Wolters Kluwer

GLOBAL TAX WEEKLY
a closer look

ISSUE 301 | AUGUST 16, 2018

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

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

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

Wolters Kluwer

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.

Unique contributions from the Big4 and other leading firms provide unparalleled insight into the issues that matter, from today's thought leaders.

Topicality, thoroughness and relevance are our watchwords: CCH's network of expert local researchers covers 130 countries and provides input to a US/UK team of editors outputting 100 tax news stories a week. GTW highlights 20 of these stories each week under a series of useful headings, including industry sectors (e.g. manufacturing), subjects (e.g. transfer pricing) and regions (e.g. asia-pacific).

Alongside the news analyses are a wealth of feature articles each week covering key current topics in depth, written by a team of senior international tax and legal experts and supplemented by commentative topical news analyses. Supporting features include a round-up of tax treaty developments, a report on important new judgments, a calendar of upcoming tax conferences, and "The Jester's Column," a lighthearted but merciless commentary on the week's tax events.

Wolters Kluwer

GLOBAL TAX WEEKLY
a closer look

ISSUE 301 | AUGUST 16, 2018

CONTENTS

FEATURED ARTICLES

NEWS ROUNDUP

For article guidelines and submissions, contact GTW_Submissions@wolterskluwer.com

New Compliance Campaigns By The IRS In 2018

by Mike DeBlis, DeBlis Law

Department of the Treasury
Internal Revenue Service

Regularly, the Internal Revenue Service focuses its attention on new areas that may need regulation and tax scrutiny from the federal government. Because of the IRS's reputation, it's easy to confuse related initial contacts with audits, but the IRS has a very specific approach when it comes to creating new tax regulatory schemes over previously unregulated areas.

On the corporate tax side, it's the IRS' Large Business and International (LB&I) that handles much of the new compliance development. For 2018, the LB&I has specified five new target areas that either represent brand new regulation or enhanced attention from the tax agency. These include:

- S corporation distributions;
- Cryptocurrency or virtual currency;
- Transition tax;
- AMT credits carryforwards; and
- Reorganizations

Again, a compliance campaign, which is the term used by the IRS, is not an audit contact *per se*. In many ways, the activity is a field research exercise by IRS analysts and management when developing a new regulatory scheme. The process begins with identifying a topic to be examined. Internally, the IRS then comes up with a draft mockup of how compliance should work with existing federal laws. However, the mockup is untested. Further, taxpayers will need to be trained on how any compliance addition or change should work, which requires additional planning and content to be developed correctly as well.

The field research comes in the form of what is known in tax jargon as a "soft letter." It's not an audit per se but the notice definitely counts as a potential red flag that a taxpayer should pay attention to. The communication is couched as an "inquiry" which 1) tells the taxpayer a specific activity may be an issue, and 2) it may ask for additional data from that taxpayer (basically to see how the issue plays out in real time). The combination of internal analysis recommendations within the IRS bureaucracy and the results from the inquiries then builds the case for the campaign conclusions, ultimately generating a new tax compliance change in final form. It's important to understand as well that just because the LB&I seems to be focused on corporations by name, it doesn't mean small businesses are off the hook. If the compliance view applies, a small business is just as vulnerable to a new compliance change as any corporation.

S Corporations

Given how much gray area there is on rules for S corporations, the IRS has pegged three specific areas for additional examination and potential compliance tightening.

The first involves property transfer to a shareholder. Specifically, where a property distribution to a shareholder is expected to be reported to the IRS. No surprise, it could be considered as a gain from the IRS perspective.

The second has to do with omission on the part of the S corporation, and failing to identify whether a given distribution is really a dividend or a transfer of ownership, either in cash or alternatively, as property.

Finally, the third area focuses on the S corporation shareholder who doesn't report non-dividend distributions beyond what his or her stock basis was at the time, and this is basically seen as a taxable bonus.

These areas speak to how a shareholder is made whole for the initial property provided to the S corporation to get it started or enhance its growth. If the later distribution is within the basis amount of stock held by the shareholder, then it's not taxable. If over, on the other hand, the tax gloves come off. Tracking, as in any business case, is the task of the business for tax reporting, but some are failing, and the IRS is paying attention.

Cryptocurrencies

It has been widely reported that people are earning lots of money on Bitcoin investment and cryptocurrencies. However, in 2016, the IRS only received 802 personal tax returns showing a cryptocurrency taxable income. That was out of 132 million tax returns filed through e-file or electronic filing. Clearly, a good number of folks have decided that taxes don't yet apply to their gains, which the IRS probably has a bit of a different opinion on (as well as the rest of the federal government). To true up the cryptocurrency world, which isn't going away anytime soon, the IRS is now beefing up its apparatus to fully incorporate cryptocurrencies as a taxable income area for compliance. And that means that there is a very real possibility of an IRS contact coming to a mailbox near you sometime soon if you dabble in Bitcoins and the like.

Transition Tax

Under existing tax code (Section 965), a shareholder in the US has to pay a transition tax when repatriating earnings from a foreign source corporation that have not already been taxed. This rule applies even if the funds, in fact, have not yet been repatriated. To many, this is essentially applying taxes to overseas income earned in another country simply because one is a US shareholder. Most people are not fully aware of this implication of Section 965, but now the IRS is going to make sure that it is widely known going forward.

AMT Credit Carryforward

Under certain circumstances, a corporation can utilize an Alternative Minimum Tax or AMT credit which can then be applied, or carried forward, to the next tax year. This means that if the company has higher losses than revenues in a given tax year, the losses can roll forward and be applied against revenues in the next year. So far, so good.

However, in 1985 the federal laws were changed under the Balanced Budget and Emergency Deficit Control Act. In that bill, also commonly referred to as the Gramm-Rudman-Hollings Act, companies must also reduce their credit by what is known as a "sequestration rate." This caps the losses to be claimed, meaning that there is no recovery whatsoever above a certain threshold. In other words, you don't get to defer them to another tax year. However, some companies do so regardless. As a result, the IRS is now clamping down on this practice.

Reorganizations

Foreign triangular reorganization – that's a term to say three times fast. This has to do with companies that purchase or acquire stock of their parent corporation. The parent corporation then uses the funds to acquire a foreign company. In theory, the foreign company acquisition is assumed to be tax-free insofar as it is an offshore business transaction. The IRS has decided to challenge these "purchases" to be certain they are in fact, tax-free.

International Tax Compliance After the End of the Offshore Voluntary Disclosure Program

by Chris Klug, Klug Law Office PLLC

For the last several years, retroactive offshore disclosures have been the method of the IRS' efforts to ensure that US taxpayers were reporting their foreign assets and foreign income. Curative programs for prior reporting failures have been seen as appropriate given the IRS' past lack of emphasis on international requirements. The most expansive disclosure program is the offshore voluntary disclosure program (OVDP).

The IRS' recent focus in the international area and time establishing reporting under the Foreign Account Tax Compliance Act (FATCA) has presumably made retroactive disclosure programs less appropriate. There has been an increased emphasis on international reporting in the recent years. As the world becomes more global, the reporting requirements apply to a far greater scope and variety of individuals. The IRS announced that the OVDP will close on September 28, 2018.

Alternative disclosure options will exist after the closing of the OVDP, however, these options will have a narrower focus. Many taxpayers will be left with less than great options for disclosures. Taxpayers who cannot comfortably certify non-willfulness, which is an increasing proportion of the noncompliant taxpayers, will be affected. Practitioners expect the IRS' future approach in the international compliance area will shift from disclosures to assessments.

OVDP

The OVDP has been a key disclosure method for taxpayers who could not certify non-willfulness in the nondisclosure of their foreign assets and foreign income. In lieu of the penalties that were otherwise assessed for failure to report foreign assets, the taxpayers in the OVDP pay a 20 percent accuracy related penalty (and pay failure-to-file and failure-to-pay penalties where applicable). The disclosing taxpayer also agreed to pay the miscellaneous Title 26 offshore penalty, a one-time penalty that was 27.5 percent or 50 percent of the highest value for foreign income-generating assets during the eight-year disclosure period. The OVDP process is lengthy but offers taxpayers in this position certain assurances: (1) participating taxpayers would not be recommended to face criminal penalties, and (2) a closing letter upon completion of the OVDP indicating that all prior failures to properly report foreign assets have been resolved.

On March 13, 2018, the IRS issued IR-2018-52 providing its intention to close the OVDP effective as of September 28, 2018. If a taxpayer has unreported foreign assets or income, they should review their options quickly before the OVDP is no longer an option. The release stated that part of the IRS' rationale was based on advances in third party reporting. Two primary mechanisms provide for these advances: (1) FATCA, which essentially requires foreign financial institutions to disclose specific foreign assets held by US taxpayers and (2) settlements between the IRS and foreign financial institutions who agree to turn over US account owner information. These two methods allow the IRS to more easily access information on overseas assets of US taxpayers. This reduces the IRS reliance for taxpayers to voluntarily disclose their foreign assets and income.

Alternative Disclosure Options

Even with the OVDP's end, there are other options for offshore disclosures depending on the circumstances. The delinquent FBAR submission procedures and the delinquent international information return procedures are appropriate for taxpayers whose failure to report foreign assets do not create reportable income or additional taxes due. These two procedures have a narrow application, if there is additional tax due connected to undisclosed foreign assets, then these procedures are not available. The most expansive remaining program is the streamlined filing compliance procedures (SFCP). There are two versions of the SFCP, one for taxpayers residing in the US and the other for taxpayers residing outside the US.

Under the SFCP for taxpayers residing in the US, a five percent penalty is imposed on the highest end of year balance of a taxpayer's foreign assets subject to penalty over the six year covered period, along with tax and interest on tax amounts. Under the SFCP for taxpayers residing outside the US, there is no base penalty on foreign assets; the taxpayer pays the additional tax and interest on tax due. Under the SFCP there is no accuracy related penalties. As compared with the OVDP, the SFCP has fewer submission obligations, but receives fewer assurances: the taxpayer will receive no closing letter from the IRS or any type of statement from the IRS.

The SFCP requires that a taxpayer's prior failure to file FBARs or include income from foreign assets on their tax returns were non-willful. The non-willfulness standard must apply to all aspects of the prior reporting failures. If the failure to report the assets was non-willful, but the failure to report the income connected with the foreign assets was willful, the taxpayer will not qualify to file under the SFCP.

The IRS defines non-willful as conduct:

> *"Due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law (Internal Revenue Manual section 4.26.16.4.5.3)."*

Determinations of willfulness are made at the IRS' discretion, based primarily on a statement with relevant facts submitted with the taxpayer's SFCP certification. If a submission is denied based on a failure to meet the non-willfulness standard, the taxpayer is subject to all applicable penalties.

As awareness of international reporting requirements increase, the ability for a taxpayer to certify and for the IRS to accept non-willfulness decreases. Prior to the IRS increasing its efforts to educate taxpayers on international reporting, it was easier for taxpayers to claim ignorance of the requirements.

In IR-2018-52 the IRS mentions that the voluntary disclosure program maintained by the IRS criminal division will remain open after the end of the OVDP. There are fewer assurances offered through this program as compared to the OVDP.

Assessments for FBAR Failures

The IRS is now more able to identify unreported foreign assets and unreported foreign income. However, the FBAR penalties are generally the highest and allows the IRS huge discretion in assessing penalties.

The IRS has the authority to enforce civil FBAR matters. This authority generally does not extend to the collection of assessed penalties. Assessable FBAR penalties depend on whether the failure is determined to be willful or non-willful. There is a six-year statute of limitations for failure to file FBARs.

For non-willful failure to file FBARs, the IRS can assess penalties up to USD10,000 per account per year. Taxpayers who hold numerous accounts overseas, especially taxpayers residing overseas, can face significant penalties regardless of the accounts aggregate value. However, the Internal Revenue Manual (IRM), incorporating SBSE-04-0515-0025 (IRS Memorandum), generally limits the assessment to one non-willful penalty per open year, with the penalty not to exceed USD10,000. The IRM provides that in no case should the non-willful penalty exceed 50 percent of the highest aggregated balance of all accounts to which the violations relate during the years at issue.

For willful FBAR violations, the penalties permissible are an annual penalty of the greater of USD100,000 or 50 percent of the amount of the balance of unreported accounts at the time of the violation, for each year a failure occurs. The IRS typically will limit the penalty amount for all years to no more than 50 percent of the highest aggregated account balance, and the IRM provides that in no case should the penalty exceed 100 percent of the highest balance.

The IRM provides the examiners with discretion in imposing the penalties, so the examiner can impose lower penalties when appropriate. The IRM provides that the examiner should ensure that the amount of the penalty is commensurate to the harm caused by the FBAR violation.

The penalties for willful violation of the FBAR are significantly higher than non-willfulness. It is therefore important to understand what constitutes a willful violation. Willfulness for FBAR violations mirrors the willfulness concept under criminal tax law: a voluntary, intentional violation of a known legal duty. The IRM provides that the definition of willfulness for FBAR filing is as follows:

Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the person only need to know that a reporting requirement exists. If a person has that knowledge, the only intent needed to constitute a willful violation is a conscious choice not to file the FBAR.

Willful blindness is when a taxpayer makes a conscious effort to avoid learning of the FBAR requirements, which also constitutes willfulness for these purposes.

Enforcement of FBAR Assessments

The FBAR penalties are enforced under Title 31 rather than Title 26 (Internal Revenue Code) of the United States Code, which is significant in the collection context. FBAR penalties are debts owed to the US government and the standards for the collection of FBAR penalties are provided by regulations under Title 31.

For FBAR penalties, notice of penalties are sent prior to collection activities. Installment options for payment are available, and the debts can be deemed uncollectible. When a taxpayer has debts with a principal balance exceeding USD100,000, the Justice Department must approve any compromise or a suspension or termination of collection activity.

FBAR penalties are enforced through government offsets and the commencement of civil actions to collect assessed penalties. The government's collection options through offset include: (1) administrative offset, (2) tax refund offset, (3) federal salary offset, (4) referral to private collection, (5) referral to agencies operating a debt collection center, (6) reporting delinquencies to credit reporting bureaus, (7) garnishing wages of delinquent debtors, and (8) litigation or foreclosure. There are no limitation periods for offsets.

For civil actions, delinquent debts are referred to the Justice Department after aggressive collection activity has been taken and when compromise of the penalties is not appropriate. Any action to enforce FBAR penalties must be filed within two years, with the applicable period typically beginning on the date of penalty assessment. If a law suit is filed and an enforceable judgment results, collection options increase for the government.

The collection mechanisms for FBAR penalties are different than for tax penalties under Title 26. FBAR penalties are not classified as tax penalties.Therefore, a multitude of options that are available without court approval for tax penalties (such as liens and levies) are unavailable, at least until there is an enforceable judgment (court action required). These differences are important in advising taxpayers of collection options available to the government and in ensuring the government actions do not overstep their authority.

Conclusion

With the closing of the OVDP on September 28, 2018, it is important that anyone who needs the assurances offered through the OVDP act now, otherwise their penalty, both civil and criminal, will be less certain. For taxpayers who do not need the OVDP but have undisclosed foreign assets or income, should also move quickly to file under the proper procedure before the IRS, through third party reporting, is alerted to the undisclosed foreign accounts and foreign income. There are recent reports that the IRS will be focusing on how to more effectively use the information obtained through FATCA and other third party reporting to target taxpayers with unreported foreign accounts.The FBAR penalties are significant even for non-willful violations.

For taxpayers subject to FBAR penalties, there is an expectation that collection efforts will be aggressive given the prior opportunity to come clean through the OVDP and other procedures. When these collection efforts occur, the taxpayer will need experienced counsel to ensure all feasible options to challenge the assessments. Of course, the better option is for taxpayers to use the appropriate procedure to become compliant with their reporting obligations prior to an FBAR assessment.

Topical News Briefing: A Gulf In VAT Readiness

by the Global Tax Weekly Editorial Team

As the United Arab Emirates' value-added tax regime continues to mature following the introduction of VAT refunds for tourists and the publication of new guidance on labor accommodation (reported in this week's issue of *Global Tax Weekly*), VAT across the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) as a whole continues to splutter into life.

VAT was intended to replace revenues lost as a result of the elimination of tariffs and taxes on trade in the GCC free trade area, as well as to diversify revenue streams in countries traditionally reliant on the sale of hydrocarbons. However, the lead-up to the agreement was fraught with indecision, delay, disagreements, and political opposition. And the roll-out of VAT has been far from trouble-free either. In fact, besides the UAE, the only other GCC member state to have implemented VAT is Saudi Arabia.

A combination of a lack of technical capacity and political opposition have thus far hindered the implementation of VAT elsewhere in the GCC. Oman and Qatar are expected to introduce VAT in 2019. However, neither of these tentative start dates should be considered set in stone, given the difficulties the member states have experienced in agreeing the terms of tax and implementing the tax. For its part, Kuwait, while having approved the VAT framework, has encountered strong internal political opposition to VAT, and while recent reports suggest that the Government plans to bring forward VAT legislation soon, the situation remains fluid. Bahrain, however, has indicated that VAT could be introduced by the end of 2018.

Nevertheless, as also reported in this week's issue, the introduction of VAT hasn't been a complete success in Saudi Arabia either, after recent investigations by the Saudi tax authority uncovered low rates of VAT compliance in certain sectors.

It was perhaps inevitable that VAT would have a difficult start to life in the GCC given that this is an entirely new tax for the countries involved, and that the reform required extensive preparations. Nevertheless, for businesses in the region, the current situation is far from ideal, and the moving targets which are the VAT start dates in those member states which have yet to introduce it are hardly helping businesses prepare for what is a major change in their tax requirements.

ISSUE 301 | AUGUST 16, 2018

International Aspects of US Estate Planning: Special Considerations

by Stephen Flott, Joseph Siegmann, Brittany Oravec and Amy Hmood, Flott & Co

This is the third in a series of articles on the international aspects of US estate planning for US citizens, US residents, and non-resident aliens owning US situs property. This article provides an overview of international considerations in estate planning.[1]

Introduction

The tax consequences and the manner in which estate and gift transfers are treated by the US depend on a variety of factors. These include the citizenship status of the transferor, the citizenship status of the transferee, the method of transfer, the nature of interest retained after the transfer, and more. This article discusses the considerations one must keep in mind when estate planning for persons with property and/or residences in multiple jurisdictions. Whether the transferor is a US citizen living abroad or a nonresident alien (NRA) with property located in the US, there are many factors to consider when drafting an estate plan that will be respected by the applicable courts and result in distributions in the manner sought by the decedent. This article endeavors to highlight the major problem areas created by different citizenships, residencies of the parties, and situses of the estate's property.

Different Tax Regimes

The rate of taxation, or whether an individual is subject to taxation at all, depends on the individual's citizenship status. There are three relevant statuses: (1) US citizens, regardless of their residency or domicile; (2) US residents, which includes green card holders as well as non-US citizens domiciled in the US; and (3) NRAs, which are non-US citizens not domiciled in the US. For example, individuals on F-1 student visas are NRAs.[2]

Transfer Taxes

As discussed in the second article in this series, the US imposes tax on certain estate and gift transfers. However, exemptions reduce or eliminate the US tax on most estates and gifts. The amount of these exemptions vary depending on the residency and citizenship status of the relevant parties. US citizens and residents receive an estate tax exemption of USD11.18m, while NRAs receive a USD60,000 exemption.[3] This means a US citizen or resident may bequeath USD11.18m of property without paying any US tax, but an NRA's estate has to pay tax on any bequest over USD60,000. However, for US citizens and residents the US tax is on assessed on the value of their worldwide estate while the US tax on NRAs only applies to the value of the NRA's US situs property.[4]

US citizens and residents' USD11.18m exemption is unified with the gift tax, meaning that gifts made in their lifetimes are exempt from taxation insofar as they have their USD11.18m exemption available, the remainder of which exempts transfers made after death from taxation.[5] NRAs do not have a lifetime exemption for gifts. To offset this inequality, the US only taxes NRAs on gifts of US situs property, while US citizens and residents are taxed on all gifts no matter the situs of the property.[6]

One area in which citizenship status does not matter is the annual gift tax exemption. Citizens, residents, and NRAs may gift up to $15,000 per transferee per year without triggering a US gift tax liability or consuming part of their unified exemption.[7] In addition, gifts below this threshold do not need to be reported to the IRS. Nevertheless, US citizen and US resident spouses have the option to combine their annual exemptions to gift up to USD30,000 per transferee per year; NRAs may not split their gifts with their spouses. Any such gift splitting must be reported to the IRS.

Citizenship also matters for the marital deduction, however it is the citizenship of the transferee that matters, not the transferor. The marital deduction permits spouses to transfer property to each other without incurring gift or estate tax liabilities. A transfer of property to a US citizen spouse is excluded from taxation – there is no tax or consumption of an exemption on such transfers. However, if the same transfer was to a US resident noncitizen spouse or to an NRA spouse, then there is a special marital exemption amount above which there is a US tax liability or consumption of the spouse's lifetime exemption. The special marital exemption amount is USD152,000 per year, which may be combined with the lifetime exemption. Consider the following examples.

If an NRA gifts $500,000 of US situs property to his US resident or NRA spouse, he may use his $152,000 annual exemption and will owe tax on the transfer of the remaining USD348,000. However, if a US resident gifts USD500,000 of US situs property to his US resident or NRA spouse, he would first use his USD152,000 annual exemption, then deduct the USD348,000 from his lifetime exemption, and owe no tax.

Income Tax

US citizens and residents are taxed on their worldwide income.[8] NRAs are only taxed on effectively connected income (ECI), fixed, determinable, annual, or periodical (FDAP) income, and proceeds from the sale of US real property.[9] Income is effectively connected if it is earned from a US source in connection with a trade or business. FDAP income is all other income earned from US sources aside from gains from the sale of property and income which is excluded from gross income. Examples of FDAP income include dividends, interest, pensions, and alimony.

ECI is taxed at the same graduated rates which apply to citizens and residents. In contrast, FDAP income is taxed at a flat rate of 30 percent, unless a tax treaty grants a more favorable tax rate. The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) imposes a fifteen percent tax when an NRA sells a US real property interest, such as a piece of land or stock in a US real property holding company.[10]

Conflict of Laws

In the case of estates, conflict of laws issues occur when laws of two jurisdictions apply simultaneously to an estate and the two jurisdictions resolve the issue differently. Such issues are common in international estate planning. Any individual with assets in multiple jurisdictions should be aware of the impact that conflict of laws will have on his estate and ultimate tax liability.

Classification of Property

The classification of property influences how such property transfers under intestate succession, testate succession, and trust validity. Property classification may also influence the foreign death tax credits available to an estate. There are two types of property - real and personal.[11] Real property refers to land and anything attached to it, such as a building. Personal property refers to all property other than real property.

Conflict of laws arises when one jurisdiction, such as the decedent's domicile, classifies a piece of property as personal property while a second jurisdiction, where the property is located, classifies the same property as real property. When a conflict occurs, generally the law of the jurisdiction in which the property is physically located determines its classification. Depending on the classification of the property, the property's disposition will either be governed by the law of the jurisdiction of the property's situs, or of the decedent's domicile at death. Typically the law of the jurisdiction of the property's situs controls disposition of real property,[12] and the law of the jurisdiction of the decedent's domicile at death controls disposition of personal property.[13] For example, if a decedent dies while domiciled in Jurisdiction A and owns property located in Jurisdiction B, Jurisdiction B classifies the property. If Jurisdiction B classifies the property as personal, then Jurisdiction A's law would control its disposition. If Jurisdiction B classifies the property as real, then Jurisdiction B's law would control its disposition.

Understanding the classification of property is useful in estate planning because it can help avoid forced heirship laws. Forced heirship laws are present in some jurisdictions[14] and require a certain portion of a decedent's estate pass to his spouse, children, or other relatives. If this is not a desired outcome, then the decedent should ensure that he is not domiciled in a forced heirship country and owns no real property in a forced heirship country.

Marital Property

Marital property may cause conflict of laws issues because of community ownership laws. Civil law jurisdictions, including several US states[15] apply community property regimes under which most property acquired during a marriage is jointly owned by spouses regardless of which spouse purchased the property or in whose name the property is titled. When one spouse dies, the surviving spouse retains his own share and may receive the deceased spouse's share. For example, a spouse buys a home during his marriage, and the jurisdiction is a community property jurisdiction which treats each spouse as owning fifty percent of the property. When the first spouse dies, the surviving spouse retains his fifty percent interest and may receive all, none, or some of the deceased spouse's fifty percent interest, depending on the jurisdiction and the decedent's will.

However, in common law property jurisdiction, spouses do not necessarily have equal shares in the property acquired during the marriage. Nevertheless, most common law property jurisdictions have laws prohibiting the complete disinheritance of a spouse.[16] Conflict of laws issues arise when a couple is domiciled in a community property jurisdiction and owns property in a common law property jurisdiction, or vice versa.

Understanding this conflict is especially important for married couples when one of the spouses is a non-US citizen. As discussed above in section II, transfers to a US citizen spouse benefit from an unlimited exemption, but transfers to NRAs and US resident spouses do not receive this benefit. In the case of property passing to a non-US citizen spouse, non-community property decedents are subject to tax on the full value of assets owned at death. However, community property decedents are subject to tax on only one-half the value of assets owned at death, since their surviving spouse is considered to already own the other half. Couples who want to avoid community property treatment ought to execute a pre- or post-nuptial agreement voiding this default treatment.

Intestate Succession

If an individual dies without a will, known as dying intestate, then the individual's estate is distributed according to the intestacy laws of his domicile. In common law jurisdiction, intestacy laws usually distinguish between real and personal property, however, civil law jurisdictions do not typically draw this distinction.

For example, assume the intestacy laws of Jurisdiction A deem the decedent's entire estate to pass to the surviving spouse while the intestacy laws of jurisdiction B deems a third of the estate to pass to the surviving child, and two-thirds to the spouse. Consider a decedent domiciled in Jurisdiction B who died intestate, having jewelry and a condominium held in Jurisdiction A. If Jurisdiction A is a common law jurisdiction, the jewelry would pass by the intestacy laws of decedent's domicile (Jurisdiction B) because it is personal property, allowing a 1/3 share to the surviving child. However, the condominium would pass by the intestacy laws of its situs jurisdiction (Jurisdiction A) because it is real property, allowing the entire share to pass to the surviving spouse. However, if Jurisdiction A is a civil law jurisdiction, both the jewelry and the condominium would pass under Jurisdiction B's intestacy law because no distinction is made between the different types of property.

Will Validity

A court may not enforce a will unless the will is valid under that court's jurisdictional requirements. Such requirements may include the will being notarized and having a certain number of witnesses; each jurisdiction has its own requirements. An estate plan should ensure that the will is valid in every jurisdiction in which the estate owns property. Otherwise, a court may declare the will invalid and impose intestacy laws on property in the court's jurisdiction. Fortunately jurisdictions have begun recognizing this as a problem and there is a recent trend laws treating wills as valid if the will was executed in accordance with local law, the law of the place of execution, or the law of the decedent's domicile, abode, or nationality at execution or death.[17]

Marital Status

Marital status is relevant to estate planning, in relation to intestate succession and jurisdictions with forced heirship laws. Generally, if a marriage is valid in the jurisdiction where it was performed the marriage is recognized as valid in other jurisdictions. Likewise, if a marriage is considered invalid where it was performed, it will be invalid in other jurisdictions. However, marriages valid in one jurisdiction may be voided in another jurisdiction on public policy or other grounds. For example, a New Jersey court voided a marriage between an uncle and his niece which was allegedly validly performed in Italy.[18] On the other hand, a California court allowed a polygamous decedent's two wives to jointly inherit his property under California's intestacy laws when the decedent was domiciled in California but the wives were not.[19]The court said public policy could not void the marriages because the wives resided in India, not California.[20]

Correspondingly, courts in the US usually recognize the validity of a divorce executed in a foreign jurisdiction when the court executing the divorce had jurisdiction over the spouses. For the court to have jurisdiction, usually one of the spouses must be domiciled in the jurisdiction. In one instance, a Florida court invalidated a divorce executed by a Dominican Republican court because the decedent obtained the divorce after spending only six days in the Dominican Republic.[21] Proper estate planning requires ensuring marriages and divorces are valid to avoid litigation from former or current spouses, which may alter the decedent's desired distribution of property.

Validity of Trusts

The second article in this series mentioned that trusts are a useful estate planning tool. However, to maximize their utility, a settlor needs to ensure the validity of the trust. If a trust holds real property, then the law of the jurisdiction where the property is located determines the validity of the trust. If the trust owns personal property, the law governing the validity of the trust depends on whether it is a living trust or a testamentary trust. Often times, trusts hold both personal and real property located in multiple jurisdictions, meaning the trust must be valid in each of those jurisdictions.

To determine the validity of a will establishing a testamentary trust that holds personal property, the law of the jurisdiction of the grantor's domicile at death controls. But if the validity of the trust provisions are at issue, then the law of the jurisdiction the testator elected to govern the trust applies. If no jurisdiction was selected to govern the trust, or if the jurisdiction selected has no substantial relation to the trust, then the law of the jurisdiction of the testator's domicile at death controls.

Nevertheless, if a jurisdiction's law would invalidate the trust, the validity of the trust is determined by the law of the jurisdiction where the trust is to be administered. Finally, notwithstanding all of this, if a provision of the trust is contrary to the public policy of the jurisdiction of the testator's domicile at death, then only that trust provision will be considered invalid, not the entire trust.[22]

The validity of a living trust holding personal property is governed by the law of the jurisdiction that the settlor chose to govern the trust. This is true so long as that jurisdiction has a substantial relation to the trust.[23] However, if no such election is made or if application of the chosen law would violate public policy of the jurisdiction with the most significant relationship to the trust, then the law of the jurisdiction with the most significant relationship to the trust governs.[24]

EU Regulation No. 650-2012

In 2012, the European Union (EU) adopted a regulation establishing a uniform rule for succession matters across several jurisdictions. This regulation was adopted by all EU countries except the United Kingdom, Ireland, and Denmark.

The regulation applies to decedents who were habitual residents of an EU country at death.[25]Additionally, if an individual had property in an EU country and was either a citizen of an EU country at death or was a habitual resident of an EU country within the five years prior to his death, the country where the property is located may rule on the succession as a whole.[26] Otherwise, any property located in an EU country, but no other parts of the estate, may be subject to the succession laws of the jurisdiction in which the property is located.[27]

The regulation permits a person to elect the law of the country of his citizenship or habitual residence[28] to govern the transfer of all of their property. The default, in the absence of election, is the law of the country of habitual residence.[29] The law elected by a decedent may be the law of a country which is not a member of the EU, as long as the decedent was a citizen of that country or in which the decedent maintained a habitual residence there.[30]

The law chosen by the decedent may be refused only if such application is "manifestly incompatible with the public policy" of the country of the administering court.[31] A person possessing multiple citizenships may choose the law of any of his countries of citizenship to govern his or her succession.[32] Thus, a person who is a citizen of both Greece and the US, but has his habitual residence in Spain may elect the law of Greece, the US, or Spain to govern the succession or disposition of his property. However, the choice of law must be made explicitly in a valid will.[33]

To ensure the election of a particular jurisdiction's laws governs, the regulation strongly favors will validity. The will is valid and enforceable if it was valid in one of four jurisdictions: where it was made, the country of citizenship, the country of domicile, or the country of residence.[34]However, there is an exception built in for real or immovable properties. For immovable properties such as land, the will is valid only if it complies with the law of the country where such property is located.

The regulation appears to only allow individuals to choose the law of their country of citizenship or domicile, not a specific subdivision thereof. So, a US citizen may choose US law in his will but not the law of a particular state. In order to decide which US state law applies, because the US does not have a general common law to decide the issue, a court following the regulation would use the law of the US state "with which the deceased had the closest connection."[35]

It is important to note that this is EU law, not US law. A US state court might decline to apply the law of a US state to the estate, depending on that state's rules. So while a court in the EU would apply US law, if the will is probated in the US or is admitted for ancillary probate in the US in order to dispose of property located in the US, the US court may apply the law of another country.[36]

Foreign Death Tax Credit

US citizens living or owning property abroad, or non-citizens residing in the US, may owe death taxes to foreign jurisdictions. IRC Section 2014 authorizes a credit against the US federal estate tax for foreign death taxes paid by individuals who were US citizens or residents at death. The purpose of the credit is to minimize double taxation on a decedent's assets. It is important to note that the foreign death tax credit applies to estate taxes and not gift taxes. Thus, in the absence of a gift tax treaty credit, a US citizen or resident may be subject to double taxation on a gift. As discussed below, if a tax treaty provides more favorable treatment an individual may elect to receive tax credits under the treaty instead of under Section 2014.

Tax Treaties

The US is a party to fifteen bilateral transfer tax treaties.[37] These treaties offer deductions, exemptions, credits, and otherwise reduce double taxation. However, each treaty differently defines which taxes are covered, who can invoke the treaty, and what benefits are received.

All bilateral transfer tax treaties address the estate tax, while only some address the gift tax.[38] A few of the treaties address the generation skipping transfer tax.[39] Each treaty applies to taxes imposed at the national level, while some apply to local taxes as well.[40]

Most treaties apply its benefits to both US citizens and domiciliaries of the foreign country.[41] A few of the treaties apply to domiciliaries of either country,[42] and in fact one applies to both citizens and domiciliaries of both countries.[43] Citizenship is defined by the domestic law of each country. Domiciliary status is typically defined by national law, meaning an individual might be deemed a domiciliary of multiple jurisdictions. Some treaties contain tiebreaker rules to determine the individual's fiscal domicile.

Finally, the benefits available under the treaties vary. All of the treaties provide for tax treaty credits, but some treaties provide additional deductions for debts, charitable donations, and transfers to spouses. US citizens and residents may choose to apply either the Section 2014 credit or the tax treaty credit to their estate. Both credits cannot be claimed simultaneously, except in some situations involving foreign national and local taxes.

Conclusion

While estate planning cannot prevent the unforeseen, taking the time to understand the many factors discussed in this article, as well as others, such as the residence/citizenship of the decedents and beneficiaries, and the situs and nature of the property, will help to ensure that the decedent's bequeaths are respected by both the courts in all jurisdictions as well as their heirs.

Subsequent articles in this series will discuss specific estate planning considerations for US citizens, US expatriates, US residents, and NRAs.

Endnotes

1 This article is not legal advice. It contains general information about the US gift and estate tax system. Please consult a qualified US estate planning professional to assist with your estate planning. All references in this article to the "IRC" refer to the Internal Revenue Code, located in Title 26 of the United States Code.

2 Many US states have their own estate, gift and inheritance taxes. This article only discusses US federal, estate, gift and inheritance taxes.

3 *See* IRC § 2010(c)(3)(c); IRC § 2102(b)(1).

4 IRC § 2031(a); IRC § 2106(a).

5 IRC § 2505(a).

6 IRC § 2511(a).

7 *See* IRC § 2503(b).

8 *See* IRC § 61.

9 *See* IRC § 1441; IRC § 1445.

10 A US real property holding company is a corporation which holds US real property interests that equal or exceed fifty percent of the fair market value of (1) its US real property interests, (2) its non-US real property interests, and (3) any other assets. IRC § 897(c)(2).

11 Or, in a civil law jurisdiction, immovable and moveable.

12 Restatement Second of Conflict of Laws § 236 (1988).

13 *Id.* at § 260.

14 *Eg*, France, Germany, Brazil, Argentina, Russia, Japan, Scotland, and Saudi Arabia.

15 Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

16 Restatement Third of Property: Wills and Other Donative Transfers § 9.1 (2003).

17 *See, e.g.*, Succession Law Reform Act, R.S.O. 1990, c. S.26, s. 37 (Ontario).

18 *Bucca v. State*, 128 A.2d 506 (N.J. Super. Ct. 1957).

19 *Estate of Bir*, 188 P.2d 499 (Cal. App. 1948).

20 *Id.* at 502.

21 In re *Estate of Schorr*, 409 So. 2d 487 (Fla. Dist. Ct. App. 1981).

22 *See* Restatement Second of Conflict of Laws § 269 (1988).

23 *See* Restatement Second of Conflict of Laws § 270 (1988).

24 What constitutes the "most significant relationship" is based on the factors set out in § 6 of the Restatement Second of Conflict of Laws.

[25] Council Regulation No. 650-2012, art. 4, 2012 O.J. (L 201) 107, 118.

[26] *Id.* at art. 10.

[27] *Id.*

[28] To determine habitual residence, the competent authority "should make an overall assessment of the circumstances of the life of the deceased during the years preceding his death and at the time of his death, taking account of all relevant factual elements, in particular the duration and regularity of the deceased's presence in the State concerned and the conditions and reasons for that presence. The habitual residence thus determined should reveal a close and stable connection with the State concerned taking into account the specific aims of this Regulation." *Id.* at para. 23.

[29] *Id.* at art. 21.

[30] *See id.* at arts. 20-22.

[31] *Id.* at art. 35.

[32] *Id.* at art. 22.

[33] *Id.*

[34] *Id.* at art. 27.

[35] *Id.* at art. 36.

[36] Such a situation has not yet arisen in any US court.

[37] Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, South Africa, Switzerland, and the United Kingdom. However, Australia and Austria abolished their estate, inheritance, and gift taxes, so those treaties are of little practical importance. Additionally, Canada does not have an estate or inheritance tax, but rather a gains at death tax.

[38] Australia, Austria, Denmark, France, Germany, Japan, and United Kingdom.

[39] Austria, Denmark, France, Germany, and United Kingdom.

[40] Canada, Finland, and Switzerland.

[41] Australia, Canada, Denmark, Finland, France, Germany, Ireland, Japan, the Netherlands, Switzerland, and United Kingdom.

[42] Austria, Greece, and South Africa.

[43] Italy.

The Work Of The EU Code of Conduct Group (Business Taxation) Against Harmful Tax Regimes

by Stuart Gray, Senior Editor, Global Tax Weekly

The campaign against harmful tax regimes is an agenda most often associated with the OECD, seen as an integral part of its base erosion and profit shifting work. However, behind the scenes, the much more low-profile European Union Code of Conduct Group (Business Taxation) has helped to change the face of taxation not only in many parts of the EU but also outside of the Union. And as this article shows, while the Code Group has managed to bring about widespread changes to the tax regimes of many member states and and third territories, there is still plenty of work on its agenda.

Introduction

Established in 1998 – the same year in which the OECD published its seminal report on harmful tax regimes[1] – the Code Group was tasked with detecting legislative, regulatory, and administrative measures in EU member states that were distorting business decisions surrounding the location of business activity in the EU. It did so by challenging tax regimes that offer concessionary tax treatment to non-residents not generally available to domestic businesses.

For the purpose of identifying such harmful measures, the Code set out the criteria against which any potentially harmful measuresweare to be tested. Covering legislative, regulatory, and administrative measures which have, or may have, a significant impact on the location of business in the EU, these were as follows:

- An effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- Tax benefits reserved for non-residents;

- Tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- Granting of tax advantages even in the absence of any real economic activity;
- A basis of profit determination for companies in a multinational group which departs from internationally accepted rules, in particular those approved by the OECD; and
- A lack of transparency.

By adopting this Code, member states agreed to "roll back" existing tax measures that were deemed to result in harmful tax competition and refrain from introducing any such measures in the future ("standstill"). And while the Code is not legally binding, the Commission acknowledges that it has "political force."

Harmful Tax Regimes

Following the publication of a report in November 1999 [2] in which the Group identified 66 tax measures with harmful features (40 in EU member states, three in Gibraltar, and 23 in dependent or associated territories), EU finance ministers resolved to push forward with the "harmful tax measures" initiative at their meeting in Brussels in July 2001. Many of these regimes were directed at attracting the headquarters companies of multinationals and usually allowed a very low rate of tax to be paid both by the company itself and often by its executives as well.

After this meeting, it was announced that the Commission was targeting 15 of the measures already identified as illegal state aid schemes. Eleven of them were investigated, but four of them were branded illegal immediately. The national regimes which were to be investigated included:

- Germany – Special Fiscal Regime for Control and Coordination Centers of Foreign Companies;
- Spain – Special Fiscal Regime for Bizkaia Coordination Centers;
- France – Headquarters and Logistics Centers Regime;
- France – Régime des Centrales de trésorerie;
- Ireland – Tax Exemption on Foreign Income;
- Luxembourg – Coordination Centers Regime;
- Luxembourg – Finance Companies Regime;
- The Netherlands – Special Fiscal Regime for International Financing Activities;
- Finland – Åland Island Captive Insurance Regime;
- United Kingdom – Gibraltar Qualifying Offshore Companies Rules; and
- Gibraltar – Exempt Offshore Companies Rules.

The four regimes branded illegal right away included

- Belgium's Fiscal Regime of Co-ordination Centers;
- Greece's Fiscal Regime for Offices of Foreign Companies;
- Italy's Tax Incentives Linked to the Trieste Financial Services and Insurance Centre; and
- Sweden's Foreign Insurance Companies Taxation Regime.

Harmful Tax Regimes In The Accession States

In a report released in June 2003, the European Commission revealed that all of the incoming new members of the EU - with the exception of Estonia and Latvia - had corporate tax measures in place that could disrupt the EU's internal market.

The EC identified nine tax measures that it deemed "harmful" in Cyprus, one in the Czech Republic, two in Hungary, three in Lithuania, five in Slovakia, and one in Slovenia. Poland came in for criticism over a general lack of transparency. But Malta's tax regime in particular came under the microscope, and the Commission described the seven "harmful" tax measures that it wanted the Maltese Government to abolish. The first three measures identified by the Commission concerned offshore trading and non-trading companies, offshore insurance firms, and offshore banking companies.

While Malta agreed with the Commission's verdict on these measures, the Government said they were repealed in 1996, with a transitional period put in place until September 23, 2004. Other measures singled out by the Commission as harmful were:

- International Trading Companies: these were considered harmful by the Commission as they created an effective tax rate of 4.2 percent for non-residents (the standard rate being 35 percent);
- Dividends from (other) Maltese companies with foreign income: this was deemed to establish a favorable holding regime for non-residents, providing for a tax exemption on income derived from a subsidiary based in a country with significantly lower taxes than Malta without the appropriate anti-evasion measures in place;
- Investment Service Companies: this measure gave deductions not available to other resident firms, and the Commission claimed that this could seriously affect the location of business activity, especially in the financial services sector; and
- Non-resident Companies: this regime allowed the taxation of foreign income to be delayed, in some cases indefinitely.

In 2008, the ECOFIN Council endorsed the idea that the development or revision of guidance notes could help build on the results of the Group. Several of these guidance notes have been agreed by the Group and endorsed by the Council over the years. Their implementation by member states is regularly reviewed by the Group.

The Code of Conduct Group has also prepared a number of Council conclusions, notably the EU list of non-cooperative jurisdictions for tax purposes, which was adopted by the ECOFIN Council on December 5, 2017.

Subgroups

Several subgroups have been created since the creation of the Group in 1998. The more recently established subgroups include the following:

- Subgroup on anti-abuse: Created in 2013, it was tasked with drafting guidance on anti-abuse issues related to inbound and outbound profit transfers and mismatches between tax systems.
- Subgroup on the clarification of the third and fourth criteria: Established by the Council of Finance Ministers (ECOFIN) on March 8, 2016, this subgroup was created to "deal with the clarification of the third and fourth criteria of the Code."
- Subgroup on third countries: Established by the ECOFIN Council on March 8, 2016, this subgroup was created to "deal with dialogues with relevant third countries" and in practice assists the Code of Conduct Group with work related mainly to the EU list of non-cooperative jurisdictions for tax purposes.

These subgroups are chaired by the member state holding the Presidency of the Council and report to the Code of Conduct Group.

Recent Work

Although the Code of Conduct Group has been an influence behind substantial changes to tax regimes in the EU and in third countries, its work seems far from done. The Group meets on a regular basis and has issued reports to the Council every year from 1999 to 2017. Its last report, published on November 27, 2017,[3] reveals that the Group met four times under the Estonian presidency of the EU, in July, September, October, and November 2017. At its meeting on July 20, in line with the work package agreed by the EU Council of Finance Ministers on December 8, 2015, the Group decided to focus work on the following items:

- Monitoring of standstill and the implementation of rollback.
- Monitoring developments in the administrative practices of member states.
- Continuation of the work on the establishment of the EU list of non-cooperative jurisdictions.
- Maintaining links with third countries, including, with regard to Liechtenstein, continuation of the dialogue on harmful regimes and, concerning Switzerland, monitoring of the outcome of the dialogue.
- Monitoring member states' compliance with agreed guidance.
- Procedural issues, specifically the continuation of the work regarding the clarifications of the third and fourth criteria and launch of work on guidelines setting working methods for an effective monitoring of member states' compliance with agreed guidance.

The Code Group also continues its close scrutiny of the tax regimes of the UK Crown Dependencies, Guernsey, Jersey, and the Isle of Man. On August 6, 2018 the former two began consultations on possible measures to ensure that companies operating in certain sectors identified by the Code Group can demonstrate a sufficient level of economic substance in these jurisdictions.[4],[5] On August 7, the Isle of Man published an update on progress made towards ensuring the Code Group's concerns in this area are addressed.[6]

The proposals follow the screening of a large number of non-EU jurisdictions undertaken by the European Commission Code of Conduct Group in 2017, the territories said. This was to assess standards of tax transparency, fair taxation, and compliance with measures to prevent base erosion and profit shifting.

While the Crown Dependencies were re-affirmed as co-operative jurisdictions in December 2017, the European Commission highlighted concerns about the ability of Jersey, Guernsey, and the Isle of Man to demonstrate that companies tax resident in their jurisdictions operated with sufficient substance to justify access to their corporate tax regimes. The three jurisdictions made a commitment in November 2017 to the European Commission to address these concerns and have since worked closely together to develop proposals that will meet this commitment by December 31, 2018.

These proposals will require companies that are tax resident in Jersey, Guernsey, or the Isle of Man, and are engaged in key activities identified by the EU, to demonstrate that they meet minimum substance requirements as part of their annual tax return. The key activities identified by the European Commission Code of Conduct Group are: banking, insurance, fund management, financing and leasing, shipping, intellectual property, collective investment vehicles, and holding companies that generate income from any of these key activities.

The substance requirements are said to vary for each key activity to reflect the different needs of the companies involved and are designed to be fair and proportionate while ensuring that there are sufficient activities undertaken in the relevant jurisdiction to reflect the amount of profits accounted there. The substance requirements will include being able to demonstrate that the company is directed and managed from the relevant Crown Dependency, that the company has adequate levels of employees as well as annual expenditure and physical offices.

Transparency – Or Lack Thereof?

The Code of Conduct Group is composed of high level representatives of member states and the European Commission. It is chaired by a representative of a member state, serving for a mandate of two years, and assisted by the General Secretariat of the Council. The current Chair, Fabrizia Lapecorella, was elected in January 2017.

However, the body has been criticized for its lack of transparency. The legal foundations, powers, and accountability of the Code Group seem unclear, and as the Commission itself suggests, the Code Group's powers are political rather than legal. With member states' commitments to adhere to the Code implied, rather than enforced, questions have been raised about the body's legitimacy, especially as it appears to have been used to bypass normal legislative and judicial mechanisms to bring about often major changes to the tax regimes of member states and third territories.

Another controversial aspect of the Code Group's work is that the European Council of Finance Ministers agreed that the work of the Group is confidential. This has frustrated attempts by parliamentarians at national and EU level to gain access to its internal reports as well as an insight into the Group's reasoning when deciding what does or doesn't constitute a harmful tax regime.

Conclusion

Established around the same time as the OECD launched its campaign against harmful tax regimes around the world, the Code of Conduct Group (Business Taxation) has in the intervening 20 years effected substantial changes to the corporate tax regimes across the European Union and beyond, from the core founding member states to the new intake which acceded to the union in 2003 and 2008 and several third jurisdictions. And, like the OECD, lacking any direct legal authority, it has done so more through influence and its powers of political persuasion rather than through recourse to legal measures.

However, with its absence of a legal foundation, coupled with concerns over its accountability and lack of transparency, the Code Group has helped to achieve these widespread changes under a cloud of controversy. Despite these criticisms, the Code Group is now a well-established function of the European Union, and as its latest report to the EU Council shows, its work looks far from complete.

Endnotes

1 https://read.oecd-ilibrary.org/taxation/harmful-tax-competition_9789264162945-en#page1

2 http://data.consilium.europa.eu/doc/document/ST-14313-1999-INIT/en/pdf

3 http://data.consilium.europa.eu/doc/document/ST-14784-2017-INIT/en/pdf

4 https://www.gov.gg/article/166654/Consultation-on-the-introduction-of-substance-requirements-for-companies-tax-resident-in-Guernsey

5 https://www.gov.je/Government/Consultations/Pages/IntroductionSubstanceRequirementsCompanies.aspx

6 https://www.gov.im/news/2018/aug/07/update-on-work-to-meet-code-of-conduct-group-commitment/

Topical News Briefing: The Digital Drift

by the Global Tax Weekly Editorial Team

While all members of the G20 group of nations have taken appropriate steps to implement the OECD's base erosion and profit shifting recommendations, according to an interim report by the G20 Research Group, perhaps the most challenging aspect of the BEPS project has yet to be resolved: taxing the digital economy.

While digital technology has brought the world closer together, the news stories in this week's issue of *Global Tax Weekly* suggest that the international community is drifting further apart over the most appropriate means to tax companies operating digital business models, which are challenging traditional pre-digital age concepts of taxation such as nexus and permanent establishment. And this even though most governments concede that an international agreement on new tax rules would be far preferable to a fragmented, incoherent response to the problem, which risks distorting the global economy and investment environment.

The waves created by the European Union after it pre-empted the OECD's upcoming recommendations in this area (due in 2020) by publishing its own digital tax plans last March continue to reverberate. And, as reported in this week's issue, the United Kingdom Government has given its clearest indication yet that it would be prepared to explore its own digital tax options in the absence of an international agreement.

Indeed, the digital tax coalition, if there ever was one in place, is threatening not just to break down, but to degenerate into conflict, with Republican members of Congress in the United States having urged President Donald Trump to "defend US tax interests abroad" by resisting efforts by the European Union to introduce special tax measures on US-based digital companies, as also reported in this week's issue.

It is arguable that governments have already arrived at the conclusion that a multilateral consensus on the taxation of the digital economy is going to be elusive and are now acting to shore up their tax bases. The European Commission, for example, has used state aid rules to challenge the transfer pricing arrangements of Amazon and Apple, among other multinational companies, while the UK is extending its withholding tax regime to certain outbound royalty payments, a move which in the Government's words forms part of its "longer-term ambition of domestic and international reform of the taxation of digital businesses." And in the United States, the Tax Cuts and Jobs Act included measures intended to discourage the shifting of income associated with intangible assets overseas.

With governments growing ever more impatient with the OECD on digital tax matters, additional tax measures elsewhere targeting digital businesses cannot be ruled out.

Foreign Tax Credit Planning: The Potential Benefits Of Subpart F Income

by Stewart R. Lipeles, Julia Skubis Weber, Ethan S. Kroll, and Ian Y. Siu, Baker & McKenzie, LLP

Importance of FTCs in a Post-US Tax Reform World

Recent US tax reform[1], notably, the new Global Intangible Low Tax Income ("GILTI") regime, will reduce opportunities for US taxpayers to utilize foreign tax credits ("FTCs") to avoid double tax on foreign earnings. In particular, the lower US corporate tax rate of 21 percent means less US tax for FTCs to offset. FTCs with respect to GILTI are haircut by 20 percent. Cross-crediting, or utilizing excess FTCs from high-taxed foreign earnings to offset incremental US tax on low-taxed foreign earnings, also will be more difficult with the addition of separate limitation categories under Code Sec. 904 for foreign branch income and GILTI.

The good news is that there may be opportunities for taxpayers to better utilize FTCs, even in the near term, with no changes or relatively modest changes to their structures.[2] In this column, we first address how FTCs now apply to subpart F income and GILTI, post-US tax reform. We then discuss circumstances where earning subpart F income may lead to additional FTC benefits. Finally, we examine possible approaches for generating subpart F income to capture these benefits.[3]

2. How FTC Rules Apply to Subpart F Income and GILTI Post-U.S. Tax Reform

a. Subpart F Income

Under Code Sec. 960, a taxpayer that is a domestic corporation may be able to claim FTCs with respect to the "Deemed Paid Taxes" on a subpart F inclusion.[4] The Deemed Paid Taxes are the foreign income taxes that the taxpayer's controlled foreign corporations ("CFCs") [5] are determined to have paid or accrued with respect to the inclusion and on the distribution of the related "PTI," such as foreign withholding taxes. PTI or previously taxed earnings refers to undistributed earnings that have already been subject to U.S. tax under subpart F (*e.g.,* subpart F income, GILTI). Following the repeal of Code Sec. 902[6] the amount of Deemed Paid Taxes would no longer depend on Code Sec. 902 concepts, namely, the post-1986 foreign income taxes and post-1986 undistributed earnings of the taxpayer's CFCs at or above the sixth tier. [7] Instead, the amount of Deemed Paid Taxes would be tied to the foreign income taxes that are "properly attributable" to the Inclusion. Interestingly, properly attributable foreign income taxes may include foreign income taxes incurred at CFCs below the sixth tier, even though those credits were not creditable under Code Sec. 902 [8] Any unused FTCs can continue to be used in the preceding taxable year or the succeeding 10 years.[9]

Congress intended that the rules for determining which foreign taxes are "properly attributable" to an inclusion under Code Sec. 960 would operate in a similar manner to the rules for allocating foreign taxes to separate limitation categories under Code Sec. 904 (the "904 Allocation Rules"). [10] These rules allocate foreign taxes only to a separate category of income under Code Sec. 904 that relate to income in that category. [11] Post-TCJA, Code Sec. 904 classifies income as passive category income, general category income, foreign branch income, or GILTI. [12]

As of the time we submitted this column to the publisher, the IRS was considering various approaches for determining which foreign taxes relate to subpart F income. One approach would be to closely trace which foreign taxes relate to which foreign earnings give rise to subpart F income. Another approach would be to treat foreign taxes as related to subpart F income under Code Sec. 960 only if the taxpayer accrued the foreign taxes in the same year as the subpart F income for U.S. tax purposes. While the latter approach potentially could be simpler from a tax administration standpoint, it could also result in timing mismatches between when a taxpayer accrues income and could claim FTCs. [13]

Code Sec. 78 has been amended to reflect the repeal of Code Sec. 902, but otherwise continues to provide that, for subpart F income, the taxpayer is treated as receiving a dividend equal to the amount of Deemed Paid Taxes (the "Code Sec. 78 Gross-Up"). Any unused FTCs can continue to be used in the preceding taxable year or the succeeding 10 years. [14]

Under the Code Sec. 904 (d)(3) look-thru rule, the subpart F inclusion, the related Code Sec. 78 Gross-Up, and the related foreign income taxes are placed in the general limitation category or the passive limitation category to the extent the underlying subpart F income is general category income and passive category income. [15]

b. GILTI

The FTC consequences of a GILTI inclusion are the same as for a subpart F inclusion, with a few notable exceptions.

First, unlike for subpart F inclusions, any FTCs with respect to GILTI inclusions cannot be used in the preceding taxable year or the succeeding 10 years. [16] In other words, any excess GILTI FTCs are lost forever. This inability to carry forward or carry back excess GILTI FTCs could be particularly detrimental for taxpayers if, as discussed earlier, the IRS were to adopt a properly attributable standard that creates timing mismatches between when a taxpayer accrues income and is able to claim the FTCs.

Second, a taxpayer that is a domestic corporation is deemed to directly pay 80 percent, instead of 100 percent, of the foreign income taxes that its CFCs are determined to have paid or accrued with respect to the GILTI inclusion. The taxpayer's Code Sec. 78 Gross-Up on the GILTI inclusion, nevertheless, is equal to 100 percent of these foreign income taxes. [17] These foreign income taxes are equal to an "inclusion percentage" multiplied by the foreign income taxes paid or accrued by the CFCs that are "properly attributable" to the tested income of the CFCs. [18] The inclusion percentage is equal to the percentage of the taxpayer's aggregate tested income that constitutes GILTI. Put differently, this percentage is equal to the fraction of aggregate tested income that is not shielded from immediate U.S. tax by tested loss or net deemed tangible income return ("NDTIR"). [19]

The 20 percent haircut on FTCs with respect to a GILTI inclusion means that, in theory, a taxpayer would not have any incremental US tax on this inclusion if its CFCs were subject to an effective foreign tax rate of 13.125 percent, since the FTCs would equal 13.125% multiplied by 80 percent, or 10.5 percent, of the sum of the GILTI inclusion and the related Code Sec. 78 Gross-Up, which would be the same as the effective US tax rate on this income. [20] This "break-even" effective foreign tax rate is equal to the effective U.S. tax rate on foreign-derived intangible income, which presumably was intended to encourage taxpayers to retain intangible property in the United States rather than to migrate intangible property offshore. [21]

Of course, there would be no "break-even" effective foreign tax rate with respect to GILTI inclusions if expenses at the taxpayer level, including interest expense on U.S. borrowings, are allocated and apportioned to the GILTI inclusion. Recall that the 904 Limitation for GILTI FTCs is equal to the deemed U.S. tax on the taxpayer's GILTI foreign source income. In effect, the 904 Limitation would, at best, always limit the GILTI FTCs to the "break-even" effective foreign tax rate before taking into account any expenses at the taxpayer level that are allocated and apportioned to the GILTI inclusion. Accordingly, every dollar of these expenses would necessarily reduce GILTI foreign source income by a dollar and result in 21 cents of additional U.S. tax.

Third, there is a possibility that the related Code Sec. 78 GILTI Gross-Up would not always be placed in the same basket as the GILTI inclusion. [22] While non-passive GILTI would be placed in the GILTI category, the related Code Sec. 78 Gross-Up might instead be treated as a dividend for purposes of the Code Sec. 904(d)(3) look-thru rule. In that case, theCode Sec. 78 GILTI Gross-Up possibly could be placed in the general category or passive category, rather than the GILTI category. [23]

As of the time we submitted this column to the publisher, the IRS had informally indicated that it would publish proposed regulations that would always place the Code Sec 78 GILTI Gross-Up in the GILTI basket. [24] If published, it seems unlikely that the IRS would assert negligence or substantial understatement penalties if a taxpayer, relying on these proposed regulations, always placed the Code Sec. 78 GILTI Gross-Up in the GILTI basket. [25] It potentially could be beneficial, however, for a taxpayer to place the Code Sec. 78 GILTI Gross-Up in a non-GILTI basket because any FTCs that are also placed in this basket would not be subject to a 20 percent haircut and could be carried forward or backward. [26] If the taxpayer chose instead to place the Code Sec. 78 GILTI Gross-Up in a non-GILTI basket, contrary to any proposed regulations, the plain language of the Code and the legislative history of the TCJA [27] would appear to provide the taxpayer with a strong defense against negligence or substantial understatement penalties. [28]

3. Advantages Of Subpart F Income *Versus* GILTI

Although subpart F income would be subject to a higher effective US tax rate than a GILTI inclusion, it may nevertheless be advantageous for a taxpayer's CFCs to earn subpart F income, rather than GILTI, for at least two reasons. First, any excess GILTI FTCs are lost forever while excess general or passive FTCs from a subpart F inclusion can be carried back 1 year and forward 10 years. The risk of having lost FTCs in the GILTI basket may be somewhat higher than in the general basket because taxpayers generally will have more opportunities to structure transactions so that they generate general basket income than opportunities to generate GILTI basket income.

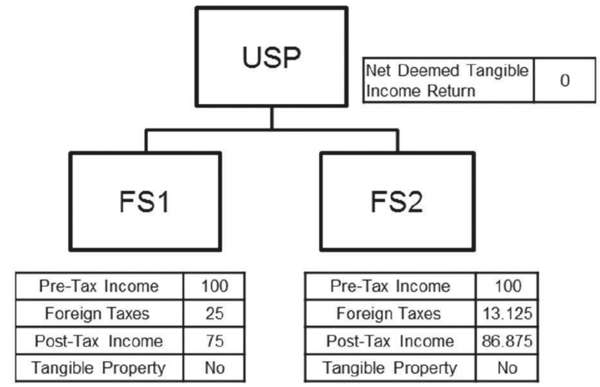
Second, subpart F income may provide a way to claim the full benefit of high-taxed foreign earnings. Recall that FTCs with respect to GILTI are limited to 80 percent of properly attributable foreign taxes, multiplied by an inclusion percentage. Accordingly, to the extent that the inclusion percentage is low, even high-taxed foreign earnings, if GILTI, may be subject to incremental US tax because only a small percentage of the properly attributable earnings would result in FTCs. Conversely, these high-taxed foreign earnings, if subpart F income, may not be subject to incremental US tax because the properly attributable foreign taxes, when not haircut by 20 percent and the inclusion percentage, may result in FTCs that more than offset the US tax on these earnings before FTCs.

The following examples illustrate each of these potential advantages in turn, and circumstances that could erode or entirely eliminate these advantages. For purposes of these examples, we assume that the Code Sec. 78 Gross-Up for a GILTI inclusion is treated as GILTI category income. We also assume that pre-tax income would be the same for both US and foreign tax purposes.

Example 1—FTC Carry Back or Carry Forward

Suppose a taxpayer that is a domestic corporation ("USP") wholly owns two foreign subsidiaries. One foreign subsidiary ("FS1") earns pre-tax income of 100 from active business operations, subject to an effective foreign tax rate of 25%. The second foreign subsidiary ("FS2") earns pre-tax income of 100, subject to an effective foreign tax rate of 13.125%. Neither FS1 nor FS2 holds any tangible property that gives rise to any NDTIR for USP. Neither FS1 nor FS2 incurs any expenses besides foreign income taxes (*see* Figure 1).

FIGURE 1.



If neither FS1 nor FS2 earns any subpart F income, USP's net CFC tested income would be 161.875 (100 of FS1 pre-tax income, less 25 of FS1 foreign income taxes paid, plus 100 of FS2 pre-tax income, less 13.125 of FS2 foreign income taxes paid). USP's GILTI inclusion would equal its net CFC tested income because there are no tested losses and USP does not have any NDTIR. Accordingly, the inclusion percentage would be 100% (161.875 of GILTI, divided by 161.875 of aggregate tested income). [29] The foreign income taxes properly attributable to the aggregate tested income presumably would be 38.125 (25 of FS1 foreign income tax paid, plus 13.125 of FS2 foreign income taxes paid). The Code Sec. 78 Gross-Up with respect to the GILTI inclusion would be 38.125 (100 percent inclusion percentage, multiplied by the 38.125 of foreign income taxes properly attributable to aggregate tested income). The Code Sec. 250 deduction for the GILTI inclusion and related Code Sec. 78 Gross-Up would be 100 (50 percent multiplied by 200, where the 200 would be the 161.875 of GILTI inclusion, plus 38.125 of Code Sec. 78 Gross-Up). The US tax on the GILTI inclusion and Code Sec. 78 Gross-Up before FTCs would be 21 (21 percent US tax rate, multiplied by 100, where 100 would represent the 161.875 of GILTI inclusion, plus 38.125 of Code Sec. 78 Gross-Up, less the 100 of Code Sec. 250 deduction). The Deemed Paid Taxes with respect to the GILTI inclusion would be 30.5 (80 percent multiplied by the 38.125 of Code Sec. 78 Gross-Up). Twenty-one of the GILTI FTCs would entirely offset the 21 of U.S. tax on the GILTI inclusion and Code Sec. 78 Gross-Up. The excess GILTI FTCs of 9.5 would be lost forever. These calculations are summarized in Table 1.

TABLE 1.

GILTI	161.875
GILTI Code Sec. 78 Gross-Up	38.125
Code Sec. 250 Deduction	100
Taxable Income	100
U.S. Tax at 21%	21
GILTI Deemed Paid Taxes	30.5
Net U.S. GILTI Tax	**0**
Excess GILTI FTCs Lost	**(9.5)**

If all of FS1's income was instead treated as subpart F income, USP would have a subpart F inclusion of 75 (100 of FS1 subpart F income, less 25 of FS1 foreign income taxes). The foreign income taxes properly attributable to the subpart F income would presumably be the 25 of FS1 foreign income taxes. In that case, the Deemed Paid Taxes and Code Sec. 78 Gross-Up with respect to the subpart F inclusion would also be 25. The US tax on the subpart F inclusion before FTCs would be 21 (21 percent US tax rate, multiplied by 100, where 100 would represent the 75 of subpart F inclusion, plus 25 of Code Sec. 78 Gross-Up). Twenty-one of the subpart F FTCs would entirely offset the 21 of U.S. tax on the subpart F inclusion. The excess subpart F FTCs of four could be carried back 1 year and carried forward 10 years. These excess FTCs would be allocated to the general category because FS1 derived its subpart F income from active business operations.

Assuming FS1's income is all subpart F income, USP's net CFC tested income for GILTI purposes would be limited to the income FS2 generates, which would be 86.875 (100 of FS2 pre-tax income, less 13.125 of FS2 foreign income taxes paid). USP's GILTI inclusion would equal its net CFC tested income because there are no tested losses and USP does not have any NDTIR. Accordingly, the inclusion percentage would again be 100 percent (86.875 of GILTI, divided by 86.875 of aggregate tested income). The foreign income taxes properly attributable to the aggregate tested income presumably would be the 13.125 of FS2 foreign income taxes. The Code Sec. 78 Gross-Up with respect to the GILTI inclusion would be 13.125 (100 percent inclusion percentage, multiplied by the 13.125 of foreign income taxes properly attributable to aggregate tested income). The Code Sec. 250 deduction for the GILTI inclusion on FS2's income and related Code Sec. 78 Gross-Up would be 50 (50 percent multiplied by 100, where the 100 would be the 86.875 of GILTI inclusion, plus 13.125 of Code. Sec. 78 Gross-Up). The US tax on the GILTI inclusion for FS2's income and related Code Sec. 78 Gross-Up before FTCs would be 10.5 (21 percent US tax rate, multiplied by 50, where 50 would represent the 86.875 of GILTI inclusion, plus 13.125 of Code Sec. 78 Gross-Up, less the 50 of Code Sec. 250 deduction). The Deemed Paid Taxes with respect to the GILTI inclusion would be 10.5 (80 percent multiplied by the 13.125 of Code Sec. 78 Gross-Up). All 10.5 of the GILTI FTCs would entirely offset the 10.5 of U.S. tax on the GILTI inclusion and related Code Sec. 78 Gross-Up. The foregoing subpart F and GILTI calculations are summarized in Table 2.

TABLE 2.

		GILTI	86.875
Subpart F Inclusion	75	GILTI Code Sec. 78 Gross-Up	13.125
Subpart F Code Sec. 78 Gross-Up	25	Code Sec. 250 Deduction	50
Taxable Income	100	Taxable Income	50
U.S. Tax at 21%	21	U.S. Tax at 21%	10.5
Deemed Paid Taxes	25	GILTI Deemed Paid Taxes	10.5
Net U.S. Tax	**0**	Net U.S. GILTI Tax	**0**
General FTC Carryover/back	**4**	Excess GILTI FTCs Lost	**0**

In this example, it would be highly advantageous for FS1's income to constitute subpart F income, assuming USP could utilize the resulting excess FTCs. Regardless of whether FS1's income constitutes subpart F income, USP pays no U.S. tax with respect to the earnings of its CFCs. Moreover, assuming FS1 earns some low-taxed subpart F income from other sources (*eg*, royalties from its foreign subsidiaries that look through to active earnings), USP would have four of additional FTCs available to offset that income. If there are insufficient low-taxed earnings, the taxpayer could use those additional FTCs the preceding year, or the succeeding 10 years. This US tax benefit would not exist if FS1 did not earn subpart F income.

This FTC advantage should remain even if FS1 and FS2 were disregarded below another CFC because the Deemed Paid Taxes arising from FS1's subpart F income would presumably be the same under the new Code Sec. 960 "properly attributable" standard. Under former Code Sec. 960, the Deemed Paid Taxes would have been determined under Code Sec. 902 post-1986 pooling concepts that would have instead blended together FS1's high taxes with FS2's low taxes, reducing the Deemed Paid Taxes on the subpart F inclusion. Accordingly, in this respect, new Code Sec. 960 potentially provides taxpayers with more opportunities than before for obtaining FTCs on high-taxed foreign earnings.

Importantly, the result would be different if FS1 were subject to an effective foreign tax rate below 21 percent. In that case, if FS1 earned subpart F income, the related FTCs would not be enough to completely offset the 21 percent US tax on USP's subpart F inclusion. Accordingly, USP would owe less U.S. tax if FS1 instead did not earn any subpart F income and USP instead was subject to the lower 10.5 percent US tax on the resulting GILTI inclusion.

Even if FS1 were subject to an effective foreign tax rate above 21 percent, it may be still more advantageous for FS1 not to earn any subpart F income if FS2 were subject to a low effective foreign tax rate. Consider the same example as above except that FS2 is subject to subject to an effective foreign tax rate of 5 percent instead of 13.125 percent. Similarly, it may be advantageous to avoid subpart F income if the taxpayer cannot use the FTCs because expense allocations for interest or R&D offset the Code Sec. 904 imitation that would otherwise be available.

If neither FS1 nor FS2 earns any subpart F income, the GILTI inclusion would be equal to net CFC tested income of 170 because USP would have no NDTIR and no tested losses (100 of FS1 pre-tax income, less 25 of FS1 foreign income taxes paid, plus 100 of FS2 pre-tax income, less five of FS2 foreign income taxes paid). For the same reason, the inclusion percentage would remain 100 percent. The Code Sec. 78 Gross-Up would be 30 (100 percent inclusion percentage, multiplied by the 30 of FS1 and FS2 foreign income taxes properly attributable to aggregate tested income). In other words, the GILTI inclusion and related Code Sec. 78 Gross-Up would still be 200 and the US tax on the GILTI inclusion and Code Sec. 78 Gross-Up before FTCs would remain 21. The Deemed Paid Taxes would be 24 (80 percent multiplied by the 30 of Code Sec. 78 Gross-Up). Twenty-one of the GILTI FTCs would entirely offset the 21 of U.S. tax and three of excess GILTI FTCs would be lost forever. These calculations are summarized in Table 3.

TABLE 3.

GILTI	170
GILTI Code Sec. 78 Gross-Up	30
Code Sec. 250 Deduction	100
Taxable Income	100
U.S. Tax at 21%	21
GILTI Deemed Paid Taxes	24
Net U.S. GILTI Tax	**0**
Excess GILTI FTCs Lost	**(3)**

If all of FS1's income were instead treated as subpart F income, the subpart F calculations would be the same as before so there would be no incremental U.S. tax on the subpart F inclusion and excess subpart F FTCs of four. The GILTI inclusion would be equal to net CFC tested income of 95 (100 of FS2 pre-tax income, less five of FS2 foreign income taxes paid). The inclusion percentage would remain 100% and the Code Sec. 78 Gross-Up would be five (100 percent inclusion percentage, multiplied by the five of FS2 foreign income taxes properly attributable to aggregate tested income). The GILTI inclusion and related Code Sec. 78 Gross-Up would still be 100 and the US tax on the GILTI inclusion and Code Sec. 78 Gross-Up before FTCs would be 10.5. The Deemed Paid Taxes would be four (80 percent multiplied by the five of Code Sec. 78 Gross-Up). After applying the GILTI FTCs, the U.S. tax on the GILTI inclusion and Code Sec. 78 Gross-Up would be 6.5 (10.5 of US tax, less four of Deemed Paid Taxes). These calculations are summarized in Table 4.

TABLE 4.

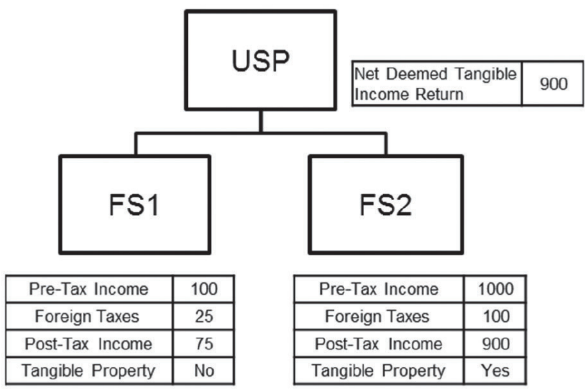
		GILTI	95
Subpart F Inclusion	75	GILTI Code Sec. 78 Gross-Up	5
Subpart F Code Sec. 78 Gross-Up	25	Code Sec. 250 Deduction	50
Taxable Income	100	Taxable Income	50
U.S. Tax at 21%	21	U.S. Tax at 21%	10.5
Deemed Paid Taxes	25	GILTI Deemed Paid Taxes	4
Net U.S. Tax	**0**	Net U.S. GILTI Tax	**6.5**
General FTC Carryover/back	**4**	Excess GILTI FTCs Lost	**0**

As this example shows, USP would owe less US tax if FS1 did not earn any subpart F income. While FS1's subpart F income would result in four of excess general category FTCs, there would be an additional 6.5 of US GILTI tax because FS1's foreign taxes would no longer result in GILTI FTCs to offset the US GILTI tax from FS2's low-taxed earnings.

Example 2—Low Inclusion Percentage

Assume, as in example 1, that USP is a domestic corporation that wholly owns two foreign subsidiaries, FS1 and FS2. As before, FS1 earns pre-tax income of 100 from active business operations, subject to an effective foreign tax rate of 25 percent. FS1 also does not hold any tangible property that gives rise to any NDTIR for USP. FS2 now earns pre-tax income of 1000, subject to an effective foreign tax rate of 10 percent. FS2 holds tangible property that gives rise to 900 of NDTIR for USP. Neither FS1 nor FS2 incurs any expenses besides foreign income taxes. Assume neither FS1 nor FS2 has any PTI (*see* Figure 2).

FIGURE 2.



If neither FS1 nor FS2 earns any subpart F income, USP's net CFC tested income would be 975 (100 of FS1 pre-tax income, less 25 of FS1 foreign income taxes paid, plus 1000 of FS2 pre-tax income, less 100 of FS2 foreign income taxes paid). USP's GILTI inclusion would equal 75 (975 of net CFC tested income, less 900 of NDTIR). Accordingly, the inclusion percentage would be roughly 7.7 percent (75 of GILTI, divided by 975 of aggregate tested income). [30] The foreign income taxes properly attributable to the aggregate tested income presumably would be 125 (25 of FS1 foreign income tax paid, plus 100 of FS2 foreign income taxes paid). The Code Sec. 78 Gross-Up with respect to the GILTI inclusion would be roughly 9.6 (7.7 percent inclusion percentage, multiplied by the 125 of foreign income taxes properly attributable to aggregate tested income). The Code Sec. 250 deduction for the GILTI inclusion and related Code Sec. 78 Gross-Up would be approximately 42.3 (50 percent multiplied by 84.6, where the 84.6 would be the 75 of GILTI inclusion, plus 9.6 of Code Sec. 78 Gross-Up). The US tax on the GILTI inclusion and Code Sec. 78 Gross-Up before FTCs would be 8.9 (21 percent U.S. tax rate, multiplied by 42.3, where 42.3 would represent the 75 of GILTI inclusion plus, 9.6 of Code Sec. 78 Gross-Up, less the 42.3 of Code Sec. 250 deduction). The Deemed Paid Taxes with respect to the GILTI inclusion would be 7.7 (80 percent multiplied by the 9.6 of Code Sec. 78 Gross-Up). All of the 7.7 of GILTI FTCs would be available to offset the 8.9 of U.S. tax on the GILTI inclusion and Code Sec. 78 Gross-Up, resulting in net U.S. tax on the GILTI inclusion of 1.2. These calculations are summarized in Table 5.

TABLE 5.	
GILTI	75
GILTI Code Sec. 78 Gross-Up	9.6
Code Sec. 250 Deduction	42.3
Taxable Income	42.3
U.S. Tax at 21%	8.9
GILTI Deemed Paid Taxes	7.7
Net U.S. GILTI Tax	**1.2**
Excess GILTI FTCs Lost	**0**

Assume USP chooses to repatriate the NDTIR by way of dividends rather than loans to, for example, avoid possible tax or legal complexities that might arise from intercompany loans. In that case, the dividends should be exempt from incremental US tax because of the Code Sec. 245A participation exemption. All of the foreign income taxes properly attributable to the NDTIR would be lost forever.

If all of FS1's income were instead treated as subpart F income, the subpart F calculations would be the same as in Example 1. In other words, there would be no incremental US tax on the subpart F inclusion and excess subpart F FTCs of four. USP's net CFC tested income would be 900 (1000 of FS2 pre-tax income, less 100 of FS2 foreign income taxes paid). USP would not have a GILTI inclusion because its 900 of NDTIR would entirely offset its 900 of net CFC tested income. These calculations are summarized in Table 6.

TABLE 6.			
		GILTI	0
Subpart F Inclusion	75	GILTI Code Sec. 78 Gross-Up	0
Subpart F Code Sec. 78 Gross-Up	25	Code Sec. 250 Deduction	0
Taxable Income	100	Taxable Income	0
U.S. Tax at 21%	21	U.S. Tax at 21%	0
Deemed Paid Taxes	25	GILTI Deemed Paid Taxes	0
Net U.S. Tax	**0**	Net U.S. GILTI Tax	**0**
General FTC Carryover/back	**4**	Excess GILTI FTCs Lost	**0**

Assume again that USP chooses to repatriate the earnings related to NDTIR by way of dividends rather than loans. In that case, these dividends should be exempt from incremental U.S. tax because of the Code Sec. 245A participation exemption. All of the foreign income taxes properly attributable to these NDTIR-related earnings would be lost forever.

In this example, when FS1 does not earn any subpart F income, there is additional GILTI equal to all of FS1's 75 of tested income, even though only a small percentage of FS1's 25 of foreign taxes result in FTCs that can offset US GILTI tax because of the low inclusion percentage. Accordingly, there is effectively an incremental 1.2 of US tax on this additional 75 of GILTI and no excess general category FTCs. By comparison, when FS1's income constitutes subpart F income, FS1's high-taxed earnings are not subject to any incremental US tax because FS1's 25 of foreign taxes are not haircut by 20 percent or the low inclusion percentage. As a result, USP pays no US tax with respect to the earnings of its CFCs and obtains four additional FTCs available to offset any low-taxed foreign general category income, whether in the current year, the preceding year, or the succeeding 10 years. Accordingly, in this example, it would be advantageous for FS1's income to constitute subpart F income.

Along with a higher inclusion percentage, the result in this example could be different if FS1 rather than FS2 were the entity that held tangible property. Because FS1 would not have any tested income, there is a risk that FS1's tangible property would not lead to any NDTIR for USP, resulting in a GILTI inclusion for USP. We believe the better view is that tangible property in a CFC with only subpart F income could still give rise to NDTIR for the related U.S. shareholder.[31] That said, until Treasury resolves this uncertainty with additional guidance, the safer course may be for a taxpayer to avoid restructuring in a way that would otherwise convert all of the earnings that a CFC derives from using high-tax basis tangible property to subpart F income from tested income.

4. Generating Subpart F Income

Taxpayers may currently have structures that are intended to minimize subpart F income. The following section discusses several approaches for generating subpart F income, where desirable, in these structures.

We first provide a brief background on the subpart F rules relevant for the discussion in this section. A US shareholder of a CFC is required to include in gross income its pro rata share of the CFC's subpart F income. [32]A US shareholder is a US person who owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation or 10 percent or more of the total value of shares of all classes of stock of the foreign corporation. [33] A CFC is any foreign corporation with respect to which more than 50 percent of the total vote or value of the corporation is owned by US shareholders on any day during the taxable year of the foreign corporation. [34] The term "subpart F income" includes foreign base company income. [35]Foreign base company income, in turn, includes both foreign base company sales income ("FBCSI") and foreign base company services income ("FBCSVI"). [36] If income that would constitute foreign base company income is subject to an effective foreign tax rate of more than 18.9 percent, the U.S. shareholder may elect to exclude this income when computing subpart F (the "High Tax Exception"). [37]

FBCSI may arise from purchasing and selling personal property where a CFC either purchases from, or sells to, a related party, or purchases or sells on behalf of a related party. [38] A sale does not give rise to FBCSI if, among other things, (i) the property is sold for use, consumption, or disposition in the CFC's country of organization (the "Same-Country Use Exception") [39] or (ii) the CFC manufactures, produces, or constructs the sold property (the "Manufacturing Exception"). [40] Under the so-called "branch rule," a branch of a CFC is treated as a separate corporation for purposes of applying the FBCSI rules if, broadly speaking, the branch conducts purchasing, selling, or manufacturing activities and there is sufficient disparity between the effective tax rates of the CFC and the branch. [41] If, without applying the branch rule, income gives rise to FBCSI, this rule does not apply. [42]

FBCSVI may arise from performing technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services for or on behalf of any related person outside the CFC's country of organization.[43] Accordingly, performing services does not give rise to FBCSVI if the CFC performs services in its country of organization (the "Same-Country Services Exception"). A CFC performs services for or on behalf of any related person where, among other things, a related person pays or reimburses the CFC for performing the services. [44] There is no analog to the branch rule in the FBCSVI context.

High Tax Exception

One simple approach for generating subpart F income would be for a US shareholder to refrain from electing the High Tax Exception with respect to any foreign base company income of a CFC that is subject to an effective foreign tax rate of more than 18.9 percent. Income that is subject to the High Tax Exception does not constitute tested income. [45] Accordingly, converting this income into subpart F income would not affect whether the CFC's tangible property is treated as producing tested income and giving rise to NDTIR.

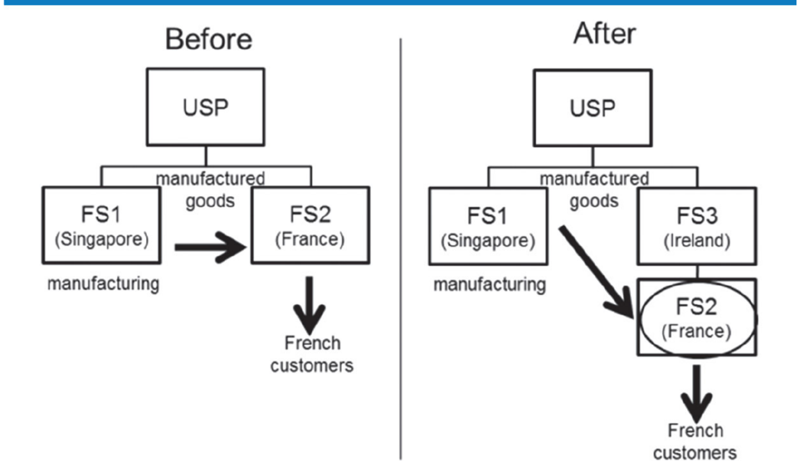
Because Code Sec. 954(b)(4) only requires that a "taxpayer establishes to the satisfaction of the Secretary" that it meets the High Tax Exception, it is conceivable that the IRS and Treasury could attempt to revise the regulations to remove the requirement that a US shareholder affirmatively elect the High Tax Exception. If valid, such regulations would make the High Tax Exception mandatory. The regulations would thus preclude a taxpayer from generating subpart F income by refraining from electing to apply the High Tax Exception.

Example 3—Reseller

Assume, as in example 1, that USP is a domestic corporation that wholly owns two foreign subsidiaries, FS1 and FS2. FS1, a Singapore company, manufactures products and is subject to an effective foreign tax rate of 5 percent. FS2, a French company, purchases manufactured products from FS1 and resells them to French customers. FS2 is subject to an effective foreign tax rate of 25 percent.

While FS1 sells products to a related party, FS2, FS1's income from these sales should not constitute FBCSI because FS1 should qualify for the Manufacturing Exception. While FS2 resells products that it acquires from a related party, FS2's income from these sales should not constitute FBCSI because FS2 should qualify for the Same-Country Use Exception (*see* Figure 3).

FIGURE 3.



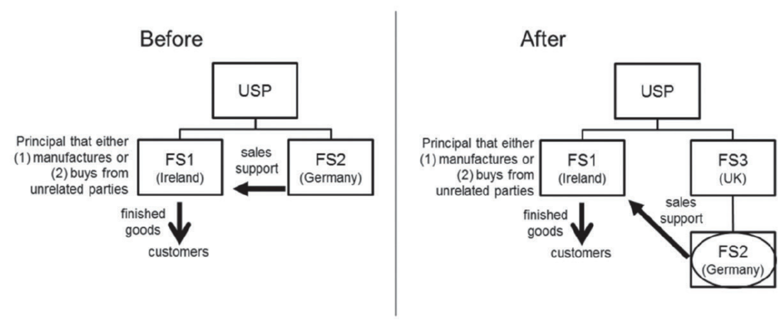
Suppose USP would like FS2 to earn subpart F income because it would result in excess general category FTCs. USP could contribute FS2 to an Irish subsidiary ("FS3") with pre-existing business operations, and then FS2 could elect to be treated as a disregarded entity for U.S. tax purposes. Assuming there is a *bona fide* business purpose for this restructuring, these steps should be treated as a tax-free reorganization under Code Sec. 368(a)(1)(D)). [46] This restructuring could be undertaken relatively quickly with minimal disruption to USP and its subsidiaries because it would involve changes to the legal structure but not to actual business operations.

Following this restructuring, from a U.S. perspective, FS3 rather than FS2 should be treated as selling to customers outside of Ireland, FS3's country of organization. Accordingly, FS3's income from these sales should give rise to FBCSI because these sales should no longer qualify for the Same-Country Use Exception. The branch rule does not apply because FS3's income gives rise to FBCSI even before applying this rule.

Example 4—Sales Support Services

Assume, as in the previous example, that USP is a domestic corporation that wholly owns two foreign subsidiaries, FS1 and FS2. FS1, an Irish company, manufactures or otherwise buys products from unrelated parties. FS1 sells these products to customers. FS1 is subject to an effective foreign tax rate of 12.5 percent. FS2, a German company, provides post-sales support services *via* employees located in Germany to FS1 in connection with FS1's sale of products to German customers. [47] FS1 pays FS2 a fee in consideration for these services. FS2 is subject to an effective foreign tax rate of 30% (*see* Figure 4).

FIGURE 4.



FS1's income from selling to customers should not give rise to FBCSI because FS1 should qualify for the Manufacturing Exception and/or should not be treated as buying from or selling to related parties. FS2 should be treated as performing services for or on behalf of a related person because FS1 pays FS2 for these services. FS2's income from performing these services, however, should not constitute FBCSVI since FS2 should qualify for the Same-Country Services Exception.

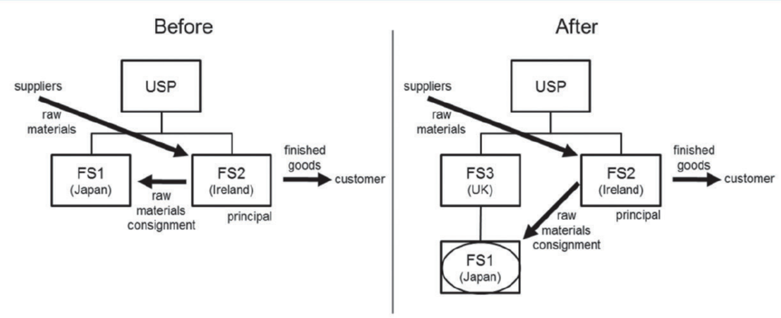
Assume that USP would like FS2 to earn subpart F income because it would result in excess general category FTCs. Similar to Example 3, USP could "drop and check" FS2 into a subsidiary organized outside of Germany, FS3, in a Code Sec. 368(a)(1)(D) tax-free reorganization, assuming there is a *bona fide* business purpose for this restructuring. As in the prior example, this restructuring could be undertaken without disrupting the underlying business operations.

Following this restructuring, from a US perspective, FS3 rather than FS2 should be treated as performing services for or on behalf of a related person outside of its country of organization. FS3's income from performing these services should therefore give rise to FBCSVI. As noted earlier, there is no branch rule that could otherwise require FS2 to be treated as a CFC for purposes of applying the FBCSVI rules.

Example 5—Manufacturing Services

Assume, as in the previous two examples, that USP is a domestic corporation that wholly owns two foreign subsidiaries, FS1 and FS2. FS2, an Irish company, purchases raw materials from third-party suppliers. FS2 engages FS1, a Japanese company, to manufacture goods in Japan on a consignment basis using these raw materials. FS2 then sells the finished goods to third-party customers. FS2 is subject to an effective foreign tax rate of 12.5%. FS1 is subject to an effective foreign tax rate of 30 percent (*see* Figure 5).

FIGURE 5.



FS2's income from selling to customers should not give rise to FBCSI because FS2 should qualify for the Manufacturing Exception and/or should not be treated as buying from or selling to related parties. FS1 should be treated as performing services for or on behalf of a related person because FS2 pays FS1 for these services. FS1's income from performing these services, nonetheless, should not constitute FBCSVI since FS1 should qualify for the Same-Country Services Exception.

Assume that USP would like FS1 to earn subpart F income because it would result in excess general category FTCs. USP could drop and check FS1 into a subsidiary organized outside of Japan, FS3, in a Code Sec. 368(a)(1)(D) tax-free reorganization, assuming there is a *bona fide* business purpose for this restructuring. As in the prior two examples, this restructuring could be undertaken without disrupting the underlying business operations.

Following this restructuring, from a US perspective, FS3 rather than FS1 should be treated as performing services for or on behalf of a related person outside of its country of organization. FS3's income from performing these services should therefore give rise to FBCSVI. If FS1 has tangible property that gives rise to significant NDTIR, as noted above, this restructuring may not be desirable because of the uncertainty surrounding whether tangible property used to produce only subpart F income can give rise to NDTIR.

5. Conclusion

Taxpayers should consider whether, in light of US tax reform, there would be an FTC benefit to earning more subpart F income. As the examples in the column illustrate, modeling will be crucial for determining whether these benefits exist. This modeling should take into account factors not touched on in this column, including how expense apportionment would affect a taxpayer's foreign source income and whether the base erosion and anti-abuse tax under Code Sec. 59A would apply to effectively disallow FTCs. In cases where there would be an FTC benefit to generating additional subpart F income, it may be possible to obtain this benefit without any restructuring or with relatively quick restructuring with little or no disruption to the underlying business operations.

Endnotes

1 Unless otherwise stated, any "section" or "§" reference is to the Internal Revenue Code of 1986, as amended (the "IRC"), or to the Treasury regulations ("Reg." or "Treas. Reg.") issued pursuant to the IRC. U.S. tax reform refers to An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, H.R. 1, P.L. No. 115-97 (2017) (the "Tax Cuts and Jobs Act" or "TCJA").

2 By contrast, other changes that taxpayers may wish to implement in response to recent U.S. tax reform may be feasible only on a longer term basis (*e.g.*, increasing investments in tangible assets offshore to reduce GILTI).

3 In this column, we do not address whether there are any FTC planning opportunities with respect to deemed income inclusions under Code Sec. 956.

4 Specifically, under Code Sec. 960, the taxpayer may be deemed to directly pay the Deemed Paid Taxes. Under Code Sec. 901, the taxpayer may be able to claim FTCs with respect to any foreign income taxes that the taxpayer directly pays or accrues, including any Deemed Paid Taxes.

5 Section 4 of this column describes when a foreign corporation would be a CFC.

6 *See* TCJA, §14301(a), (d) (repealing Code Sec. 902 effective as of the taxable years of foreign corporations beginning after December 31, 2017, and to the taxable years of U.S. shareholders in which or with which the taxable years of foreign corporations end). Code Sec. 902 in conjunction with Code Sec. 901, provided that a taxpayer, if a domestic corporation, might be able to claim FTCs with respect to foreign income taxes that the taxpayer indirectly paid or accrued with respect to dividends from its CFCs. Instead of granting foreign tax credits to avoid double tax with respect to these dividends, new Code Sec. 245A provides a dividends received deduction to offset any incremental U.S. tax on the dividend income.

[7] Code Sec. 902(a), (b).

[8] Code Sec. 960(a), (b).

[9] Code Sec. 904(c).

[10] TCJA Conference Report, at 628 ("It is anticipated that the Secretary would provide regulations with rules for allocating taxes [under the 'properly attributable' standard of Code Sec. 960] similar to rules in place for purposes of determining the allocation of taxes to specific foreign tax credit baskets." This quote included a cite to Reg. §1.904-6(a)). ***See also*** Code Sec. 960(f) ("The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.").

[11] Reg. §1.904-6(a).

[12] As background, Code Sec. 904(a) essentially limits the FTCs that a taxpayer can claim in a given year to the deemed U.S. tax on the taxpayer's foreign source income (the "904 Limitation"). The 904 Limitation is applied separately with respect to different categories of income. Code Sec. 904(d)(1). The TCJA introduced two new categories of income, one for foreign branch income and another for GILTI. Code Sec. 904(d)(1)(A), (d)(2)(J).

[13] Alexander Lewis, ***Regs to Confirm Section 78 Gross-Up Includable in GILTI Basket***, 2018 Worldwide Tax Daily 93-5 (May 14, 2018) ("[Barbara Felker, branch 3 chief, IRS Office of Associate Chief Counsel (International)] said the IRS is considering several options for applying the new section 960. 'The range of options has trade-offs between accuracy and simplicity, or you might say administrability. We could try to trace every euro included in U.S. [earnings and profits] to a euro in the foreign tax base—accurate, but not too administrable—or stick with the conventional approach of treating taxes that accrue in a US period as relating to the income that's computed for U.S. tax purposes in that period,' Felker said. 'Administrability concerns are in favor of the latter approach, where tax dumps in the basket and the income in the basket is deemed to relate to that tax, but you will have some trade-offs in terms of mismatches, particularly with the limitations on the usability of the credits in the GILTI basket.'").

[14] Code Sec. 904(c).

[15] Code Sec. 904(d)(3)(B), (G); Reg. §1.904-5(c)(1)(i) ; Reg. §1.904-6(b). While Reg. §1.904-6(b) refers to former Code Sec. 960, presumably, once updated, the regulations would continue to allocate the income, Code Sec. 78 Gross-Up, and foreign income taxes under the same pro rata approach. None of the CFC's earnings should constitute foreign branch category income because the CFC is not a foreign branch of a U.S. person. Additionally, none of the CFC's earnings should consist of GILTI category income. GILTI may only exist at the US shareholder level. ***See, eg,*** Sony Kassam, ***IRS Mulls Foreign Corporation Income as Part of " GILTI ",*** BNA Daily Tax Report (Apr. 26, 2018) ("'We need to make a fundamental decision about whether or not tested income at the CFC level is in the 951A basket,'

Marjorie A. Rollinson, associate chief counsel (International) at the Internal Revenue Service, said April 25 at an annual New York University School of Law and KPMG LLP tax event in New York."). Even if the CFC's earnings could be GILTI category income, any tested income should not be GILTI category income when applying the look-thru rule to the subpart F inclusion, because GILTI is computed after determining the amount of subpart F income. ***See*** Code Sec. 951A(c)(2)(A)(i)(II) (defining tested income to exclude subpart F income, which presumably means that subpart income is computed before GILTI).

16 Code Sec. 904(c).

17 Code Sec. 960(d); Code Sec. 78.

18 Code Sec. 960(d)(1).

19 Code Sec. 960(d)(2).

20 Under Code Sec. 250(a)(1)(B), the taxpayer would be eligible for a deduction equal to 50% of the GILTI inclusion and related Code Sec. 78 Gross-Up, so that the effective U.S. tax rate on this income would be 21% × (100%–50%), or 10.5%.

21 Under Code Sec. 250(a)(1), a taxpayer would be eligible for a deduction equal to 37.5% of its foreign-derived intangible income, which translates into an effective U.S. tax rate of 21% × (100%–37.5%) or 13.125%.

22 In the case of a subpart F inclusion, Code Sec. 904(d)(3)(G) sidesteps this potential issue by treating the Code Sec. 78 Gross-Up with respect to a subpart F inclusion as subpart F income for purposes of the Code Sec. 904(d)(3) look-thru rule.

23 None of the CFC's earnings should constitute foreign branch category income because the CFC is not a foreign branch of a U.S. person.

24 Alexander Lewis, ***Regs to Confirm Section 78 Gross-Up Includable in GILTI Basket***, 2018 Worldwide Tax Daily 93-5 (May 14, 2018) ("Treasury plans to issue proposed regulations confirming that the section 78 gross-up attributable to global intangible low-taxed income will be includable in the GILTI basket for foreign tax credit limitation purposes.").

25 *See* Reg. §§1.6662-3(b)(3), -4(d)(3)(iii) (citing proposed regulations as authority for purposes of determining whether there is a reasonable basis or substantial authority defense against these penalties); IRM 4.10.7.2.3.3.1.a (Jan. 1, 2006) ("Taxpayers may rely on a proposed regulation, although they are not required to do so. Examiners, however, should follow proposed regulations, unless the proposed regulation is in conflict with an existing final or temporary regulation.").

26 Whether there would be any benefit to placing the Code Sec. 78 GILTI Gross-Up in a non-GILTI basket would depend on, for example, the foreign taxes that would be properly attributable to the Code Sec. 78 Gross-Up or how much, if any, of the Code Sec. 250 deduction would be allocated to the general basket. Although a discussion of these points is beyond the scope of this column, we note that there

is some uncertainty on both of these points. See Reg. §1.904-6(b)(3) ("For purposes of treating taxes deemed paid by a taxpayer under section 902(a) and section 960(a)(1) as a dividend under section 78, taxes that were allocated to income in a separate category shall be treated as income in that same separate category."). This provision suggests that no taxes might be properly attributable to the Code Sec. 78 Gross-Up. Elizabeth J. Stevens & H. David Rosenbloom, ***GILTI Pleasures***, 89 Tax Notes Int'l 615, 617 (Feb. 12, 2018) ("One could reasonably argue that under Treas. reg. section 1.8618 the [250] deduction is attributable entirely to GILTI and so belongs entirely in the GILTI basket.").

27 ***See*** Code Sec. 250(a)(1)(B) (suggesting that a Code Sec. 78 GILTI Gross-Up itself is a dividend and not GILTI); Code Sec. 78 (providing that the Code Sec. 78 GILTI Gross-Up "shall be treated for purposes of this title (other than sections 245 and 245A) as a dividend received by such domestic corporation from the foreign corporation."); Code Sec. 904(d)(3)(G) (suggesting that, besides for subpart F income, a Code Sec. 78 Gross-Up, including with respect to GILTI, is treated as a dividend for purposes of the Code Sec. 904(d)(3) look-thru rule); TCJA, Engrossed Amendment Senate (Dec. 14, 2017), Section 14301 (containing a proposed amendment, not in the final version of the TCJA, that the Code Sec. 78 GILTI Gross-Up "shall be treated for purposes of this title (other than section 960) as an addition to [GILTI].").

28 See Reg §§1.662-3(b)(3) , -4(d)(3)(iii) (citing applicable provisions of the Code as authority for purposes of determining whether there is a reasonable basis or substantial authority defense against negligence or substantial understatement penalties); ***R.H. Yocum***, FedCl, 2005-2 USTC, Parar50,470, 66 FedCl 579, 590 ("[I]n general, proposed regulations have no legal force or effect until they become final."); ***In re Appletree Markets, Inc.***, CA-5, 19 F3d 969 (holding that proposed regulations, including Treasury Regulations, are entitled to no deference until final); ***F.J. Tedori***, CA-9, 2000-1 USTC, Para50,433, 211 F3d 488 (noting that proposed regulations carry no more weight than a position advanced in a brief). ***See also*** Sony Kassam, ***IRS Mulls Foreign Corporation Income as Part of " GILTI "***, BNA Daily Tax Report (Apr. 26, 2018) ("The [IRS] will also consider whether it has 'the authority to say that the GILTI gross-up is in the GILTI basket,' [Marjorie A. Rollinson, Associate Chief Counsel (International) at the Internal Revenue Service] said, adding that she appreciates 'the point that reading the statute does not get you there.'").

29 Because there are no tested losses, net aggregate tested income would equal net CFC tested income. Accordingly, we use net CFC tested income in the denominator of the inclusion percentage.

30 Because there are no tested losses, net aggregate tested income would equal net CFC tested income. Accordingly, we use net CFC tested income in the denominator of the inclusion percentage.

31 ***See*** Ethan S. Kroll et al., ***GILTI, FDII, and the Future of International IP Planning***, Taxes (May 2018); Code Sec. 951A(d)(2)(A) (stating that tangible property can give rise to NDTIR only if this property is "used in the production of tested income").

[32] Code Sec. 951(a)(1)(A).

[33] Code Sec. 951(b). Before the TCJA, Code Sec. 951(b) tested U.S. shareholder status by reference to voting power. Section 14214 of the TCJA expands the definition of a U.S. shareholder by amending Code Sec. 951(b) so that a U.S. shareholder now includes a U.S. person that holds 10% or more of the total ***value*** of shares of all classes of stock of the foreign corporation.

[34] Code Sec. 957(a).

[35] Code Sec. 952(a)(2).

[36] Code Sec. 954(a)(3), (4).

[37] Code Sec. 954(b)(4) ("[F]oreign base company income … shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11."); Reg. §1.954-1(d)(ii) (providing that the High Tax Exception applies only if "the net item of income was subject to foreign income taxes imposed by a foreign country or countries at an effective rate that is greater than 90 percent of the maximum rate of tax specified in section 11 for the taxable year of the controlled foreign corporation."); Code Sec. 11(b) (providing for a 21 percent tax rate). Ninety percent multiplied by 21 percent would be 18.9 percent.

[38] Code Sec. 954(d)(1).

[39] Code Sec. 954(d)(1)(B).

[40] Reg. §1.954-3(a)(4)(i).

[41] Code Sec. 954(d)(2); Reg. §1.954-3(b).

[42] Reg. §1.954-3(b)(2)(ii)(f).

[43] Code Sec. 954(e)(1).

[44] Reg. §1.954-4(b)(1)(i). ***See also*** Reg. §1.954-4(b)(1)(ii)-(iv) (addressing services which a related person is obligated to perform, services in relation to property sold by a related person where the performance constitutes a condition or material term of the sale, and services performed by a CFC receiving substantial assistance from a related person).

[45] ***See*** Code Sec. 951A(c)(2)(A) (determining tested income without regard to both subpart F income and any foreign base company income that is excluded from gross income by reason of the High Tax Exception).

[46] Rev. Rul. 2004-83.

[47] The regulations do not provide explicit overlap rules to address circumstances where income potentially constitutes both FBCSI and FBCSVI. The regulations suggest that the rules for FBCSI, but not FBCSVI, apply to commission income derived from pre-sale activities. Reg. §1.954-3(a)(1)(iii),

ex. 3. More relevant here, the regulations also suggest that the rules for FBCSVI, but not FBCSI, apply to income derived from post-sales activities (*eg*, installation and maintenance services). *See* Reg. §1.954-4(b)(3), exs. 1, 8, 9, & 10.

Saudi Tax Agency Challenging Low VAT Compliance Rate

Saudi Arabia's General Authority of Zakat and Tax has announced that during a recent nationwide inspection campaign, the authority found that around a fifth of retailers are failing to comply with their VAT obligations.

VAT was introduced in Saudi Arabia from January 1, 2018, under a harmonized framework agreed by Gulf Cooperation Council states (Kuwait, Qatar, Bahrain, the United Arab Emirates, and Oman). However, so far, the United Arab Emirates is the only other state to have introduced VAT.

The agency found that during inspections of 1,876 telecommunications businesses in commercial centers, 323 had committed tax offenses. These included issuing the wrong documentation or invoices, failing to disclose a correct tax number, and failing to register.

The agency said it is to undertake further field campaigns to raise awareness among enterprises of their VAT obligations and ensure the proper application of all tax procedures. It pointed out that its VAT application for taxpayers enables them to determine whether a business is registered for VAT.

UAE To Introduce VAT Refunds For Tourists

The United Arab Emirates has recently confirmed that it will introduce a system to refund value-added tax paid by tourists, following approval from the Cabinet.

Under the scheme, the tourist must be in the United Arab Emirates when the purchase is made, and the tourist must leave the Gulf Cooperation Council states with the goods within 90 days of the purchase.

The Federal Tax Authority has been empowered to exclude certain goods from the arrangement.

In July, the FTA revealed that the project is nearing its final preparation stages, where an advanced system will be put in place to corresponds with international best practices. It will establish real-time lines of communication between retailers and UAE ports of entry and exit.

After finalizing details of the regime, the FTA will engage a contractor to operate the scheme.

The Federal Tax Authority said retailers will be able to join up to the scheme providing they meet requirements to be set by the FTA.

UAE Issues VAT Guidance On Labor Accommodation

The United Arab Emirates' Federal Tax Authority has warned taxpayers that labor accommodation can be either subject to a five percent value-added tax rate, if additional services are provided to residents, or exempt from VAT (or zero rated, for the first supply of such property).

The FTA said that taxpayers must determine whether they simply supply use of a residential building (exempt) or provide serviced accommodation (subject to the headline five percent rate).

It advised that the following supply of labor accommodation would be exempt, or zero-rated, if the building or lodging is occupied by the employees as their principal place of residence; it is a building which is fixed to the ground and which cannot be moved without being damaged; the building has been constructed or converted with lawful authority; and it is not a building that is similar to a hotel, motel, bed and breakfast establishment, or serviced apartment, for which services in addition to the supply of accommodation are provided.

The Federal Tax Authority said, where extra services are provided, it must be determined whether the amount of service provided transforms the building from a residential building to a serviced accommodation. "There are 'ancillary' services that are typically provided – for no additional cost – as part of supplying a residential building, which form part of the first supply; these services do not transform the facility into a serviced accommodation subject to VAT," it said.

According to the FTA, ancillary services include: cleaning of communal areas; maintenance services required for the general upkeep of the property; pest control; garbage collection; security; utilities; facilities within the building for residents to use, e.g. launderette facilities, gym, pool, prayer rooms, etc.

However, the following services would result in labor accommodation being subject to VAT at five percent: telephone and internet access; cleaning of the rooms, other than purely the communal areas of the property; laundry services, including the regular changing of bed linen; catering; and maintenance services other than those required for the general upkeep of the property.

The FTA concluded: "Suppliers of labor accommodation should also consider whether they are making a single composite supply (of either residential accommodation, or serviced accommodation based on the above), or whether they are making a mixed supply with separate component parts. Where a single composite supply is made, the entire consideration for the supply shall be subject to the VAT treatment of the principal component. Where a mixed supply is made, each component part must be valued and the correct VAT treatment applied to each component part."

Kuwaiti Lawmakers To Discuss VAT Bill This Year: Report

Kuwait is looking to bring forward the implementation of the Gulf Cooperation Council's value-added tax framework in the country, according to local media reports.

Citing "well-informed sources," the Kuwait Times reported, rather than delay implementation to 2021, Kuwait's Cabinet has now agreed to table a bill in parliament in October 2018, which could result in the levy being implemented from January 1, 2019.

A law to introduce VAT would be tabled before parliament's financial affairs committee beforehand, in September, the paper said.

The GCC is comprised of Saudi Arabia, the United Arab Emirates, Bahrain, Kuwait, Qatar, and Oman. The GCC VAT features a harmonized base and a five percent rate. Each of the territories were to introduce VAT simultaneously on January 1, 2018, but so far just Saudi Arabia and the United Arab Emirates have introduced the levy.

UK Chancellor Confirms Government Is Mulling 'Amazon Tax'

The UK's Chancellor, Philip Hammond, has confirmed earlier comments from Mel Stride, the Financial Secretary to the Treasury, that the UK is prepared to act unilaterally on the taxation of the digital economy, if the international community does not move swiftly enough.

Earlier, Stride told the Guardian newspaper that there are issues around whether the international tax system is "fit for purpose in the 21st century for businesses such as search engines, online marketplaces, and social media sites, where value has been generated as a consequence of interaction with UK users of those sites." Stride told the paper, in an interview published on August 1, 2018, that the UK Government has "a strong preference for moving multilaterally" on digital taxation. However, in the event that multilateral discussions do not "move fast enough," then the UK "could consider [acting] unilaterally, or perhaps with a smaller group of other tax authorities."

"In the event that we ultimately feel the need to make some unilateral moves then that's something we have on the table," he added.

Now, in an interview with Sky News, the Chancellor has reaffirmed this commitment, stating that the Government is considering the introduction of an "Amazon tax."

"We're changing our shopping habits," he told Sky News. "More and more of us are buying online. Indeed, Britain has the biggest percentage of online shopping of any major developed economy. That means the high street will change. We're very clear that you have to support the high street through that process of change. The nature of the offer on the high street is going to change over time. There's going to be less retail, more leisure, bars, community facilities."

"We want to ensure that taxation is fair between businesses doing business the traditional way and those doing business online," he continued. "That requires us to renegotiate international tax treaties because many of the big online businesses are international companies. If we can't get international agreement to do this we may have to look at temporary tax measures to rebalance the playing field until we can get international agreements."

His comments, and the comments from Stride, are in response to the EU's proposals for two new tax measures on the digital economy, issued in March 2018.

The first is an interim tax on the turnover of companies engaged in digital activities that would otherwise go untaxed, at a rate of three percent. The interim measure would be levied on revenues created from selling online advertising space; created from digital intermediary activities; and those created from the sale of data generated from user-provided information. Such would apply only to companies with total annual worldwide revenues of at least EUR750m (USD875m) and EU revenues of EUR50m.

The proposal has been opposed by most EU member states, who have instead come out in support of multilateral efforts towards the EU's proposed longer-term solution: an international consensus, under the leadership of the OECD, on the creation of new digital permanent establishment rules.

US Lawmakers Seek Robust Challenge To EU Digital Tax Plans

Republican lawmakers are urging US President Donald Trump to ensure that his preferred candidate for US Ambassador to the OECD "defends US tax interests abroad" by resisting efforts by the European Union to introduce special tax measures on digital companies.

In a letter dated August 1, 2018, 12 Republican senators warned the President that any positive economic effects of the recent tax reforms in the US could be "perceived as a threat to the European Union."

According to the signatories, most of the companies likely to be affected in the event that the EU introduced its "interim tax" on the revenue of certain digitalized companies would be US-based.

"The European Commission has proposed a tax on digital services intended to make technology companies pay more. The Commission is calling for a three percent tax on the turnover of large digital enterprises - those with EU digital revenues over USD58m and total global revenues over USD877m. The Commission claims this tax is a facially neutral attempt to tax digital service providers without a physical presence, yet over 50 percent of the companies affected are US-based."

The letter also stated that the EU has asked the OECD to review certain international provisions of the Tax Cuts and Jobs Act, despite the fact that these measures are intended to "curb the very practices that this digital services tax alleges to address."

For these reasons, the senators urged the President to appoint "a strong and powerful voice defending the United States and US-based companies at the OECD."

The Commission's proposals, released on March 21, 2018, are said to have been designed to ensure digital business activities are taxed "fairly" and in a growth-friendly way in the European Union. They were drafted in response to calls from member states for a permanent and lasting solution, to ensure a "fair share" of tax revenues from online activities where digital firms derive revenue from users in their territory, which might otherwise go untaxed.

The Commission noted: "Profits made through lucrative activities, such as selling user-generated data and content, are not captured by today's tax rules. Member states are now starting to seek fast, unilateral solutions to tax digital activities, which creates a legal minefield and tax uncertainty for business. A coordinated approach is the only way to ensure that the digital economy is taxed in a fair, growth-friendly, and sustainable way."

Details Of Amazon's EU Tax Ruling Appeal Published

The European Union has published in its Official Gazette details of the action brought by Amazon against the European Commission's ruling against a tax ruling issued to the company by Luxembourg in 2003.

Background

The Commission's decision, published in non-confidential form on February 28, 2018, found that Amazon received unlawful state aid worth about EUR250m (UD290m) as a result of a tax ruling issued by Luxembourg in 2003.

Following an in-depth investigation, the Commission concluded that the tax ruling, which was extended in 2011, lowered the tax paid by Amazon in the country without any valid justification. It said that the tax ruling enabled Amazon to shift the vast majority of its profits from an Amazon group company that is subject to tax in Luxembourg (Amazon EU) to a company that was not subject to tax (Amazon Europe Holding Technologies). In particular, the tax ruling endorsed the payment of a royalty from Amazon EU to Amazon Europe Holding Technologies that significantly reduced Amazon EU's taxable profits, the Commission said.

The Commission found that the tax ruling endorsed an unjustified method to calculate Amazon's taxable profits in Luxembourg. In particular, the level of the royalty payments, endorsed by the tax ruling, was inflated and did not reflect economic reality, it said. On this basis, the Commission concluded that the tax ruling granted a selective economic advantage to Amazon by allowing the group to pay less tax than other companies subject to the same national tax rules.

Amazon's action

Amazon EU Sarl and Amazon.com brought an action against the Commission's decision on

May 22, 2018. According to the newly published details, the action relies on nine pleas in law, as follows:

- The first plea in law alleges that the decision violates Article 107(1) of the Treaty of the Functioning of the European Union (TFEU) because the decision fails to establish the existence of an advantage benefiting the applicants in view of the comparables adduced by the applicants. It alleges that the decision improperly ignores direct evidence showing that the royalty LuxOpCo (Amazon EU) actually paid for the intangibles over the relevant period was at arm's length.
- The second plea in law alleges that the decision violates Article 107(1) TFEU because the decision's finding of an advantage is based on an erroneous analysis of the functions of LuxOpCo and Amazon European Holding Technologies. Such errors invalidate the decision's application of the transactional net margin method and the resulting primary finding of advantage, it is alleged.
- The third plea in law alleges that the decision violates Article 41 of the Charter of Fundamental Rights of the EU and the principle of sound administration because the decision's finding of an advantage fails to consider all of the evidence.
- The fourth plea in law alleges that the decision violates Article 107(1) TFEU and the duty to state reasons because the decision's finding of an advantage is premised on a royalty that violates the arm's length principle. The decision's finding of an advantage implies that LuxOpCo should have paid a transfer price that manifestly deviates from the arm's length principle and is therefore unfounded, it is alleged.
- The fifth plea in law alleges that the decision violates Article 107(1) TFEU because the it fails to show an advantage under the subsidiary line of reasoning. The decision's subsidiary finding that the 2003 tax ruling conferred an economic advantage on LuxOpCo because it was based on three inappropriate methodological choices relies on a mischaracterization of LuxOpCo's and LuxSCS's respective roles and is unfounded, it is alleged.
- The sixth plea in law alleges that the decision violates Article 107(1) TFEU because the decision mischaracterizes the 2003 tax ruling as an ad hoc individual measure and as a result wrongly relies on a presumption of selectivity.
- The seventh plea in law alleges that the decision violates Article 107(1) TFEU and the principle of legal certainty because the decision's selectivity analysis relies on a flawed reference framework. Under its subsidiary findings of selectivity, the decision improperly excludes Luxembourg's general administrative practice concerning transfer pricing from the reference framework, in violation of the applicable case law, it is alleged.

- The eighth plea in law alleges that the decision violates the principles of legal certainty, retroactivity, and non-discrimination, and an essential procedural requirement because it assesses the validity of the 2003 tax ruling by reference to post-dated OECD Guidelines. Therefore, it is alleged that the decision retroactively and discriminatorily applies, and improperly holds the applicants and Luxembourg to, standards in the 2017 OECD Guidelines on transfer pricing first issued after the Commission opened the procedure under Article 108(2) TFEU, and long after the adoption of the 2003 tax ruling.
- The ninth plea in law alleges that the decision violates Article 17 of Regulation 2015/1589 (2) because the decision orders the recovery of aid even though the applicable ten-year limitation period had already expired.

Canada Publishes APA Report For 2017

The Canada Revenue Agency has published its yearly report on its Advance Pricing Arrangement program, which shows that 24 companies applied to discuss their transfer pricing affairs with the authorities in 2017.

The CRA's APA program aims to assist taxpayers in achieving certainty with regards their international tax affairs, to prevent transfer pricing disputes that could arise in future years. Taxpayers have to provide a pre-file package before being granted a pre-file meeting, which must include detailed information on financial statements, business operations, and the industry in which the group operates.

The CRA said that, based on the number of pre-file meetings with taxpayers, there were 24 new applicants to the APA program in 2017.

At the start of 2017, the CRA had an active case inventory of 90 APAs. Over the course of the year, it accepted 16 new cases into the program and 36 cases were completed. Three cases were withdrawn. The closing inventory was 67 cases at the end of 2017.

The CRA said that 88 percent of cases involve taxpayers seeking an APA on a bilateral or multilateral basis. APAs involving the US represented 52 percent of APAs in process. The average time to conclude a bilateral APA from acceptance into the program to completion was 48.5 months.

The majority of APAs concerned the cross-border transfer of tangible property (58 percent); 18 percent involved intangible property; 19 percent concerned intra-group services; and four percent related to financing arrangements.

The CRA stated that it is "optimistic that increased rigor in the earliest phases of the APA process will reduce the time needed to complete bilateral APAs successfully with Canada's tax treaty partners." It added that "this focus will help ensure that only taxpayers who are willing to openly work with the CRA will be permitted to the APA program."

Canadian Tax Agency Probes Bitcoin Users' Tax Compliance

The Canada Revenue Agency (CRA) has carried out research into the use of bitcoin ATMs to ensure that the tax rules are being followed.

According to CBC, the CRA commissioned a survey of 20 businesses that had installed bitcoin automated tellers on their premises. The aim of the research was to find out more about "attitudes towards tax compliance in the crypto-commercial sphere" and about the perceived value to businesses and customers of installing a bitcoin ATM.

CBC reported that the research summary noted that the CRA intends to use the information collected to "refine audit approaches and improve risk assessment capabilities" and to "enhance education efforts around bitcoin tax compliance."

Ireland To Hike Environmental Taxes

Ireland will need to increase its carbon tax in the coming years if it is to meet its emissions targets, Prime Minister Leo Varadkar has said.

In his summer briefing with reporters, Varadkar told Irish media: "If we're going to meet our targets we're going to have to grasp the nettle in pricing carbon and increasing the carbon tax in the next couple of years."

"We will be working on a set of proposals for setting a price on carbon to bring the tax up as part of our climate change obligations," he was reported as saying.

Varadkar added that the Government recognizes that lower income will be most affected and the Government will therefore look to introduce compensatory measures also.

A Solid Fuel Carbon Tax applies to coal and peat supplied in Ireland at a rate of EUR20 per tonne of CO_2 emitted.

Varadkar also spoke more broadly about his administration's plans for the upcoming Budget. He said that the Government will continue to focus on raising the threshold for the highest rate of income tax, to provide relief to middle-income taxpayers.

France Reveals Plastics Tax Strategy

France has announced plans for a plastics tax, on plastics made of not recycled materials.

In an interview with the Journal du Dimanche newspaper, Brune Poirson, Secretary of State for Ecological Transition, said that products made from unrecycled plastics would cost up to 10 percent more under the plans, with additional taxes charged on waste sent to landfill sites.

However, reductions in taxation will also be used to encourage the greater use of recycled plastic, including reducing the level of value-added tax on recycling.

Under the plan, France aims to recycle all of its plastic by 2025.

The idea of using tax measures to encourage more recycling of plastic has already been proposed by the European Union. In a document published as part of the EU's Strategy for Plastics in January 2018, the European Commission said that the the EU should make better use of taxation to "reward the uptake of recycled plastics and favor reuse and recycling over land-filling and incineration" and to "step up separate collection of plastics waste and improve the way in which this is done."

Australia Cracks Down On Tobacco Tax Avoidance

The Australian Government is consulting on proposals to change the point at which tax is payable on tobacco, with the aim of preventing its entry into the black market.

Under the proposed measure, licensed tobacco importers will be required to pay all duties and taxes upon importation to Australia. At present, duties and taxes must be paid when the imported product leaves a customs warehouse and enters the domestic market.

Revenue Minister Kelly O'Dwyer said: "Taxing tobacco closer to its point of origin will make it harder to defraud the Commonwealth and Australian taxpayers."

The change will enter into effect on July 1, 2019. Transitional arrangements will apply for tobacco products that are still in warehouses on that date.

A consultation on the proposals will close on August 22.

US To Ramp Up Taxes On Chinese Goods

The Office of the US Trade Representative has listed Chinese imports worth about USD16bn per year that will be subject to additional tariffs of 25 percent, in response to Chinese "unfair trade practices."

The list contains 279 of the original 284 tariff lines that were on a proposed list announced on June 15 and covers a range of products such as plastics, electrical and mechanical machinery, and electronic integrated circuits.

US Customs and Border Protection staff will begin to collect the additional duties on these Chinese imports on August 23, 2018, the USTR confirmed.

A formal notice of the USD16bn tariff action will be published shortly in the Federal Register. The notice will announce a process by which interested persons may request the exclusion of particular products covered by a tariff line subject to the additional duties, the USTR said.

This second tranche of additional tariffs follows the first round of tariffs increases on approximately USD34bn of imports from China, which went into effect on July 6, 2018.

The US Government is also in the process of finalizing a third list of tariff lines that will be subject to increased tariffs of 25 percent (up from 10 percent). These are due to be imposed on USD200bn worth of Chinese products included in a list proposed by the USTR on

July 10 in response to the earlier application of retaliatory tariffs by China on some US goods.

The deadline for comments on the third list was recently extended from August 30 to September 6, 2018.

The US Government began increasing tariffs on Chinese products after a USTR investigation found that "China's acts, policies, and practices related to technology transfer, intellectual property, and innovation are unreasonable and discriminatory and burden US commerce," the USTR's August 7 statement stated.

However, China has responded by placing additional tariffs of 25 percent on 545 tariff lines, effective July 6, 2018, covering USD34bn worth of products. Additional tariffs of 25 percent are also expected to kick in on August 23, affecting a further USD16bn in imports from the US. Additional tariffs ranging from five to 25 percent on around USD60bn of US products are expected to come into force in October 2018.

Bahamas Backs Down On Owner-Occupier Property Tax Change

The Bahamas Government has announced it will amend the territory's real property tax act to reverse its budget change to the definition of "owner-occupied" properties.

Several measures were announced in the recent Budget to boost the tax take from property taxes used for commercial purposes. This had included a requirement that for a property to be classified as "owner-occupied," and therefore benefit from lower tax rates or exemption, the owner would need to demonstrate that they live in the property for at least six months a year. It also would likely result in an obligation on the owner to register and account for VAT on rental property services.

After consultation with a range of stakeholders, the Government said it intends to revert to the previous definition of owner-occupied properties that was in effect up until June of this year, that owners should live in the property at least temporarily, such as on a seasonal basis.

Legislation giving effect to the change will be introduced after parliament's summer recess.

The Government has clarified that the change to the owner-occupied definition will not impact on tax changes that raise property tax on undeveloped property and impose value-added tax on vacation home rentals.

Croatia To Hike Tourism Taxes

The Croatian Government has announced that tourism taxes will rise by 25 percent from next year, the first increase since 2005.

As a result of the measure, tourist stays in Croatia will attract a tax of HRK10 (USD1.56) per person per night, up from the current level of HRK8. Campsites will be exempt from the increase, meaning campers will continue to pay HRK8 per night.

The Government says that additional revenues from the tax will be used to promote Croatia as a tourist destination.

The measure is due to enter into force on January 1, 2019.

UK To Support Ethiopia To Overhaul Tax System

The UK is to enter into a tax partnership program with Ethiopia, with the aim of supporting the African nation to transform its tax system.

The UK will contribute GBP35m (USD45m) to the Ethiopia Tax Transformation Programme.

The partnership is intended to help Ethiopia generate more revenue, so that it is better able to finance its own services and development and become less reliant on aid.

The UK also hopes that overhauling the Ethiopian tax system will help the country "to harness the potential of its booming economic growth."

Ethiopia has yet to sign up to the BEPS Inclusive Framework. Inclusion in the Framework would require the nation to implement minimum standards on mitigating base erosion and profit shifting that would boost its ability to ensure a greater share of tax revenues from multinationals.

Andorra Consolidates Income Tax Laws

Andorra's Government in early August 2018 approved the publication of consolidated texts of the territory's individual and corporate income tax laws.

The Government said the consolidation of the laws, including all amendments since 2014, is intended to support businesses and individuals to better understand their tax obligations and ease the compliance burden.

The laws incorporate amendments introduced in the 2018 Budget and the 2018 corporate tax reform law; changes to the taxation of gambling, introduced in 2014; law introduced in 2015 to support the restructuring of banks and an amendment on company restructuring. Further, it brings together tax provisions covering public limited companies and limited liability companies and provisions on the capital gains tax treatment of real estate transfers, the Government stated.

Italy To Implement EU Intermediary Tax Reporting Rules

On July 30, 2018, the Italian Ministry of Economy and Finance launched a public consultation on proposals to implement new European Union rules for the reporting of potentially aggressive cross-border tax arrangements.

Directive 2018/822, which entered into force on June 25, 2018, is intended to enable new risks of tax avoidance to be identified earlier and for measures to be taken to block harmful arrangements. EU member states will be required to automatically exchange the information they receive through a centralized database.

The draft directive establishes "hallmarks" to identify the types of schemes that will need to be reported to the tax authorities by intermediaries, such as tax advisers, accountants, banks, and lawyers. Such hallmarks include: the use of cross-border losses to reduce tax liability; the use of special preferential tax schemes; or arrangements through countries that do not meet international good governance standards.

The obligation to report a cross-border scheme bearing one or more of these hallmarks will be borne by:

- The intermediary who supplied the scheme for implementation and use by a company or individual;
- The individual or company receiving the advice, when the intermediary providing the scheme is not based in the EU, or where the intermediary is bound by professional privilege or secrecy rules;
- The individual or company implementing the scheme when it is developed by in-house consultants or lawyers.

However, the requirement to report a scheme is not intended to imply that the scheme is harmful, rather that it may be of interest to the authorities for further scrutiny.

EU member states will now have until December 31, 2019, to transpose the directive into their national laws and regulations. The new reporting requirements will apply from July 1, 2020. Member states will be obligated to exchange information every three months, within one month from the end of the quarter in which the information was filed. The first exchanges should therefore be completed by October 31, 2020.

The Italian Ministry of Economy and Finance is accepting comments on the proposed measures until September 28, 2018.

Belgium Publishes Decree On Transfer Pricing Penalties

The Belgian Government has published a decree detailing the level of penalties taxpayers can expect to face for breaching transfer pricing documentation requirements.

The decree, dated June 29, 2018, and published by the Ministry of Finance on August 2, prescribes escalating levels of fines for offenses where there was no intent on the part of the taxpayer to evade tax, starting at zero for the first offense and rising to EUR1,250 (USD1,450) for the second offense; EUR6,250 for the third offense; EUR12,500 for the fourth offense; and EUR25,000 for any subsequent offense.

In circumstances where a taxpayer is adjudged to have made a transfer documentation error with the intention of evading tax, the fine for the first offense is EUR12,500 and EUR25,000 for subsequent offenses.

According to the decree, no fines are applicable in cases where mistakes occur because of circumstances beyond the taxpayer's control.

Indonesia, Turkey Lagging Behind Rest Of G20 On BEPS Implementation

All members of the G20 group of nations have taken appropriate steps to implement the OECD's base erosion and profit shifting recommendations, according to an interim report by the G20 Research Group, published on August 5.

Implementing measures consistent with the BEPS Action Plan is among a number of commitments agreed to by the G20 membership, and according to the interim report, member countries of the G20 and the OECD, as well as developing nations participating in the development of the BEPS package, "are establishing a modern international tax framework under which profits are taxed where economic activity and value creation occur."

All G20 countries received a score of +1 in relation to BEPS implementation, meaning that the country in question is making progress "in implementing domestic reforms consistent with the BEPS package or supports countries interested in applying anti-BEPS rules during the compliance period."

A score of zero would mean that a G20 member hasn't made sufficient progress in implementing BEPS reforms or supporting other countries to do so, but has managed to implement some reforms. A score of -1 would mean that a country is not making progress implementing or supporting BEPS and has not managed to implement reforms addressing base erosion and profit shifting.

Despite receiving a score of +1, Indonesia was found to have provided no indication of its intention to adopt several BEPS actions, including Action 1 (value-added tax on business-to-customer digital services), Action 2 (hybrid mismatch arrangements), Action 5 (harmful tax practices), Action 7 (permanent establishment status), Action 11 (methodology for data collection and analysis), Action 12 (disclosure of aggressive tax planning), and Action 14 (dispute resolution).

The interim report also noted some shortcomings with respect to Turkey's implementation of the BEPS Action Plan, including its failure to expand VAT rules to cover digital sales and to fully implement changes in the areas of Action 4 (interest deduction) and Action 5 (countering harmful tax practices more effectively). In addition, the report notes that it is unclear whether the Turkish Government is working on new measures in the areas of Action 2 (hybrid mismatches), Action 3 (controlled foreign companies), and Action 14 (making dispute resolution mechanisms more effective).

Furthermore, clarifications to a draft general transfer pricing communique announced by the Government in 2016 are still in progress, affecting Turkey's implementation of Actions 8 to 10 (transfer pricing) and Action 13 (transfer pricing documentation). Turkey has also yet to join the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country reports.

BELARUS - UNITED KINGDOM

Into Force

On July 27, 2018, the DTA between Belarus and the United Kingdom entered into force.

CHINA - CHILE

Signature

On May 29, 2018, China and Chile signed a DTA.

ECUADOR - SWITZERLAND

Ratified

On August 1, 2018, Ecuador ratified the pending Protocol to the 1994 DTA with Switzerland.

HONG KONG - NEW ZEALAND

Into Force

On August 9, 2018, the amending protocol to the DTA between Hong Kong and New Zealand entered into force.

RUSSIA - BELGIUM

Ratified

On August 3, 2018, Russia ratified the protocol to the DTA with Belgium.

RUSSIA - JAPAN

Ratified

On August 3, 2018, Russia ratified its pending DTA with Japan.

SAN MARINO - GUERNSEY

Ratified

On August 3, 2018, San Marino ratified the amending protocol to its TIEA with Guernsey.

SINGAPORE - LATVIA

Into Force

On August 3, 2018, the second protocol amending the DTA between Singapore and Latvia entered into force.

TAIWAN - SPAIN

Negotiations

On July 30, 2018, Taiwan expressed its desire to negotiate a TIEA with Spain.

VIETNAM - CAMBODIA

Ratified

On July 31, 2018, the Vietnamese Government issued a resolution approving the DTA with Cambodia.

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

THE AMERICAS

STEP Global Congress

9/13/2018 - 9/14/2018

STEP

Venue: The Westin Bayshore, 1601 Bayshore Drive, Vancouver, British Columbia, V6G 2VA, Canada

Key speakers: Ivan Sacks (Withersworldwide), Jason Sharman (University of Cambridge), Desmond Teo (EY), Leanne Kaufman (RBC Estate and Trust Services), among numerous others

http://www.stepglobalcongress.com/About-Congress

STEP Wyoming Conference

9/21/2018 - 9/22/2018

STEP

Venue: Four Seasons Resort and Residences, Jackson Hole, 7680 Granite Loop Road, Teton Village, WY 83025, USA

Key speakers: Amy Castoro (The Williams Group), Joseph Field (Pillsbury Winthrop Shaw Pittman LLP), Michael Karlin (Karlin & Peebles LLP), Carl Merino (Day Pitney), among numerous others

https://www.step.org/wyoming-2018

Fiduciary Institute 2018

9/27/2018 - 9/27/2018

American Bar Association

Venue: Steptoe & Johnson LLP, 1330 Connecticut Avenue NW, Washington, DC 20036, USA

Chairs: Joni Andrioff (Steptoe & Johnson), Peter Kelly (Blue Cross and Blue Shield Association)

https://shop.americanbar.org/ebus/ABAEventsCalendar/EventDetails.aspx?productId=320379633

STEP LatAm Conference

10/4/2018 - 10/5/2018

STEP

Venue: Hyatt Regency Mexico City, Campos Elíseos 204, Polanco, Polanco Chapultepec, Ciudad de México, 11560, Mexico

Key speakers: Bill Ahern (Ahern Lawyers), Simon Beck (Baker McKenzie), Mauricio

Cano del Valle (Brook Y Cano), Ceci Hassan (Baker McKenzie), among numerous others

https://www.step.org/events/step-latam-conference-4th-5th-october

Family Office & Private Wealth Management Forum West

10/24/2018 - 10/26/2018

Opal Group

Venue: Napa Valley Marriott, 3425 Solano Ave, Napa, CA 94558, USA

Key speakers: TBC

http://opalgroup.net/conference/family-office-private-wealth-management-forum-west-2018/

Family Office Summit: Integrating the Full Balance Sheet

11/1/2018 - 11/1/2018

ClearView Financial Media

Venue: The New York Times Building, 37th Floor, 620 Eight Avenue, New York, 10018-1405, USA

Key speakers: TBC

http://clearviewpublishing.com/events/fwr-summit-complete-view-familys-balance-sheet-long-term-investment-lifestyle-management/

TP Minds West Coast

11/13/2018 - 11/15/2018

Informa

Venue: Four Seasons Silicon Valley, 2050 University Ave, East Palo Alto, CA 94303, USA

Key speakers TBC

https://finance.knect365.com/tp-minds-west-coast/?_ga=2.241077507.122439778.1526991001-1525335460.1512406535

111th Annual Conference on Taxation

11/15/2018 - 11/17/2018

National Tax Association

Venue: Sheraton New Orleans Hotel, 500 Canal St, New Orleans, LA 70130, USA

Chair: Rosanne Altshuler (National Tax Association)

https://www.ntanet.org/event/2017/12/111th-annual-conference-on-taxation/

8th Annual Institute on Tax, Estate Planning and the World Economy

2/4/2019 - 2/5/2019

STEP

Venue: Fashion Island Hotel, 690 Newport Beach, Newport Beach, 92660, USA

Key speakers: Jay D. Adkisson (Riser Adkisson), Colleen Barney (Albrecht & Barney), Joseph A. Field (Pillsbury), Sandra D. Glazier (Lipson Neilson), among numerous others

http://www.stepoc.org/institute/

ASIA PACIFIC

72nd Congress of the International Fiscal Association

9/2/2018 - 9/6/2018

IBFD

Venue: COEX Convention & Exhibition Center, 513, Yeongdong-daero, Gangnam-gu, Seoul 06164, Republic of Korea

Key speakers: TBC

https://www.ifaseoul2018.com/

TP Minds Asia

9/18/2018 - 9/20/2018

Informa

Venue: Novotel Clarke Quay Singapore, 177A River Valley Rd, Singapore 179031, Singapore

Key speakers: Melinda Brown (OECD), Monique van Herksen (UN Transfer Pricing Subcommittee), Audrey Low (DBS Bank), Gena Cerny (Goldman Sachs), among numerous others

https://finance.knect365.com/tp-minds-asia/?_ga=2.241077507.122439778.1526991001-1525335460.1512406535

Practical Aspects of Tax Treaties

10/10/2018 - 10/12/2018

IBFD

Venue: Address TBC after registration, Kuala Lumpur, Malaysia

Instructors: Bart Kosters (IBFD)

https://www.ibfd.org/Training/Practical-Aspects-Tax-Treaties

International Tax Planning after BEPS and the MLI

10/15/2018 - 10/17/2018

IBFD

Venue: Address TBC, Singapore

Key speakers: Bart Kosters (IBFD), Tom Toryanik (Deloitte), Hemal Zobalia (Deloitte Haskin & Sells), among numerous others

https://www.ibfd.org/Training/International-Tax-Planning-after-BEPS-and-MLI

STEP Asia Conference 2018, Hong Kong

11/20/2018 - 11/21/2018

STEP

Venue: Grand Hyatt Hong Kong, 1 Harbor Rd, Wan Chai, Hong Kong

Key speakers: Jonathan Midgley (Haldanes), James Lau (Financial Services and the Treasury Bureau, Hong Kong), among numerous others

https://www.step.org/asia2018

The 4th International Conference on Private Capital and Intergenerational Wealth

11/22/2018 - 11/22/2018

STEP

Venue: The University of Hong Kong, Pokfulam, Hong Kong

Key speakers: TBC

https://www.step.org/events/4th-international-conference-private-capital-and-intergenerational-wealth-22-november-2018

International Taxation Conference 2018

12/6/2018 - 12/8/2018

IBFD

Venue: ITC Maratha, Sahar Andheri, Mumbai 400099, Maharashtra, India

Key speakers: Mukesh Butani (BMR Legal), Murray Clayson (International Fiscal Association), Marc Levey (Baker & McKenzie), William Morris (PwC), among numerous others

https://www.ibfd.org/IBFD-Tax-Portal/Events/International-Taxation-Conference-2018

STEP Australia 2019

5/15/2019 - 5/17/2019

STEP

Venue: The Stamford Plaza, Brisbane, Australia

Key speakers: TBC

https://www.step.org/events/step-australia-2019-conference-save-date-15-17-may-2019

CENTRAL AND EASTERN EUROPE

Ukrainian Business Forum Kiev 2018

11/12/2018 - 11/12/2018

CIS Wealth

Venue: Fairmont Grand Hotel Kyiv, 1 Naberezhno-Khreshchatytska Street, Kyiv 04070, Ukraine

Key speakers: TBC

http://cis-wealth.com/en/konferencii/21-ubf2018.html

MIDDLE EAST AND AFRICA

Tax Planning in Africa and the Middle East

10/28/2018 - 10/30/2018

IBFD

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

Key speakers: Ridha Hamzaoui (IBFD), Reggie Mezu (Baker McKenzie Habib Al Mulla), among numerous others

https://www.ibfd.org/Training/Tax-Planning-Africa-and-Middle-East-1

TP Minds Africa

10/31/2018 - 11/2/2018

Informa

Venue: Radisson Blu Hotel Sandton, Rivonia Rd & Daisy St, Sandown, Sandton, 2146, South Africa

Key speakers: Lee Corrick (OECD), Ian Cremer (World Customs Organization), Tanya Bester (MMI Holdings), Mlondie Mohale (Swaziland Revenue Authority), among numerous others

https://finance.knect365.com/tp-minds-africa-transfer-pricing-conference/?_ga=2.241077507.122439778.1526991001-1525335460.1512406535

STEP Arabia Branch Conference

11/11/2018 - 11/11/2018

STEP

Venue: Abu Dhabi Global Markets, Al Maryah Island, Abu Dhabi, UAE

Key speakers: TBC

https://www.step.org/events/step-arabia-branch-conference-11-november-2018-save-date

Introduction to GCC VAT

3/3/2019 - 3/5/2019

IBFD

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

Key speakers: Reggie Mezu (Baker McKenzie Habib Al Mulla), Jordi Sol (IBFD), Mohamed Faysal Charfeddine (Aujan Group), Saira Menon (PwC), among numerous others

https://www.ibfd.org/Training/Introduction-GCC-VAT

WESTERN EUROPE

UK Tax, Trusts and Estates Conference 2018

9/4/2018 - 9/4/2018

STEP

Venue: Mercure Manchester Piccadilly Hotel, Portland Street, Manchester, M1 4PH, UK

Key speakers: Julia Abrey (Withers LLP), John Bunker (Irwin Mitchell), Lucy Obrey (Higgs & Sons), Chris Whitehouse (5 Stone Buildings), among numerous others

https://www.step.org/events/uk-tax-trusts-and-estates-conference-2018-manchester-4-september-2018

BEPS Country Implementation – MLI and beyond

9/10/2018 - 9/11/2018

IBFD

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

Instructors: Bart Kosters (IBFD), Tamás Kulcsár (IBFD), Ridha Hamzaoui (IBFD), Luis Nouel (IBFD)

https://www.ibfd.org/Training/BEPS-Country-Implementation-MLI-and-beyond

European Value Added Tax Masterclass

9/20/2018 - 9/21/2018

IBFD

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

Instructors: Fabiola Annacondia (IBFD), Jordi Sol (IBFD), Jan Snel (Baker & McKenzie), Claus Bohn Jespersen (KPMG)

https://www.ibfd.org/Training/European-Value-Added-Tax-Masterclass

UK Tax, Trusts and Estates Conference 2018

9/21/2018 - 9/21/2018

STEP

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

Key speakers: Julia Abrey (Withers LLP), John Bunker (Irwin Mitchell), Lucy Obrey (Higgs & Sons), Chris Whitehouse (5 Stone Buildings), among numerous others

https://www.step.org/TTE18

International Tax Academy 2018

9/24/2018 - 9/26/2018

Informa

Venue: Downing College, Regent St, Cambridge, CB2 1DQ, UK

Key speakers: Daniel Erasmus (Tax Risk Management), Robert De La Rue (Jardine Motors Group), Jan Weerth (Deutsche Bank), Anne Fairpo (Temple Tax Chambers), among numerous others https://finance.knect365.com/international-tax-academy/

International Tax Aspects of Permanent Establishments

9/24/2018 - 9/26/2018

IBFD

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

Instructors: Bart Kosters (IBFD), Carlos Gutiérrez Puente (IBFD), Hans Pijl (independent tax lawyer), Jan de Goede (IBFD), among numerous others

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

Private Equity Tax Practices

9/26/2018 - 9/26/2018

Informa

Venue: Address TBC, London, UK

Key speakers: Mary Kuusisto (Proskauer), Mark Baldwin (Macfarlanes), Jenny Wheater (Linklaters), Emily Clark (Travers Smith), among numerous others

https://finance.knect365.com/private-equity-tax-practices/

Private Investor Middle East International Conference

9/26/2018 - 9/27/2018

Adam Smith Conferences

Venue: The Montcalm London Marble Arch, 2 Wallenberg Place, London, W1H 7TN, UK

Key speakers: Jeffrey Sacks (Citi Private Bank), Michael Addison (UBS), Paul Stibbard (Rothschild Trust), Ian Barnard (Capital Generation Partners), among numerous others

http://www.privateinvestormiddleeast.com/

Wealth Insight Forum 2018

9/27/2018 - 9/27/2018

Spear's

Venue: One Great George Street, 1 Great George St, Westminster, London, SW1P 3AA, UK

Key speakers: Trevor Abrahmsohn (Glentree International), Robert Amsterdam (Amsterdam & Partners), Stephen Bush (New Statesman), Mark Davies (Mark Davies & Associates), among numerous others

http://wif.spearswms.com/

Principles of Transfer Pricing

10/1/2018 - 10/5/2018

IBFD

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

Instructors: TBC

https://www.ibfd.org/Training/Principles-Transfer-Pricing-2

UK Tax, Trusts and Estates Conference 2018

10/2/2018 - 10/2/2018

STEP

Venue: The Principal York, Station Road, York, YO24 1AA, UK

Key speakers: Julia Abrey (Withers LLP), John Bunker (Irwin Mitchell), Lucy Obrey (Higgs & Sons), Chris Whitehouse (5 Stone Buildings), among numerous others

https://www.step.org/TTE18

STEP Europe Conference

10/4/2018 - 10/5/2018

STEP

Venue: Hôtel Le Royal, 12 Boulevard Royal, 2449 Luxembourg, Luxembourg

Key speakers: John Marshall (British Ambassador to Luxembourg), Miguel Poiares Maduro (European University Institute, Italy), Serge Schroeder (Cour Administrative, Luxembourg), Judge Christopher Vajda (Court of Justice of the European Union), among numerous others

https://www.step.org/europe18

European Value Added Tax – Selected Issues

10/10/2018 - 10/12/2018

IBFD

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

Instructors: Fabiola Annacondia (IBFD), Jordi Sol (IBFD)

https://www.ibfd.org/Training/European-Value-Added-Tax-Selected-Issues-2

9th Annual International Taxation in CEE

10/11/2018 - 10/12/2018

GCM Parker

Venue: Address TBC, Prague, Czech Republic

Key speakers: TBC

http://gcmparker.com/gcm-conference-listing?menuid=0&conferenceid=77

UK Tax, Trusts and Estates Conference 2018

10/16/2018 - 10/16/2018

STEP

Venue: Bristol Marriott Royal Hotel, College Green, Bristol, BS1 5TA, UK

Key speakers: Julia Abrey (Withers LLP), John Bunker (Irwin Mitchell Private Wealth), Christopher Groves (Withers LLP), Chris Whitehouse (5 Stone Buildings), among numerous others

https://www.step.org/events/uk-tax-trusts-and-estates-conference-2018-bristol-16-october-2018

International Tax Planning Association Meeting

10/17/2018 - 10/19/2018

ITPA

Venue: Mandarin Oriental Hyde Park, 66 Knightsbridge, London, SW1X 7LA, UK

Chairs: Milton Grundy (Grays Inn Tax Chambers), Paolo Panico (Private Trustees)

https://www.itpa.org/meeting/london/

Current Issues in International Tax Planning

10/22/2018 - 10/24/2018

IBFD

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

Key speakers: Annemiek Kale (Arla Foods), Adam Zalasinski (European Commission), Tamás Kulcsár (IBFD), Jeroen Kuppens (KPMG Meijburg & Co), among numerous others

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

Transfer Pricing and Substance Masterclass

10/31/2018 - 11/2/2018

IBFD

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

Key speakers: Eric Vroemen (PwC), Önder Albayrak (Genzyme-Sanofi), Sandra Esteves (SABIC), Monica Erasmus-Koen (Tytho), among numerous others

https://www.ibfd.org/Training/Transfer-Pricing-and-Substance-Masterclass

Global VAT

11/13/2018 - 11/16/2018

IBFD

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

Key speakers: Fabiola Annacondia (IBFD), Jordi Sol (IBFD), Wilbert Nieuwenhuizen (University of Amsterdam), Bhavna Doshi (independent consultant), among numerous others

https://www.ibfd.org/Training/Global-VAT-0

Global VAT - Specific Countries

11/15/2018 - 11/16/2018

IBFD

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

Key speakers: Bhavna Doshi (Independent consultant), Toon Beljaars (Uber), Vanessa Bacchin Cardo (Unilever), Svetlin Krastanov (Tax Academy Ltd.), among numerous others

https://www.ibfd.org/Training/Global-VAT-Specific-Countries-2

Principles of International Taxation

11/19/2018 - 11/23/2018

IBFD

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

Key speakers: Premkumar Baldewsing (IBFD), Hans Pijl (Independent tax lawyer), Carlos Gutiérrez Puente (IBFD), Ruxandra Vlasceanu (IBFD), among numerous others

https://www.ibfd.org/Training/Principles-International-Taxation-1

Annual Conference on European VAT Law 2018

11/22/2018 - 11/23/2018

Academy of European Law

Venue: TBC, Trier, Germany

Key speakers: TBC

https://www.era.int/cgi-bin/cms?_SID=9e33bf77b0e4587e14991159621fbca4524365720059422613889З&_sprache=en&_bereich=artikel&_aktion=detail&idartikel=127489&idrubrik=1024

International Tax, Legal and Commercial Aspects of Mergers & Acquisitions

11/28/2018 - 11/30/2018

IBFD

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

Key speakers: Rens Bondrager (Allen & Overy LLP), Femke van der Zeijden (PwC), Frank de Beijer (Liberty Global), Danyel Slabbers (PwC), among numerous others

https://www.ibfd.org/Training/International-Tax-Legal-and-Commercial-Aspects-Mergers-Acquisitions-0

Capital Taxes Update

12/5/2018 - 12/5/2018

STEP

Venue: Holiday Inn, Impington, Lakeview, Bridge Rd, Impington, Cambridge, CB24 9PH, UK

Key speaker: Chris Whitehouse (5 Stone Buildings) https://www.step.org/events/capital-taxes-update-5-december-2018

Advanced VAT Optimization

12/6/2018 - 12/7/2018

IBFD

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

Key speakers: TBC

https://www.ibfd.org/Training/Advanced-VAT-Optimization

Transfer Pricing and Intra-Group Financing

12/10/2018 - 12/11/2018

IBFD

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

Key speakers: Antonio Russo (Baker & McKenzie), Alejandro Zavala Rosas (Baker & McKenzie), Rezan Ökten (VEON), Omar Moerer (PwC), among numerous others

https://www.ibfd.org/Training/Transfer-Pricing-and-Intra-Group-Financing-0

Transfer Pricing Masterclass

2/14/2019 - 2/15/2019

IBFD

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

Key speakers: TBC

https://www.ibfd.org/Training/Transfer-Pricing-Masterclass

Current Issues in International Tax Planning

2/27/2019 - 3/1/2019

IBFD

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

Key speakers: Jan de Goede (IBFD), Annemiek Kale (Arla Foods), Clive Jie-A-Joen (Simmons & Simmons), Jeroen Kuppens (KPMG Meijburg & Co), among numerous others

https://www.ibfd.org/Training/Current-Issues-International-Tax-Planning-1

THE AMERICAS

United States

The US Court of Appeals for the Ninth Circuit has announced that it has withdrawn its landmark ruling in the case of Altera, to allow time for a reconstituted panel to confer on the matter.

A listing of recent key international tax cases.

The decision to revisit the outcome follows the death of one of the judges on the three-member panel, Stephen Reinhardt, on March 29, 2018. Earlier, in a footnote accompanying the decision in favor of the IRS, the Court said: "Judge Reinhardt fully participated in this case and formally concurred in the majority opinion prior to his death."

Reinhardt's vote was crucial in the 2-1 decision in favor of the IRS. The decision to reconsider the case means the Court could now reverse its decision, if newly assigned Judge Susan Graber sides with Judge Kathleen O'Malley, who dissented.

Although the tax at stake for Altera (now part of the Intel Group) is said to be relatively minor, a ruling for the IRS would have huge implications for the tax affairs of tech firms in particular with regards their cost-sharing arrangements.

Altera ruling

The US Court of Appeals for the Ninth Circuit released the ruling for the IRS in Altera on July 24, 2018. Among other things, the ruling agreed with the IRS Commissioner that the Treasury Department had acted lawfully under the Administrative Procedure Act when issuing regulations that provided for a "purely internal" method of allocating costs among related parties (and specifically among cost-sharing groups) for transfer pricing purposes.

The decision was expected to empower the IRS to make adjustments to taxpayers' transfer pricing dealings in circumstances where unrelated parties do not enter into the same transactions – where a comparability analysis is impossible.

It would mark a shift away from the arm's-length standard and towards a commensurate-with-income standard for assessing groups' compliance with US transfer pricing law, with the US Tax Court earlier holding in Xilinx that the IRS is unable to enforce a transfer pricing adjustment in the absence of comparable transactions.

The Ninth Circuit Court instead said Treasury had authority to issue regulations to compel cost-sharing groups to share the cost of employee stock-based compensation in proportion to the income enjoyed by each controlled taxpayer, even though unrelated parties do not do the same. It said Treasury was empowered to do so, as in amending Section 482 of the IRC in 1986, Congress had indicated its intention to reject primacy of the arm's-length standard and, where necessary to prevent base erosion and profit shifting, enforce a commensurate-with-income standard.

Under the arm's-length standard, "a controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (an arm's length result)." However, the commensurate-with-income standard provides that related parties should assume costs in proportion to the income enjoyed by each controlled taxpayer. The Appeals Court agreed that a 1986 amendment to Section 482 adopted by Congress had provided for a shift towards this commensurate-with-income standard, as Congress sought to mitigate the amount of taxable income shifted by multinationals to lower-tax territories through intellectual property ownership transfers.

The Appeals Court ruled the Treasury was authorized to prescribe the contested regulations to achieve that objective. It ruled also that it had complied with the procedural requirements required of it by the Administrative Procedure Act.

http://cdn.ca9.uscourts.gov/datastore/opinions/2018/07/24/16-70496.pdf

US Court of Appeals for the Ninth Circuit: *Altera Corp. v. Commissioner, No. 16-70496, 16-70497 (9th Cir. 2018)*

United States

The US Court of Appeal for the Second Circuit has upheld a lower court's decision by ruling that the Internal Revenue Service can deny a taxpayer's claim for a refund associated with a deduction for foreign tax because it is time-barred.

In the case, the Court of Appeal was called upon to decide whether the special ten-year limitations period on refund claims resulting from foreign tax credits is also applicable to claims resulting from deductions for foreign taxes. Normally, refund claims must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires later.

At the center of the case was a deduction claimed by Trusted Media Brands for foreign taxes (in lieu of claiming a credit) on its amended 2002 tax return, an event which triggered a chain of adjustments to prior tax returns, ultimately resulting in a refund claim due to an alleged overpayment in its 1995 tax year, which the IRS denied.

The taxpayer sought to utilize the extended ten-year statute of limitations applicable to refund claims resulting from foreign tax credits, with such period running from its 2002 tax return. However, the United States District Court for the Southern District of New York denied the taxpayer's claim as untimely on two independent grounds: first, that the special ten-year statute of limitations for refund claims for foreign taxes applies only to credits and not deductions; and, second, because taxpayer's overpayment claim for its 1995 tax year was not properly "attributable to" its 2002 tax year, and therefore, even if the ten-year limit were applicable, the claim, filed in December 2011, was untimely.

In affirming the judgment of the District Court, the Appeal Court opinion, written by Judge Barrington Parker and published on August 10, 2018, stated: "We agree that the special ten-year statute of limitations for refund claims for foreign taxes applies only to credits and not deductions and, thus, taxpayer's refund claim is time-barred."

http://www.ca2.uscourts.gov/decisions/isysquery/16e4416d-627f-4bbf-9de4-dbc33712e44e/1/doc/17-3733_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/16e4416d-627f-4bbf-9de4-dbc33712e44e/1/hilite/

US Court of Appeal for the Second Circuit : *Trusted Media Brands, Inc., FKA The Readers Digest Association, Inc v. United States of America*

WESTERN EUROPE

Greece

Reversing its previous decision on the matter, the European Commission concluded on August 9 that a tax on admission fees to public and private casinos in Greece from 1995 to 2012 does not involve state aid, in line with decisions by the European courts.

Under Greece's system of casino levies, all casinos in Greece have been required to charge a regulated admission fee to customers. Casinos then have to pass on 80 percent of the admission fee to the Greek state as a tax, while retaining the remaining 20 percent as remuneration for issuing tickets and covering expenses. Until November 2012, the general regulated admission fee was EUR15 (USD17.37). However, state-owned casinos were subject to a lower regulated admission fee of EUR6.

Following a complaint by a private casino operator, the Commission opened a formal investigation into the differentiated tax levied on admissions to public and private casinos in Greece. In May 2011, the Commission found that the measure constituted incompatible state aid in favor of public casinos, and ordered Greece to recover the unlawful aid.

However, the decision was overturned by the General Court of the European Union in September 2014, a ruling which was subsequently upheld by the Court of Justice in October 2015.

The Commission's newly issued decision reflects the findings of the European courts and concludes that the differentiated tax levied on admissions to public casinos and private casinos did not confer a selective advantage to public casinos. According to the Commission, this is because the amounts due to be paid to the Greek state by private and public casinos corresponded to the same percentage (80 percent) of the different regulated admission fees charged to customers by the two categories of casinos. Furthermore, in November 2012, the differentiation between admission fees for private and public casinos in Greece was abolished and a EUR6 admission fee was set for all casinos, the Commission noted.

http://europa.eu/rapid/press-release_MEX-18-4941_en.htm

European Court of Justice: *SA.28973: Measures to certain Greek Casinos*

United Kingdom

The UK's First Tier Tribunal (FTT) has ruled for the taxpayer on appeal in a case concerning the VAT treatment of fixed odds betting terminals.

The claim concerned VAT paid by the taxpayer, Done Brothers (Cash Betting) Ltd, between December 2005 and January 2013. The UK subsequently approved legislation to exempt such supplies. The taxpayer sought repayment of VAT collected during the period to December 2005.

The FTT considered the taxpayer's appeal on the basis of the tests applied by the European Court of Justice in its landmark ruling in *HMRC v. The Rank Group PLC* (C-259/10 and C-260/10), which concerned the tax treatment of slot machines.

The FTT agreed with the taxpayer that the UK's decision to levy VAT on fixed odds betting terminals (FOBTs) was contrary to the EU principle of fiscal neutrality where the supplies from FOBTs were similar to comparator games, played in casinos and online, which were exempt.

In *Rank*, the ECJ confirmed that the principle of fiscal neutrality precludes a member state from treating similar goods and supplies of services, which are therefore in competition with each other, differently for VAT purposes.

The FTT said that the supplies, of bingo games on FOBTs; virtual card games on FOBTs; virtual racing games on FOBTs; slots games on a B3A machine; and roulette games, were similar to the comparator games – namely those played in casinos and/or online – and therefore the difference in the VAT treatment of the supplies was contrary to the principle of fiscal neutrality. The FTT did not rule on the VAT treatment of "other games" considered, due to a lack of evidence put forward.

The ruling was released on July 25, 2018.

https://www.bailii.org/uk/cases/UKFTT/TC/2018/TC06608.html

First Tier Tribunal: *Done Brothers (Cash Betting) Ltd. v. HM Revenue and Customs ([2018] UKFTT 0406 (TC))*

United Kingdom

The UK Supreme Court has agreed that the UK tax agency does not need to pay compound interest on tax that was levied in breach of EU law but ruled for the taxpayer, Prudential Assurance, on how the tax repayment should be calculated.

The case related to periods running from 1990–2009 and concerns the tax treatment of UK-resident companies that received dividends from portfolio shareholdings (*i.e.* where the investor holds less than 10 percent of the voting power in the company) in overseas companies.

According to the Supreme Court summary, UK tax law at that time had provided that, on receiving dividends from a UK-resident company, a UK-resident recipient company was exempt from corporation tax under Section 208 of the Income and Corporation Taxes Act 1988 (ICTA), and by Section 231(1) of the ICTA, it would receive a tax credit equal to the amount of advance corporation tax (ACT) that the distributing company had paid on the distribution.

By Section 238(1) of the ICTA, the dividend received and the tax credit together constituted "franked investment income" (FII) in the hands of the recipient company, which, by Section 241 of the ICTA, could be used to eliminate or reduce its own liability to ACT on distributions (franked payments) to its own shareholders.

In contrast, a UK-resident company receiving dividends from an overseas company was subject to corporation tax under schedule D of the ICTA (so-called DV tax). Furthermore, it did not receive a tax credit on the dividends, which did not qualify as FII, although it could be entitled to some relief against double taxation under domestic rules, or conventions between the UK and other countries.

PAC brought a claim to recover corporation tax and ACT levied contrary to EU law. Before PAC's claim was heard, the Court of Justice of the European Union (ECJ) concluded in two decisions that the UK's treatment of overseas dividends was contrary to EU law in that it treated dividends received from overseas companies less favorably than dividends from UK-resident companies.

In the case, it was common ground that PAC was entitled to an appropriate tax credit, and to repayment of any tax unlawfully charged. The dispute concerned the amount to be awarded, which depends on issues of domestic and EU law.

On the first of five issues discussed, the Supreme Court ruled for PAC. This issue was whether EU law requires the tax credit to set by reference to the overseas tax actually paid, as HMRC submitted, or by reference to the foreign nominal tax rate, as PAC submitted.

The Supreme Court dismissed HMRC's appeal on this issue. ECJ jurisprudence, particularly *Case C-35/11* "FII ECJ II," clearly establishes that the credit for foreign dividends should be by reference to the FNR, rather than by reference to the actual or effective tax incurred overseas, the UK Supreme Court said. It added that there is no suggestion in the ECJ case law that any distinction is to be drawn in this respect between portfolio and nonportfolio holdings.

The second issue concerned whether PAC is entitled to compound interest in respect of tax which was levied in breach of EU law, on the basis that HMRC was "unjustly enriched" by the opportunity to use the money in question.

The Supreme Court allowed HMRC's appeal on this issue. In *Sempra Metals Ltd v. Inland Revenue Com'rs* ([2007] UKHL 34) a majority of the House of Lords held that a claim would lie in unjust enrichment for restitution of compound interest on money which was paid prematurely as the consequence of a mistake. The Court said: "A number of developments since that decision indicate that it failed to have regard to tax legislation, created problems in the law of limitation, and caused disruption in public finances. Furthermore, it is inconsistent with *Investment Trust Companies v Revenue and Customs Com'rs* ([2017] UKSC 29), which explained the requirement for a defective transfer of value by the claimant to the defendant."

It continued: "The recipient's possession of money mistakenly paid to him, and his consequent opportunity to use it, is not a distinct transfer of value, additional to the payment of the money. Accordingly, there is no right to interest on the basis of unjust enrichment." The Supreme Court therefore departed here from the reasoning in Sempra Metals on this issue and rejected PAC's claims to compound interest.

The ruling was released on July 25, 2018.

https://www.supremecourt.uk/cases/docs/uksc-2016-0102-press-summary.pdf

UK Supreme Court: *Prudential Assurance Company Ltd (Respondent) v Commissioners for Her Majesty's Revenue and Customs (Appellant) [2018] UKSC 39*

Dateline August 16, 2018

As corporate tax rates have tumbled, value-added tax rates have tended to climb, as countries shift more of their tax burdens from income to indirect taxation. In the latest example, Russian President Vladimir Putin has signed into law legislation to **hike Russia's VAT rate** to 20 percent from January 1, 2019.

Furthermore, VAT is now a very familiar tax globally, with around 160 jurisdictions having adopted some form of this tax. India is probably one of the more notable recent entrants into the VAT and GST club. The **United States** is certainly the most visible absentee, given that state sales taxes do not operate in the same way as a VAT. And, a few unlikely legislative proposals aside, the US has shown little inclination in joining.

However, just as there are some anomalies in corporate tax trends, with a few jurisdictions having raised rates recently, there are also some notable exceptions to the rules in the world of VAT and GST. **Romania**, for example, had a standard rate of VAT of 24 percent as recently as 2015. Now it stands at 19 percent, and the Government wants to **reduce the rate further**, to 18 percent next year, although this may be delayed until 2020. **Malaysia**, meanwhile, has gone against the grain even harder as the Government sets about fulfilling its pre-election pledge to repeal the GST regime and **replace it with a sales and service tax** in September.

Governments like VATs because they usually raise a lot of money relatively painlessly – administratively time-consuming VAT compliance may be for businesses, but taxpayers tend not to notice them as much as the bite taken out of their paychecks by income and other direct taxes. Indeed, the idea of a national VAT hasn't been completely dismissed in the US. Far from it. Over the years **various bills have been submitted to Congress for a VAT** or national sales tax, often as a replacement for the federal income tax. It's just that such proposals are rarely taken seriously and are really just symbolic efforts designed to draw attention to the shortcomings of the US tax code.

However, a recent development challenges the assumption that VATs are the great tax revenue motherlode, because, according to the IMF, **India's GST has depressed revenues** rather than elevated them. However, this is likely due to not entirely unsurprising teething problems with the system rather than the beginning of a long-term structural problem.

Not that there's likely to be a sudden shift in recent VAT trends just because Romania is slashing its standard rate, Malaysia is abolishing its GST, India's GST isn't working as expected, and the US will likely remain VAT-less for years to come. But it does go to show that not everything can be taken for granted in the world of taxation.

Indeed, since I'm here, perhaps it's time to **challenge some conventional wisdom** from the international tax standard-setters about the state of play of the BEPS project. Because the overseers of the **OECD's BEPS project** were doubtless heartened to hear that every G20 member country received a positive report card in a recent interim progress report on the implementation of various G20 commitments. But on closer inspection of the conclusions, it would appear as if the examiners have been quite generous in awarding top grades in certain cases.

Indonesia, for example, like every other G20 country, was adjudged to have "shown progress in introducing BEPS measures" and "has taken steps towards implementing BEPS package during the compliance period." Except, of course, for the trifling matter that it hasn't indicated any progress towards implementing the recommendations in Action 1 (VAT and the digital economy). And Action 2 (hybrid mismatch arrangements). Oh, and Actions 5 (harmful tax practices), 7 (permanent establishment status), 11 (measuring and monitoring BEPS), and 12 (disclosure of aggressive tax planning). And Action 14 (dispute resolution).

In **Turkey's** case, sufficient progress has been deemed to have been made towards implementing BEPS despite the insignificance of shortcomings with regard to Actions 1, 2, 3, 4 and 5. And 8 to 10. And 13 and 14. Turkey also hasn't joined the Multilateral Competent Authority Agreement for the automatic exchange of country-by-country reports. If this represents progress, I'd hate to see what a lack of it might look like.

On the matter of **harmful tax regimes**, I wonder if anybody at the OECD has noticed what's been happening in **Hungary** recently. For with a corporate tax of nine percent and a **tax-slashing 2018 Budget** announced last month, Hungary must be straying dangerously close to harmful tax territory as the OECD sees such matters. A nine percent corporate tax surely can't be designed to attract investment by domestic businesses alone.

Recent measures in Hungary even forced the International Monetary Fund to depart from its usual Article IV "widen the tax base and lower the labor tax wedge" line, as it **cautioned the Government against further tax cuts**, at least without commensurate spending reductions.

Although it did still recommend that Hungary widen its tax base and continue to reduce the labor tax wedge. Some habits die hard, I suppose.

The Jester