our competitors," he added.

Varadkar also criticized the low entry point for the top marginal income tax rate, describing it as "a big disincentive."

Turning to the USC, which Fine Gael's 2016 election manifesto pledged to abolish, Varadkar said the levy is "associated with the financial crisis and you get nothing for it." He suggested it could "make more sense to simplify the system and replace the USC and PRSI with a new PRSI-style charge: Social Insurance."

Varadkar explained that under such system, social insurance would be ring-fenced to fund public services, and there could in future be a link between earnings and benefits.

"Tax cuts and social insurance reform done in a prudent manner assists economic growth, and ring-fences the additional funds for services. It's about creating the conditions to ensure our future economy is built on lines that unite rather than divide our society," he concluded.

China Hits Back At US In Latest 'Trade War' Spat

China's Ministry of Commerce (MOFCOM) has said it is "strongly dissatisfied with the high rate of anti-dumping made by the US Department of Commerce."

The statement came after the US Department of Commerce announced final duties of up to 184.01 percent on Chinese exporters of certain chemicals following an anti-dumping and countervailing duty investigation.

A MOFCOM spokesperson said: "The US has violated its obligations under the World Trade Organization (WTO) and severely impaired the interests of Chinese enterprises."

MOFCOM objected to the use of a "surrogate country" in determining applicable duties. The Chinese Government is insisting that all WTO members should treat it as a market economy (ME) after December 11, 2016, being the 15th anniversary of its WTO accession. In accordance with Article 15 of China's Protocol of Accession, it is insisting that all WTO members should abandon the non-market economy (NME) approach whereby domestic prices are not used as a benchmark against which to compare export prices.

Instead, for NMEs, WTO rules allow the use of data from another ME country – an "analogue country" – as the basis for calculation. This means that NMEs may be subject to anti-dumping duties that can be higher because they are considered to more likely provide government subsidies that artificially lower domestic prices.

According to MOFCOM, "the Chinese side is strongly dissatisfied with the high rate of anti-dumping made by the US Department of Commerce. The US ignored the fact that Article No. 15 of Protocol of China's Accession to the WTO has been due, continued to refuse to accept many evidence materials that the Chinese enterprises had submitted, insisted in using the surrogate country, refused to correct its wrong calculation, and made a rate of anti-dumping that is severely divorced from objective facts. The US has violated its obligations under the WTO and severely impaired the interests of Chinese enterprises."

The findings of the investigation follow a number of rulings and determinations in cases brought by the US Commerce Department against China including, since the beginning of the year, disputes over steel sheets, strip carbon and alloy steel cut-to-length plate, tires, amorphous silica fabric, biaxial integral geogrid products, and hardwood plywood.

New Zealand, China Agree To Discuss FTA Upgrade

New Zealand and China will begin talks on April 25 towards enhancing their existing free trade agreement (FTA).

The announcement from New Zealand's Finance Minister, Bill English, followed talks between the Prime Minister and Chinese Premier Li Keqiang in Wellington on March 27.

"The FTA with China has been an enormous success," English said. "Since [the FTA came] into force in 2008, two-way trade between our countries has tripled to NZD23bn (USD16.2bn), creating jobs and opportunities for people in both countries. An upgrade will ensure this momentum continues and ensure that the FTA remains a modern agreement that tackles barriers our exporters face. It will assist progress towards our target of NZD30bn two-way trade by 2020."

In addition to agreeing a date for talks to begin on an FTA upgrade, the two leaders agreed that ten New Zealand meat processors will be allowed to export chilled meat to China for a six-month trial period; and the two countries will provide expedited customs clearance for major, trusted exporters.

Turnbull Hails Benefits Of Australia–China FTA

Australian Prime Minister Malcolm Turnbull has hailed the "doors of opportunity" opened by the year-old free trade agreement (FTA) with China.

In a speech to a luncheon in honor of Chinese Premier Li Keqiang, Turnbull said the benefits of the agreement could already be seen.

"Wine exports are up 38 percent; fresh orange exports by 46 percent; skincare products up 82 percent; abalone exports more than doubled; and Chinese imports of Australian lobster quadrupled," he said. "The agreement is delivering great growth for Australian companies, many large and well known, but also newer firms."

Turnbull also stated that during Premier Li's visit to Australia they would "announce the next stage in the evolution of the [FTA] and our expanding economic relationship."

The FTA entered into force on December 20, 2015. Under the FTA, more than 96 percent of Australia's goods exports to China are now eligible to enter the Chinese market duty-free or with preferential access.

HMRC Consults On Improving Online VAT Collection

UK tax authority HM Revenue & Customs (HMRC) has launched a consultation on an alternative method of collecting value-added tax (VAT) on online business to consumer sales.

Specifically, it is seeking evidence on the technical feasibility of extracting VAT in real time using payment technology and having that revenue deposited with the tax authority, referred to as "split payment."

The consultation explores solutions to address issues with foreign firms' non-compliance with their UK tax obligations, which are said to arise as a result of the time lag between the payment of VAT by a customer, and the business, if compliant, remitting that revenue to HMRC, or, if non-compliant, failing to pass on that revenue.

UK Barrister To Argue Uber Responsible For UK VAT Dues

In the embattled ride-sharing app's latest tax skirmish, Uber is being sued in the UK in relation to potential VAT underpayment.

Jolyon Maugham QC, a barrister at Devereaux Chambers and founder of the Good Law Project, has argued that the firm is significantly underpaying VAT as a result of its controversial business model.

In a recent UK tribunal ruling, Uber was found to have an employer-like relationship with its drivers wherein it should be liable for the payment of employment-related taxes. However, the tribunal did not consider the VAT impact.

In a statement explaining the decision to challenge Uber's VAT liability, the Good Law Project said it does believe HM Revenue & Customs will enforce VAT liability on Uber.

Ecofin Discusses EU VAT Reform Proposals

The EU's Economic and Financial Affairs Council (Ecofin) has discussed two new European Commission proposals for VAT reform. Ecofin met on March 21.

The first proposal provides for the possibility to align the VAT rules for e-publications, which are currently taxed at the standard VAT rate (*i.e.*, a minimum of 15 percent), with those for "physical" publications, which benefit from a variety of reduced rates.

According to an Ecofin document published after the meeting, the Council's debate "focused on the possibility of applying not just reduced VAT rates but also super-reduced and

zero VAT rates." The document added that the Council presidency "confirmed its intention to broker an agreement on the proposal before the end of June 2017."

The second proposal is for a "generalized reverse charge mechanism," which would involve shifting liability for VAT payments from the supplier to the customer for domestic supplies above a certain threshold. It thereby derogates from the general principles of the EU's VAT system.

The Ecofin document explained that the debate focused on the scope of the proposal, the criteria for obtaining a derogation, the procedure for repealing a derogation, and the duration of the derogation. It stated that work will continue on the proposal, with a view to reaching an agreement, and that the presidency noted there are a number of issues to be resolved.

The proposal is intended to offer a short-term solution to the problem of VAT fraud, pending the preparation of a new VAT system under which supplies would be taxed in the country of destination.

Speaking after the meeting, Commission Vice President Valdis Dombrovskis said: "Our proposal to reduce VAT rates for e-books and other e-publications would allow us to keep step with the digital revolution. Many ministers today strongly supported this targeted and simple initiative. We hope that agreement on this can be reached quickly. We also discussed the reverse charge mechanism. More work on this is needed, and there are some diverging views on this issue."

India Approves Goods And Services Tax Legislation

India's Cabinet on March 20 approved legislation crucial for the implementation of the goods and services tax (GST) from July 1.

Lawmakers approved the Central Goods and Services Tax Bill 2017 (CGST Bill); Integrated Goods and Services Tax Bill 2017 (IGST Bill); Union Territory Goods and Services Tax Bill 2017 (UTGST Bill); and Goods and Services Tax (Compensation to the States) Bill 2017 (Compensation Bill).

The four Bills were approved earlier by the GST Council – formed of state and central government negotiators – after 12 intensive meetings held in the last six months.

The CGST Bill provides for rules on the taxation of supplies of goods or services within a state (intra-state supplies); the IGST Bill covers the same for supplies between states (interstate supplies); and the UTGST Bill covers the rules on intra-Union Territory supplies.

The Compensation Bill provides for compensation to the states for loss of revenue arising from the implementation of the GST, in place of the current multitude of indirect taxes, for a period of five years.

MEPs Approve Hybrid Mismatch Proposals

Members of the European Parliament's Economic and Monetary Affairs Committee have backed proposals to further tackle hybrid mismatch arrangements.

Such mismatches can result in either double deductions for the same expense, or deductions for an expense without the corresponding receipt being fully taxed. Hybrid mismatch outcomes can arise from hybrid financial instruments (both equity and debt) and hybrid entities, and from arrangements involving permanent establishments. They can also arise from hybrid transfers and dual resident companies.

The latest measures to tackle hybrid mismatches follow the adoption of measures that focused solely on transactions involving only companies resident in EU member states. The intention of the new proposal is to capture all hybrid mismatch arrangements where at least one of the parties involved is a corporate taxpayer in a member state.

The proposal is to now moved to the European Council for consideration. The measure would be applied throughout the EU from 2019 as part of the new Anti Tax Avoidance Directive.

Australian Diverted Profits Tax Legislation Passes Senate

The Australian Senate has passed legislation to introduce a diverted profits tax (DPT) from July 1, 2017.

The DPT will impose a 40 percent penalty tax on profits that have been "artificially diverted" from Australia by multinationals. The penalty tax must be paid immediately.

In a joint media release, Treasurer Scott Morrison and Revenue Minister Kelly O'Dwyer said the DPT "provides a powerful new tool for the Australian Taxation Office to tackle contrived arrangements and uncooperative taxpayers, and will reinforce Australia's position as having some of the toughest laws in the world to combat multinational tax avoidance." They expect the DPT to raise AUD100m (USD76.3m) in revenue a year from 2018/19.

The DPT will target entities with global income of AUD1bn or more and Australian income of more than AUD25m that shift profits to offshore associates where:

- The resulting increase in the foreign tax liability is less than 80 percent of the corresponding decrease in the Australian tax liability;
- There is insufficient economic substance; and

- One of the "principal purposes" is to obtain a tax benefit.

The DPT will not apply to managed investment trusts or similar foreign entities, sovereign wealth funds, or foreign pension funds.

AUSTRALIA - CHINA

Negotiations

Australia and China have agreed to discuss the further liberalization of services and investment under their free trade agreement (ChAFTA), and to update their double tax agreement.

AZERBAIJAN - DENMARK

Signature

Azerbaijan and Denmark signed a DTA on February 17, 2017.

HONG KONG - KOREA, SOUTH

Signature

According to a January 24, 2017, announcement from the Hong Kong Government, the territory has signed a TIEA covering financial account information with South Korea.

HONG KONG - PAKISTAN

Signature

Hong Kong and Pakistan signed a DTA on February 17, 2017.

INDIA - BELGIUM

Signature

India and Belgium signed a DTA Protocol on March 9, 2017.

INDIA - SINGAPORE

Ratified

On March 23, 2017, India published a notice ratifying the double tax protocol signed with Singapore, which entered into force on February 27, 2017.

ITALY - MONACO

Into Force

The Italian Finance Ministry announced on February 17, 2017 that Italy's new TIEA with Monaco entered into force on February 4, 2017.

JERSEY - MAURITIUS

Signature

Jersey and Mauritius signed a DTA on March 3, 2017.

MAURITIUS - GHANA

Signature

Mauritius and Ghana signed a DTA on March 10, 2017.

SINGAPORE - INDIA

Into Force

Singapore's DTA Protocol with India entered into force on February 27, 2017.

SINGAPORE - URUGUAY

Into Force

The DTA between Singapore and Uruguay entered into force on March 14, 2017.

SOUTH AFRICA - SAINT KITTS AND NEVIS

Into Force

The TIEA between South Africa and Saint Kitts and Nevis entered into force on February 18, 2017.

SWITZERLAND - PAKISTAN

Signature

Switzerland and Pakistan on March 21, 2017 signed an updated double tax agreement.

UNITED ARAB EMIRATES - BURUNDI

Signature

The UAE and Burundi signed a DTA on February 16, 2017.

VIETNAM - UNITED STATES

Ratified

According to recent media reports, Vietnam will soon ratify its new DTA with the United States.

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

THE AMERICAS

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

Chairs: M. Katharine Davidson TEP (STEP), Lawrence H. Heller TEP (Former U.S. Council Representative for STEP Worldwide)

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: Alessandro Amadeu da Fonseca (Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados), Glen Atchison (Harbottle & Lewis), James Brightwell (Barrister), Jonathan Burt (Harcus Sinclair), Russell Cohen (Farrer & Co), among numerous others.

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: Mary A. Akkerman TEP (Lindquist & Vennum LLP), Eduardo Arista TEP (Arista Law), Patricia Arrázola Jaramillo TEP (Akro Legal International), Juan Bonet (Guyer & Regules), among numerous others

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

International Estate & Tax Planning 2017

5/22/2017 - 5/22/2017

Practising Law Institute

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

Chairs: Dean C. Berry (Cadwalader, Wickersham & Taft LLP), Robert Dumont (Principal, Robert Dumont PLLC)

http://www.pli.edu/Content/Seminar/International_Estate_Tax_Planning_2017/_/N-4kZ1z10ox6?ID=289155

The 8th Annual Private Investment Funds Tax Master Class

5/23/2017 - 5/24/2017

Financial Research Associates

Venue: The Princeton Club, 15 West 43rd Street, New York, NY 10036, USA

Key speakers: TBC

https://www.frallc.com/conference.aspx?ccode=B1039

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

Global Transfer Pricing Conference: DC

6/7/2017 - 6/8/2017

Bloomberg BNA

Venue: National Press Club, 529 14th St NW, Washington, DC 20045, USA

Key Speakers:TBC

https://www.bna.com/global-transfer-pricing-dc-2017/

Tax and Immigration Planning and Compliance for High Net Worth Individuals Acquiring US Citizenship, Green Cards and Expatriating

6/12/2017 - 6/12/2017

Bloomberg BNA

Venue: AMA Conference Center, 1601 Broadway (at 48th and Broadway), 8th Floor, New York, NY 10019, USA

Key speakers: TBC

https://www.bna.com/expatriation_ny2017/

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

Basics of International Taxation 2017

7/18/2017 - 7/19/2017

Practising Law Institute

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

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

http://www.pli.edu/Content/Seminar/Basics_of_International_Taxation_2017/_/N-4kZ1z10oie?ID=299002

71st Congress of the International Fiscal Association

8/27/2017 - 9/1/2017

IFA

Venue: Winsor Barra da Tijuca, Av. Lúcio Costa, 2630 - Barra da Tijuca, Rio de Janeiro - RJ, 22620-172, Brazil

Key speakers: TBC

http://www.ifa2017rio.com.br/index.php

International Tax Issues 2017

9/11/2017 - 9/11/2017

Practising Law Institute

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

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

http://www.pli.edu/Content/Seminar/International_Tax_Issues_2017/_/N-4kZ1z10p5l?ID=288689

Basics of International Taxation 2017

9/18/2017 - 9/19/2017

Practising Law Institute

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

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

http://www.pli.edu/Content/Seminar/Basics_of_International_Taxation_2017/_/N-4kZ1z10oie?ID=299003

ASIA PACIFIC

The 8th Offshore Investment Conference Hong Kong 2017

6/14/2017 - 6/15/2017

Offshore Investment

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

Key speakers: Michael Olesnicky (KPMG), Sharon Ser (Withers)

http://www.offshoreinvestment.com/event/8th-offshore-investment-conference-hong-kong-2017/

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: Annet Wanyana Oguttu (University of South Africa), Babatunde Oladapo (West African Tax Administrations Forum (WATAF)), Barassou Diawara (The African Capacity Building Foundation), Belema Obuoforibo (IBFD), Daniel Ngumy (Anjarwalla & Khanna (A&K)), among numerous others

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

WESTERN EUROPE

17th Annual Tax Planning Strategies – US and Europe

4/5/2017 - 4/7/2017

American Bar Association

Venue: Ritz Carlton Hotel Arts Barcelona, Marina 19-21 08005, Barcelona, Spain

Chairs: Albert Collado (Garrigues), Carol P. Tello (Eversheds Sutherland (US) LLP), Sonia Velasco (Cuatrecasas)

http://shop.americanbar.org/PersonifyImages/ProductFiles/255529330/17Barcelona_brochure.pdf

UK Tax, Trusts & Estates Conference 2017 – Exeter

4/20/2017 - 4/20/2017

STEP

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

Key speakers: Emma Facey (Foot Anstey LLP), Professor Lesley King, Stephen Lawson (Forshaws Davies Ridgway), Denzil Lush, Former Senior Judge of the Court

of Protection (England and Wales), Lucy Obrey (Higgs & Sons), Peter Rayney (Peter Rayney Tax Consulting Ltd), Patricia Wass (Foot Anstey), Chris Whitehouse (5 Stone Buildings)

http://www.step.org/tte2017

The 21st Annual VAT & Financial Services

4/26/2017 - 4/26/2017

Informa

Venue: TBC, London, UK

Chair: Peter Mason (Cuckmere Chambers)

https://finance.knect365.com/vat-and-financial-services/agenda/1

The 21st Annual VAT & Property

Western Europe

4/27/2017 - 4/27/2017

Informa

Venue: TBC, London, UK

Chair: Paddy Behan (Simmons Gainsford)

https://finance.knect365.com/vat-and-property/agenda/1

UK Tax, Trusts & Estates Conference 2017 – Leeds

5/4/2017 - 5/4/2017

STEP

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

Key speakers: Emma Facey (Foot Anstey LLP), Professor Lesley King, Stephen Lawson (Forshaws Davies Ridgway), Denzil Lush, Former Senior Judge of the Court of Protection (England and Wales), Lucy Obrey (Higgs & Sons), Peter Rayney (Peter Rayney Tax Consulting Ltd), Patricia Wass (Foot Anstey), Chris Whitehouse (5 Stone Buildings)

http://www.step.org/tte2017

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

UK Tax, Trusts & Estates Conference 2017 – London

5/12/2017 - 5/12/2017

STEP

Venue: Park Plaza Westminster Bridge Hotel, 200 Westminster Bridge Road, London, SE1 7UT, UK

Key speakers: Emma Facey (Foot Anstey LLP), Professor Lesley King, Stephen Lawson (Forshaws Davies Ridgway), Denzil Lush, Former Senior Judge of the Court of Protection (England and Wales), Lucy Obrey (Higgs & Sons), Peter Rayney (Peter Rayney Tax Consulting Ltd), Patricia Wass (Foot Anstey), Chris Whitehouse (5 Stone Buildings)

http://www.step.org/tte2017

Tax Planning for Non Doms 2017 – The Future of Non Doms After 6 April 2017

5/17/2017 - 5/17/2017

Private Client Tax

Venue: TBC, London, UK

Chair: John Barnett (Burges Salmon)

https://finance.knect365.com/tax-planning-for-non-domiciliaries/

UK Tax, Trusts & Estates Conference 2017 – Birmingham

5/18/2017 - 5/18/2017

STEP

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

Key speakers: Emma Facey (Foot Anstey LLP), Professor Lesley King, Stephen Lawson (Forshaws Davies Ridgway), Denzil Lush, Former Senior Judge of the Court of Protection (England and Wales), Lucy Obrey (Higgs & Sons), Peter Rayney (Peter Rayney Tax Consulting Ltd), Patricia Wass (Foot Anstey), Chris Whitehouse (5 Stone Buildings)

http://www.step.org/tte2017

International Tax Aspects of Permanent Establishments

9/5/2017 - 9/8/2017

IBFD

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

Key Speakers: Bart Kosters (IBFD)

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

Duets in International Taxation: Single Taxation?

10/5/2017 - 10/6/2017

IBFD

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

Chairs: Prof. Frans Vanistendael (KU Leuven), Prof. Pasquale Pistone (IBFD), Prof. Dennis Weber (ACTL, University of Amsterdam and Loyens & Loeff), Prof. Stef van Weeghel (University of Amsterdam, PWC global thought leader)

https://www.ibfd.org/IBFD-Tax-Portal/Events/Duets-International-Taxation-Single-Taxation#tab_program

THE AMERICAS

A listing of recent key international tax cases.

United States

A court in the state of South Dakota has ruled against the state's new tax on sales made by out-of-state retailers, in a ruling intended to increase pressure for a new Supreme Court precedent in this area.

Under South Dakota's economic nexus law, signed by the state governor on March 29, 2016, remote sellers with annual in-state sales in excess USD100,000, or exceeding 200 transactions, are required to withhold and remit state sales tax.

The state of South Dakota sued three internet-based retailers, including Wayfair, Overstock, and Newegg, in an attempt to enforce the new tax, even though it was aware that under existing law, it was prevented from taxing sales made by retailers with no physical presence in the state, a fact noted by the South Dakota Sixth Judicial Circuit in its March 6 ruling.

Circuit Court Judge Mark W. Barnett said:

> "Because each of the defendants lacks a physical presence in South Dakota, the state acknowledges that under [existing case law], South Dakota is prohibited from imposing sales tax collection and remittance obligations on the defendants. The state further admits that this Court is required to grant summary judgment in defendants' favor."

Since the rise of e-commerce, an uneven sales tax playing field has emerged between "virtual" retailers and their physical counterparts. Brick-and-mortar retailers in states that impose sales and/or use taxes are legally obliged to collect these taxes from customers who make purchases in their stores at the point of sale and remit them to the state tax authority. However, if a resident of the same state chooses to purchase the same item from an online retailer or catalog seller based out-of-state, sales tax usually goes uncollected by the vendor because they do not have a physical presence, or tax nexus, there.

Many states have attempted to legislate around this problem by imposing an obligation on large internet retailers to collect and remit state sales tax, arguing that substantial volumes of sales, or the existence of an in-state affiliate program, is enough to establish a tax nexus in the state.

However, in the ongoing absence of federal legislation, the only source of guidance on this issue remains the 1992 Supreme Court ruling in *Quill*, which established the "physical presence" test for applying existing sales taxes to out-of-state merchants.

While Judge Barnett observed that "changing times and events" since *Quill* suggest another outcome would be more appropriate, he said he was not in a position to set a new precedent, noting that "it is simply not the role of a state circuit court to disregard a ruling from the United States Supreme Court."

While traditional retailers have long fought for a level playing field in this area, the decision was welcomed by the Retail Industry Leaders Association (RILA), which said the ruling was "one important step closer to the US Supreme Court, which is the only court that can overturn the outdated *Quill* decision."

"Retailers have long-fought for a level playing field with respect to online sales tax. Today's decision is an important and necessary step for closing the tax loophole that currently benefits large online retailers at the expense of local stores," RILA added in a statement.

Similar sentiments were expressed by the National Governors Association (NGA), which argues that the present state of affairs deprives state coffers of billions in sales tax revenues every year.

"Governors are not surprised by the decision found in *South Dakota v. Wayfair, Inc. et al.*," the NGA said. "The South Dakota law was designed to be challenged. In fact, the South Dakota court was 'duty bound' to rule the law unconstitutional because of a decades-old US Supreme Court precedent."

The US Supreme Court recently denied a review of *Quill*, by not taking up a case against Colorado's internet sales notice and reporting law. However, until Congress steps in with a federal solution to settle the issue, it is thought just a matter of time before it is once again asked to reconsider *Quill* as states increasingly take matters into their own hands.

This judgment was released on March 7, 2017.

http://cases.justia.com/federal/district-courts/south-dakota/sddce/3:2016cv03019/59193/38/0.pdf?ts=1484756528

South Dakota Circuit Court: *State of South Dakota v. Wayfair Inc. et al. (No. 3:2016cv03019)*

United States

The Internal Revenue Service (IRS) has lost a case against online retailer Amazon, with the ruling thought to be worth USD1.5bn in corporate income tax, plus future liabilities.

The case centered on transfer prices in a cost-sharing agreement (CSA) between Amazon's operations in the US and its European subsidiary in Luxembourg.

Pursuant to the CSA, the Amazon group granted the subsidiary the right to use certain pre-existing intangible assets in Europe, including the intangibles required to operate Amazon's European website business. This arrangement required the subsidiary to make an upfront "buy-in payment" to compensate the US parent for the value of the intangible assets that were to be transferred to the subsidiary.

Thereafter, the subsidiary was required to make annual cost sharing payments to compensate the US operations for ongoing intangible development costs. The IRS contended that the size of the "buy-in payment" was not at arm's length, resulting in a lower than reasonable US tax liability.

Amazon contended – and the US Tax Court agreed – that the IRS's determinations are arbitrary, capricious, and unreasonable, and that the comparable uncontrolled transaction (CUT) method is the best method to calculate the requisite buy-in payment.

The Court held further that the IRS Commissioner abused his discretion in determining that 100 percent of Technology and Content costs constitute intangible development costs (IDCs); and that Amazon's cost-allocation method, with certain adjustments, supplies a reasonable basis for allocating costs to IDCs.

Although this represents a victory for Amazon, the European Commission is currently investigating the tax ruling granted to Amazon by Luxembourg to establish whether it gives the US company an unfair advantage compared with companies in comparable circumstances.

http://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=11148

US Tax Court: *Amazon, Inc. and Subsidiaries v. IRS Commissioner (148 T.C. No. 8)*

United States

The US Court of Federal Claims has turned down a claim from an Irish citizen that more than USD5m in US tax withheld on gambling winnings should be refunded under the US–Ireland double tax avoidance treaty.

The claim was filed by the plaintiff, John P. McManus, after USD5.22m in tax was withheld from winnings of USD17.4m connected to a three-day backgammon game held in the US.

McManus, who claims citizenship in Ireland but lives in Switzerland, argued that he is entitled to a refund under the tax treaty because, at the time the event took place in 2012, he paid the Irish domicile levy and was therefore a resident of Ireland for the purposes of Article 22 of the treaty, and exempt from the tax on gambling proceeds.

Introduced in 2010, the domicile levy applies to Irish-domiciled individuals who own property in Ireland valued at more than EUR5m (USD5.3m), whose worldwide income exceeds EUR1m, and whose liability for Irish income tax in the relevant tax year was less than EUR200,000.

Citing Article 4 of the treaty, McManus argued that he was a "resident" of Ireland in 2012 because he was "liable to tax" in Ireland "by reason of his domicile." He also contended that the domicile levy falls into the definition of a "full" and "comprehensive" tax liability under the OECD's Model Tax Convention.

In her judgment, senior judge Nancy B. Firestone agreed with the US Government's view, based on a letter received by the Irish tax authority, that payment of the domicile levy in itself is not sufficient to show that an individual is "resident" in Ireland for tax purposes.

This letter stated that: "The payment of the domicile levy does not entitle [McManus] to receive treaty benefits in accordance with the provisions in the Ireland–USA Double Taxation Convention. The domicile levy is not a covered tax for the purposes of this Convention."

Judge Firestone wrote:

> "In sum, none of Mr. McManus's arguments regarding his claim for a refund based on Articles 4 and 22 of the Tax Treaty have merit. The court finds that Mr. McManus's payment of the domicile levy alone did not make him a resident of Ireland in 2012 for the purposes of Article 4 of the Tax Treaty and thus his claim for a refund based on Article 22 is denied."

McManus also argued that the US tax on gambling winnings violates the treaty's non-discrimination clauses, which he contended apply to nationals of the US and Ireland regardless of residence status under the agreement.

However, Judge Firestone stated that the plaintiff's claim in this regard is barred under the Federal Circuit's doctrine of "substantial variance," because this argument was not presented to the Internal Revenue Service prior to the court hearing, and was made for the first time at the oral argument on the parties' cross-motions for summary judgment.

This opinion was released on March 3, 2017, having previously been filed under seal.

https://ecf.cofc.uscourts.gov/cgi-bin/show_public_doc?2015cv0946-50-0

US Court of Federal Claims: *John P. McManus v. The United States (No. 15-946T)*

WESTERN EUROPE

Luxembourg

The whistleblowers at the center of the so-called Luxleaks scandal have had their sentences reduced by a court in Luxembourg.

Earlier this year, Antoine Deltour and Raphaël Halet were given suspended jail sentences for their role in passing to the media thousands of documents detailing private tax rulings between multinational companies and the Luxembourg tax authority.

Both men were also ordered to pay fines of EUR1,500 (USD1,600) and EUR1,000, respectively, but a third defendant, French Journalist Edouard Perrin, who made the initial LuxLeak revelations on French television, was acquitted of all charges.

On March 15, a Luxembourg appeal court halved Deltour's suspended sentence to six months, while Halet's suspended sentence was lifted.

However, the appeal court ruled that the criminal convictions against the two men should stand, and ordered them to pay the fines meted out by the lower court.

The ruling has disappointed transparency campaigners, who were hoping that the appeal court would quash the convictions.

The judgment was released in French on March 15, 2017.

http://www.justice.public.lu/fr/actualites/2017/03/arret-luxleaks-cour-appel/index.html?highlight=luxleaks

Luxembourg Court of Appeal: *Deltour et al. (No. 117/17 X)*

Poland

The European Court of Justice (ECJ) has rejected a challenge brought by the Polish Government concerning the inability of member states to levy a reduced rate of value-added tax to electronic publications, which would be in line with the VAT treatment of tangible publications.

The case concerned whether the European Parliament had the opportunity to be sufficiently involved in the legislative procedure for the adoption of point 6 of Annex III of the EU VAT Directive.

Under this provision, member states may apply a reduced rate of VAT to printed publications such as books, newspapers, and periodicals. Digital publications, by contrast, must be subject to the standard rate of VAT, with the exception of digital books supplied on a physical support (*e.g.*, a CD-ROM). This was confirmed in a relatively recent ECJ ruling, which had outlawed reduced rates levied by Luxembourg and France, in *European Commission v. France* (Case C-479/13) and *European Commission v. Luxembourg* (Case C-502/13).

In a ruling on March 7, the ECJ pointed out that the European Parliament should be consulted afresh when the text finally adopted, as a whole, differs in essence from the text on which the Parliament has already been consulted, except in cases where the amendments substantially correspond to a wish of the Parliament itself.

The ECJ examined whether fresh consultation of the Parliament was necessary in relation to the provision of the directive limiting the application of a reduced rate of VAT to solely the supply of books on a physical support.

The ECJ held in this regard that the final text of the provision concerned is nothing other than a simplification of the drafting of the text which was set out in the proposal for a directive, the substance of which was fully preserved. The Council was thus not required to consult the Parliament afresh, the ECJ ruled, saying that the provision of the directive is not invalid.

This judgment was released on March 7, 2017.

http://curia.europa.eu/juris/document/document.jsf?text=&docid=188625&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=25609

European Court of Justice: *Rzecznik Praw Obywatelskich et al. (Case C-390/15)*

Dateline March 30, 2017

Canada's small businesses urged the Government to cut corporate tax in the 2017 Budget. What they got instead was something entirely unsatisfactory.

It has to be said that the Liberal Government elected in October 2015 hasn't had a great track record on **small-business tax issues**. After pledging to match the then Conservative Government's plans to continue to reduce the small business tax rate in the lead up to the election, Liberal Finance Minister Bill Morneau promptly backtracked in his first Budget announcement last year, deciding instead to freeze the cut at 10.5 percent and defer any more reductions indefinitely.

Since then the Government has focused its efforts on reducing tax avoidance, and ensuring that the wealthy and large businesses pay their "fair share." This is all well and good, and a very commendable position for a Government to take. However, the 2017 Budget doesn't go anywhere near enough in addressing the **root causes of tax avoidance** – the state of the tax code – focusing heavily instead on closing loopholes.

Canada is not unique in this by any means. Almost from the day the first tax codes came into existence, governments and legislatures all over the world have used them to pick winners and curry favor with certain groups of taxpayers. They're then aghast that companies and individuals use the loopholes they created to avoid tax. And the standard response has been to create yet more tax legislation, which while closing one loophole may open one or more elsewhere in the system. Perhaps a policy of removal, rather than closure, might be a better way to tackle loopholes, because at the moment it's like a giant game of legislative whack-a-mole. And generally, governments are totally useless at it.

Another unintended consequence of a tax code riddled with loopholes is that not only does it provide taxpayers with opportunities to legally (for the most part) avoid tax, it also creates **trapdoors for the unwary**. This leads to higher levels of conflict between taxpayers and tax authorities than would be the case under a simpler regime.

It is an unfortunate fact of modern life that small businesses suffer most from such adversarial tax systems, because most can't afford to employ armies of tax attorneys to fight their corner, or expend the time necessary to defend themselves.

Indeed, as any small business owner who has been audited will no doubt testify, these procedures can be extremely stressful. The **US House of Representatives Small Business Committee** held a hearing on this very matter last year. It heard how in some cases small firms had shut down as a direct consequence of an audit. As Steve Chabot, the panel's chairman, observed in his introductory remarks: "I know members of this Committee have heard from constituents who were audited so aggressively by the IRS that they had to close their doors. Others are engaged in protracted audits that seem like vague fishing expeditions, with no end in sight."

So, rare praise for the **Internal Revenue Service** this week for its new commitment to expedite small business tax audits, limiting their length to a maximum of 60 days. That's still an awfully long time for a small business owner to sweat over the implications of an audit, with the prospect of penalties draining precious resources from their firm. But it's a slight improvement on the current situation nonetheless. At present, IRS guidance on small business audits doesn't offer taxpayers any clues on how long a tax audit may take – not even a ballpark figure. Which hints at the terrifying prospect that one might be audited in perpetuity. So perhaps we should be grateful for this small mercy.

Yes, it's fair to say that the IRS is not everyone's favorite arm of the US Government. But you could probably quite easily say that about any tax authority, anywhere in world. Although, in the **South African Revenue Service's** case, it seems to be actively trying to make itself disliked. Not only is it about to be investigated by the Tax Ombud on charges of deliberately withholding tax refunds to make its revenue collection figures look better, it has also called for Judge Dennis Davis to be removed as head of the eponymously named tax review committee.

These are worrying times for South Africa; the Government is busy attempting to head off economic and fiscal crises, but it appears to be doing so with one arm tied behind its back. Recent and serious claims of corruption have gone to the heart of government, and its unelected officials seem to be faring little better in the public eye, with Davis having alleged that the "erosion of the integrity of SARS was one of the biggest challenges facing South Africa today" – allegations that are behind SARS' call for Davis's removal from his own tax committee.

Not being acquainted with the day-to-day workings of SARS, perhaps the tax authority is entirely justified in describing Davis's accusations as "unprovoked and unwarranted." Then again, taking the tax refund probe into account as well, perhaps a case no smoke without fire?

Last, but by no means least, we come to **Brexit**. And it was certainly no secret that the British Government intended to trigger Article 50 – effectively the starting gun on its EU exit negotiations – in March. But, for the sake of clarity, at least we now know the date that gun has been fired – March 29 – even if we don't know what the outcome will be. What is significant however, is that the mood music coming out of **Brussels** seems to be much softer in tone than it was a few months ago.

The latent threat that the UK would be punished for leaving the EU with harsh post-Brexit trade terms seems to have somewhat dissipated – for now. Instead, the key actors on the EU side of the negotiations – particularly Chief Negotiator Michel Barnier and Commission President Jean-Claude Juncker – seem more amenable to a mutually beneficial **free trade agreement** between the UK and the EU.

This may come as something of a relief to UK-based businesses currently trading in the EU. But it doesn't answer the many questions companies have about important tax matters in post-Brexit Britain, especially in the area of **value-added tax**. Indeed, the British Chambers of Commerce suggested recently that most firms care little about the actual Article 50 process, but care a lot about "an unexpected VAT hit to their cash flow."

Since VAT is an EU tax, the UK Government could smooth the transition to Brexit by assuring companies that the UK VAT system would continue to mirror its EU counterpart for a certain period of time after the deal is done, say five years. This would, to a large extent, avoid the unappealing prospect of the two regimes diverging and causing firms considerable VAT compliance headaches as a result. This principle could also apply to the numerous other EU tax directives and regulations transposed into UK law.

Ultimately there probably isn't much that either side can do to avoid at least some **legal and regulatory upheaval**. It's just a question of when this will begin, and to what magnitude it will shake things up.

The Jester