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a closer look

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a closer look

Global Tax Weekly – A Closer Look

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15 Reasons Why October 5 Is A Day To Remember In The Nigerian Tax Terrain

by Seun Adu, PwC, Nigeria

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Overview

Unless October 5 was your birthday, wedding anniversary or something along those lines, chances are it was just another Monday when you had to get on with whatever it was you had to do for the week. You woke up, dragged yourself to work (if you're one of those that hate Mondays), got stuck in traffic, worked hard (or pretended to), returned to the traffic, got home and slept. But if you are a tax professional or someone with tax oversight function in any business, you should pay attention.

October 5, 2015, was not just another day. We are about to see a new set of issues in the Nigerian tax space and the events of that day could very well be the catalyst that will quickly bring those issues to the fore.

There are many events that are remembered long after they have happened. Take November 5, 1605 when Guy Fawkes was captured under the House of Lords trying to blow up King James I and his parliament. The event created an instant stir and is still commemorated in many parts of the world as a Bonfire Night.

Then there are days that go unnoticed to many, which in the long run turn out to be significant. August 6, 1991, comes to mind. On that day, Tim Berners-Lee launched the first ever web browser.

For many businesses operating in Nigeria, as well as tax and finance officers based there, October 5, 2015, could very well be a day of significance that has gone unnoticed.

On that date, the OECD released its final package on 15 BEPS actions. In case you are asking; why on earth should I be bothered about the OECD? Isn't that a gang of rich nations? And BEPS? Doesn't it have to do with complicated tax issues that only developed countries understand? Why should I be concerned? This is *Naija;* all those "*Oyinbo*" things do not matter here. Well, you could not be more wrong.

It has been a while since developing countries felt their interests on tax matters were aligned with those of the developed countries. Developing countries have always felt they do not get the right amount of taxes in their countries because the multinationals that operate there prefer to move profits to the other side of the world. In the last few years however, these countries seem to be accepting that the developed countries may not be the real problem and that in fact, none of them seems to be getting as big a chunk of the pie as they should.

BEPS stands for Base Erosion and Profit Shifting. It is a phrase used to describe complex tax avoidance schemes used by multinationals to minimize their overall tax burden. It is believed that this happens largely because the existing international tax rules are outdated. The OECD's BEPS action plan is an attempt by members of the G20 to revamp the rules to better deal with the complex structures that make profit shifting possible. Because many of these structures are not illegal, tax authorities are not able to counter them under existing tax frameworks. The foundations and fundamental principles guiding the current international tax frameworks were laid as far back as 100 years ago – long before the internet was invented.

Today you can buy almost anything online, from books to cars, or pay for services from a company based abroad. In the old days these companies would have had to open a shop in Nigeria to service their customers. But nowadays this is no longer necessary. In the old days the shop in Nigeria would have been liable to tax on the profits it made from selling to Nigerian customers, but thanks to the internet, they pay no tax because they do not have a shop in Nigeria and the law will only tax them if they do have a "shop" in Nigeria. So what has basically happened is that the way of doing business and making profits has changed, but the laws that impose tax on the profits have stayed the same; and the tax authorities are trying to change this. Think about it, it is hard to see any aspect of business or the way we live in general that has not changed in the last ten years, let alone 100 years, yet many of the core principles guiding international taxation have remained unchanged for over a century.

There is a Yoruba adage which says: "It is the way that the bird flies that the hunter will throw stones at it." The BEPS package is essentially the OECD trying to change the way that it stones the bird, since the bird's flying style (or call it swag if you like) has changed. The interesting thing is that I actually heard this Yoruba adage first from the head of the transfer pricing division of Nigeria's Federal Inland Revenue Service (FIRS). I think this nicely captures the FIRS' view on BEPS, transfer pricing and tax as a whole.

Ten years ago, it was hard to imagine a conversation with the FIRS where current international tax issues would come up. Back then, it was hard to think the FIRS would bring up issues such as BEPS, controlled foreign corporation (CFC) rules, transfer pricing, treaty abuse, *etc.* in a regular conversation. But this is happening now. And all of this has happened in a short space of roughly two years thanks to their involvement in the BEPS project. Yes, the

BEPS project is an initiative of the so-called "rich countries." But African tax authorities including the FIRS have monitored the developments very closely and are set to begin implementing a number of the recommendations which they consider to be very relevant. The African Tax Administrator's Forum (ATAF) is providing support to its members. The OECD and other multilateral organizations are also supporting African countries. All of this means that the release of the BEPS package on October 5 is set to change the practice of taxation in Africa, and indeed in Nigeria.

The BEPS action plan consists of 15 actions targeted at three broad objectives: introducing coherence in the domestic rules that affect cross-border activities; reinforcing substance requirements in the existing international standards; and improving transparency as well as certainty. I will explain all of this in a bit.

While growing up, one of my younger neighbors was often left behind in school after every other student had gone home. The reason was: his Dad would often think his Mom would be picking him up from school, while his Mom would assume his Dad was picking him up. While this lack of coherence between parents can be a sorry state of affairs for a child, it could be a very welcome arrangement if the child in the analogy is the profit from a business and the lack of coherence is coming from two taxing authorities who somehow manage not to tax the profits even though they both intended to. The OECD believes lack of coherence between countries, particularly when their domestic tax laws treat the same transactions differently, has led to instances where, like the child that is somehow forgotten by both parents, the profits from transactions are ignored by both tax authorities. The OECD believes that this type of double non-taxation happens on a significant scale and has tried to curtail this through several of the BEPS actions. In particular, Action 2 (Hybrid Mismatch), Action 3 (CFC Rules), Action 4 (Interest Deductions), and Action 5 (Harmful Tax Practices) attempt to address BEPS issues arising from a lack of coherence in the international tax rules adopted by different countries.

I once paid what I considered to be a tidy sum for a shirt. You can imagine my annoyance when I found out a friend of mine had paid almost half of the price for exactly the same shirt from the same supplier on the same day I made my purchase. Obviously if I had had this information beforehand, I would never have accepted the expensive offer. Many tax authorities feel the same way. They believe they are settling for less than they should and can never tell for sure if the profits that are being reported by subsidiaries of multinationals in their countries are adequate because they do not know what profits are being reported by the other foreign related parties who deal with these subsidiaries and make profits from the transactions. The action plans on transparency seek to ensure that tax authorities have access to information from the "other side of the transaction" to allow them make reasonable assessments of BEPS activities. These include Action 11 (Measuring and Monitoring BEPS), Action 12

(Disclosure of Aggressive Tax Planning), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting).

You may have heard the story of a supposedly "under 17" football player who was rated very highly due to his performance at a youth tournament. He got a good deal from a top football club as a result. The club believed it was a worthy investment since he was still young and had a lot of energy and many more years of good football ahead of him. They were wrong. Three years later and his career was over. It seemed the age that had been declared "in the contract" was different from his real age (substance). The contractual age and not the substantial age had determined the price. Tax authorities believe the contractual information on intercompany transactions do not always reflect the actual substance of the transactions. Because of this, many intercompany transactions are priced incorrectly, leading to base erosion. In order to counter this, the OECD has several action plans which seek to ensure that pricing will follow substance rather than contractual arrangements. These include Action 6 (Treaty Abuse) and Action 7 (Artificial Avoidance of PE). There are also Actions 8 to 10 (Aligning Transfer Pricing Outcome with Value Creation), which primarily deal with changes to the OECD Transfer Pricing guidelines.

A number of the BEPS actions deal with other issues which may not fall neatly under any of the three broad categories discussed above. They include Action 1 (Digital Business), Action 14 (Dispute Resolution), and Action 15 (Multilateral Instruments).

October 5 has come and gone and it is only a matter of time before we start to see the impact. Whereas not all the issues being addressed by the BEPS actions are an urgent concern for the FIRS, there are many of them that have tickled the taxman's interest.

As a taxpayer, there is nothing wrong with arranging your affairs in a way that helps to minimize your costs (including tax). After all, you are in business to make profits. It is not illegal and arguably you have a right to do so. You do, however, need to make sure that you are playing within the rules. You also need to be alert to changes in the rules and changes in the attitude of the rule-makers so you are not caught unawares. BEPS is changing the rules and the attitude of governments globally, including in Nigeria. When I heard the hunter and the bird adage from the FIRS, one of the proverbs in Chinua Achebe's things fall apart immediately came to mind. "Eneke the bird says that since men have learned to shoot without missing, he has learned to fly without perching." The FIRS is training to shoot without missing. What are you doing about it?

Allocation Of Benefits Arising From Pure Economies Of Scale Among Subsidiaries In An MNE

by Hugo Chary, Analyst, and Lukas Hinteregger, Consultant, NERA Economic Consulting

This article expresses exclusively the authors' views which are not necessarily the views of NERA Economic Consulting.

Most multinational groups ("MNEs") benefit from some degree of synergies derived from economies of scale. In its most common form, economies of scale result from the centralization of functions within MNEs. Typical synergies can be direct functional cost savings from the elimination of duplicative functions. Another common source of synergies is the bundling or pooling of capacities across affiliates such as borrowing or production capacities. The benefits arising to an MNE from these synergies are often direct operational cost savings; well-known examples include centralized headquarter support functions that allow for reduced "per-unit" costs due to better use of capacities or the cost efficient, central procurement of input factors due to bundling of purchasing power of affiliates.

In a transfer pricing context, the identification and subsequent allocation of benefits from economies of scale among different subsidiaries often pose challenges; first, economies of scale are not always easy to identify and to distinguish from benefits arising, for example, from the existence of valuable intangible assets; second, once the existence of economies of scale has been established, an arm's length allocation of benefits has to be determined.

In this context the recently issued guidance on transfer pricing aspects of intangibles published by the Organisation for Economic Co-operation and Development ("OECD") in September 2014 in the course of the Base Erosion and Profit Shifting project ("BEPS") states that such "synergies should generally be shared by members of the group in proportion to their contribution to the creation of the synergy".[1]

While transfer pricing literature, including the OECD, generally proposes to use allocation keys, such as sales, purchasing volumes or headcount, to determine how not-directly-allocable economies of scale synergies should be divided among affiliates of MNEs, we would like to show theoretically and practically with three case studies how game theory, more precisely the known concept of Shapley Value, may offer an additional mean to identify a single "fair" split of benefits in line with what independent parties would have negotiated.

The idea to allocate joint costs and in turn associated benefits using Shapley Value is not new. Shubik (1962)[2] was among its first proponents. In fact, the allocation of joint costs among agents has been a thoroughly investigated subject posing a central problem in public utility pricing, networks and management.[3] Thereby the Shapley Value formula is considered the "single most influential contribution of the axiomatic approach to distributive justice".[4] While the use of Shapley to share costs among departments has been often propagated in management literature, to our knowledge it has never made a substantial contribution to the allocation of benefits arising from pure economies of scale in a transfer pricing context.[5] One reason for this may be the perceived complexity of its application. In this respect, the article intends to demonstrate the merits of Shapley in practice. Indeed, the allocation of benefits from economies of scale using Shapley Value requires two principal inputs which are also relevant for multiple other management purposes and are often readily available in an MNE:
(1) an estimate of the standalone costs of local entities, and
(2) an estimate of the significance of the economies of scale (*i.e.*, the shape of the average cost curve).

The remainder of this article is structured in two main parts: Part I provides a theoretical introduction to the topic, including a definition of economies of scale based on microeconomic theory and the theoretical foundations of Shapley Value, as well as its application in the context of economies of scale allocations. Part II demonstrates the practical use of Shapley by applying the concept within three numerical transfer pricing setups: (1) the allocation of centralized management support function costs taking into account location specific advantages; (2) the allocation of benefits arising from the pooling of purchasing power; and (3) the allocation of benefits resulting from the pooling of borrowing capacity of multiple subsidiaries. Within all three examples the Shapley outcome differs from current transfer pricing practice, which often fails to quantify the real economic contribution of a single entity to the creation of a synergy.

Part I – Theoretical Foundations

As a starting point, we shall define economies of scale. A firm is said to enjoy economies of scale (or increasing returns to scale) if its average costs fall as output increases. There are many reasons why a firm may face decreasing average costs, such as:[6]

- The existence of fixed costs (at least within given ranges of output/time periods)
- The specialization of labor with increasing size

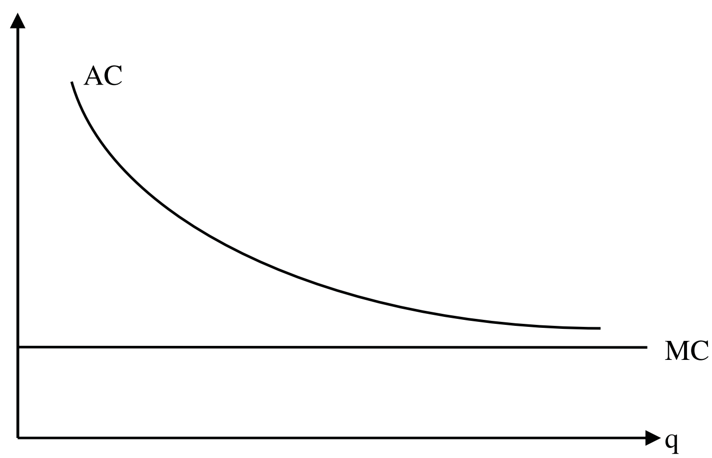
- The avoidance of a duplication in fixed costs with increasing size (*e.g.*, centralized support functions)
- The pooling of risks (*i.e.*, law of large numbers implying that random events tend to cancel out if there are enough of them)
- Physical laws (*e.g.*, relationship between volume and surface area).

More formally, economies of scale exist as longs as marginal costs are below average costs or

$$\frac{Average\ Costs}{Marginal\ Costs} > 1.$$

In areas where the above condition holds true, costs are *subadditive*, which means that it costs less to produce various quantities of outputs together than to produce them separately. Figure 1 illustrates a possible shape of *subadditive* costs for a firm, whereby a given level of fixed costs in combination with constant marginal costs (MC) leads to decreasing average costs (AC) for the levels of quantity (q) depicted.

Figure 1: Economies of scale



The existence of economies of scale implies *subadditive* average cost functions which are generally the result of economies of scale. However, in some cases, it may difficult to disentangle the reasons for decreasing average costs purely attributable to volumes from those attributable to other factors such as valuable intangibles (*e.g.*, technology or learning effects), arising benefits of which should not necessarily be allocated to multiple entities in a transfer pricing context. To determine the sources of an MNE's benefits constitutes a major challenge in many transfer pricing projects; should these be attributed to the existence of value-creating intangibles or to the existence of pure economies of scale, which arise simply "by virtue of group affiliation",[7] or maybe even both. As such, it may be that economies of scale lead to a sustained competitive advantage of a firm; however, the factors allowing it to reach such critical size may be driven by unique and valuable intangible assets (*e.g.*, high sales levels of a popular soft drink may create some economies of scale in production and bottling; whether the resulting gains should indeed only be attributed to pure economies of scale arising simply "by virtue of group affiliation" is at least questionable; an alternative view may suggest that the firm can only benefit from these economies of scale because of the unique and valuable intangible assets that are behind the soft drink's success and it is ultimately these assets which should receive the associated benefits in a transfer pricing context).

Please note that the objective of this article is not to provide guidance on how economies of scale can be identified in an MNE *per se*, but we believe that such analysis always depends on the specificities of a given case and needs to take into account the individual facts and circumstances of the MNE under review. As such, we think this necessitates a thorough understanding of an MNE's value chain in order to reliably determine the different sources of value creation.[8] However, once the existence of benefits arising from economies of scale has been established, the question arises on the allocation of the underlying costs (and in turn the implied benefits) among contributing entities. This second part of the issue is addressed in more detail below and is illustrated with practical case studies in which the arising benefits to the Group were clearly identified to be resulting simply from "virtue of group affiliation". The practical examples selected all relate to centralized headquarter services in an MNE – cases which we believe are typical cases for benefits related to economies of scale and therefore seemed to be a good starting point to address the challenge of allocating economies of scale in a transfer pricing context.

Note also that many other, often more complex cases may exist which involve benefits arising from economies of scale (*e.g.*, in production). Furthermore, transfer pricing analysis may need to take into account economies of scale that occur on a group-wide, consolidated basis, which should therefore be considered in other transfer pricing analyses (this seems notably relevant for the residual profit split method, which often assigns the entire residual by deduction to a given intangible; the non-consideration of economies of scale in deriving the residual profits may lead to a systematic overestimation of the intangible's value). As such, we think further work is needed, particularly with respect to the estimation of overall, group-wide benefits arising from economies of scale (*e.g.*, based on the analysis of comparable companies).

In cases of centralized headquarter services, the majority of management and transfer pricing literature advocates the allocation of not-directly-allocable, joint costs among entities or departments based on allocation keys. The idea behind this is that well-chosen allocation keys serve as a reliable indicator of the benefits that accrue to each entity (hereafter referred to as "agents"). As such, each agent contributes to the underlying costs in proportion to the benefits it obtains. In many cases, key-based allocations may indeed be a sufficiently good approximation. However, in other cases this may lead to over- and undercharging of participating agents. An example may concern the allocation of centralized management service costs across agents with significantly different standalone costs:

> Assume two entities of an MNE decide to centralize their accounting functions in the group's headquarter country. Both entities have the same level of sales which are used as allocation keys; however, Entity A paid less for its accounting department than Entity B prior the centralization due to local cost differences. Despite the possible existence of economies of scale, Entity A may face higher costs after the centralization than before due to the failure of the sales-based allocation to take into account the entities' initial standalone costs (see also Part II, Example 1). At arm's length, Entity A may not have agreed to a centralization of services under such conditions, although it could also realize cost savings if costs were allocated differently.

In the above and similar cases, Shapley Value offers a means to take into account the standalone costs of agents which express their best alternative option, a concept known as BATNA (best alternative to negotiated agreement), and to simulate the negotiation outcome in a hypothetical bargaining process.

The Shapley Value was introduced by Lloyd Shapley in 1953,[9] and makes part of cooperative game theory. Cooperative game theory, as opposed to non-cooperative game theory, analyzes situations where agents compete, but can decide to cooperate to increase their benefits by joining coalitions. The formalization of cooperative game theory models comprises a set of agents and a function that returns the values captured by the agents in each (sub-)coalition of agents or by its own (*i.e.*, "imputations"). Possible stable outcomes of such games have the property that they are not dominated by any other imputation through any coalition. This concept is referred to as "the core," *i.e.*, if a given imputation lies within the core, there is no group of players which has an incentive to form another (sub-)coalition. The Shapley Value offers an additional way of allocating the profits among agents (which however must not always lie within the core; see further below). To a certain degree the two approaches, Core vs. Shapley Value, conflict with each other: Core allocations are based on pure power within the negotiation process in which coalitions do not give up on their demands under any circumstance. In Shapley Value theory, coalitions may give up profits based on pure power, but additionally include a stance on fairness.[10]

Therefore, in a transfer pricing context, whereas the ultimate allocation of profits should lie within the core in order to be stable, just any allocation within the core may not comply with the arm's length principle and could reflect purely opportunistic pricing which may be contradictory to what independent parties would agree to when in a long-term, cooperative relationship (as such, one entity may squeeze almost the entire profits from cooperation, leaving the other entity only a minor profit share; while this outcome may be in the core, since it may leave the second entity also – at least marginally – better off than in the standalone case, the allocation of profits may not be deemed arm's length). Contrary to the general principle of the Core, we believe that Shapley Value, under given circumstances, offers a mean to allocate profits (and the underlying costs) from cooperation which complies with the notion of arm's length as required under BEPS.[11]

In order to show the application of Shapley Value in the context of joint cost allocation, assume that the full cost of a common service (*e.g.*, central accounting) shall be shared among n agents,[12] which are described by $N = \{1,2,\ldots,n\}$. The approach further assigns each subset S of N (*i.e.*, the coalition S of agents) a standalone cost $C(S)$ that results from contributing to coalition S.[13] For a given ordering of N, the marginal cost of serving agent i is $xi = C(S \cup \{i\}) - C(S)$, where S signifies the set of agents preceding agent i in this ordering. The Shapley Value for agent i, which attributes it its "fair" share of costs, is then given by

$$x_i = \sum_{S \subseteq N \setminus \{i\}} \frac{s!\,(n-s-1)!}{n!} [C(S \cup \{i\} - C(S)],$$

where the term

$$\frac{s!(n-s-1)!}{n!}$$

can be interpreted as the probability that in any permutation the members of coalition S do not include player i. Hence, the Shapley Value assigns to agent i the average of its marginal costs (*i.e.*, agent i's contributions) over all orderings of N, under the assumption that the coalitions form in a random order. Please note that sharing the costs based on Shapley Value allocation is fully equivalent to the sharing of the surplus (in this context the economies of scale) and yields identical results. As such, the benefits from the economies of scale attributable to agent i, bi, can directly be calculated by deducting its Shapley Value from the standalone costs, *i.e.*, $bi = C(i) - xi$.

Put differently, the Shapley Value attributes to each agent i the benefits arising from economies of scale according to the average of the additional costs the agent adds to each (sub-)coalition. As such, the concept assigns the benefits in line with the true contributions of each agent as required by the OECD: "If important group synergies exist and can be attributed to deliberate concerted group actions, the benefits of such synergies should generally be shared by members of the group in proportion to their contribution to the creation of the synergy."[14]

Furthermore, we believe that in many cases the Shapley Value based allocation better adheres to the requirements of the arm's length standard since it is the only allocation that satisfies all of the following axioms:

- *Symmetry:* If two agents are identical from a cost perspective, Shapley Value assigns them identical cost shares.
- *Dummy or inessential player:* If an agent has an incremental cost to any coalition *S* that is always equal to its standalone costs, then that agent is a dummy, *i.e.*, it doesn't contribute to the creation of any economies of scale. Shapley Value will therefore assign this agent a cost equal to its standalone costs.
- *Additivity:* For an explanation of the additivity axiom, assume that the cost function is made up of two independent costs for all coalitions *C(S) = C1(S) + C2(S)*. The additivity axiom then states that the costs to be borne by agents in each coalition should be the sum of the costs the agents would have been assigned for that coalition under the two separate games.

Please note that the above axioms, notably the symmetry axiom, are not systematically met by the use of cost allocation keys which can result in non-arm's length allocations (*e.g.*, see example above where sales-based allocation leads to Entity A being overcharged).

This is one advantage of the Shapley based allocation, particularly relevant for large MNEs with a wide-spread geographical footprint and the potential existence of location specific advantages (in the form of location savings): The Shapley cost shares will always impute every (essential) agent a positive share of the externality created by *subadditive* cost functions, this is *xi = C(i)*. The core generalizes this concept to all coalitions of agents.

Under *subadditive* costs agents would only want to form a grand coalition *N* if the cost shares would be part of the core. For circumstances in which all *S* is a subset of *N*:

$$\sum_{S \subseteq N \setminus \{i\}} x_i \leq C(S)$$

For a coalition to be stable, the core imposes that no coalition be charged more than its standalone (BATNA) costs.[15] Therefore, when applying Shapley Value analysis in practice, the analyst should ensure that the Shapley Value outcome lies indeed within the core. If this is not the case, it may suggest that an MNE foregoes additional cost savings and may consider the exclusion of particular agents from the coalition. As a principle, the Shapley Value will lie in the core if the marginal contributions of agents are larger to larger coalitions.

Using the theoretical foundations outlined above, the second part of the article intends to demonstrate the strengths of the Shapley Value application in practice using three illustrative numerical examples. The examples chosen involve three common contexts in which an MNE may benefit from economies of scale, *i.e.*, the centralization of headquarter support services, the pooling of purchasing power, and the pooling of borrowing capacities of subsidiaries.

Part II – Practical Applications

The following case studies are based on simple numerical examples with three agents (*i.e.*, subsidiaries) each. All examples involve some centralized services which have the functional profiles of low-risk/low-value service providers. For simplicity, it is assumed that the central service provider is remunerated for its services via an arm's length service fee, which does not need to be treated further in the examples below. Furthermore, all benefits associated with the centralization can be attributed entirely to economies of scale and therefore should be allocated among the three subsidiaries, *i.e.*, the benefits do not arise from any potentially existing valuable intangibles but mere economies of scale like synergies. Based on these assumptions, the only two inputs needed to determine the Shapley Value based allocation are:

1. An estimate of the standalone (opportunity) costs of each of the three subsidiaries; and
2. An estimate of the economies of scale function (*e.g.*, the shape of the average cost curve in Figure 1).

Case Study 1: Centralized headquarter support services and location specific cost advantages

Three subsidiaries, located in Vietnam, China, and France, decide to centralize their accounting functions in their Group's largest entity in France.[16] The decision allows the Group to save costs due to a reduction in duplicative services and the optimized use of the accountants' capacities. Please note that the example below is not based on any actual facts and is based on the assumption that the quality and feature of the accounting services provided by the entities before and after the changes are identical.

Table 1 sets out the pre-centralization parameters. Please note that Table 1 suggests that the subsidiaries in Vietnam and China may benefit from some degree of location savings compared to France as indicated by the lower local staff costs:

Table 1: Standalone accounting costs pre-centralization

	Vietnam	China	France	*Total pre-centralization*
Sales of local entity	5,000	11,000	20,000	**36,000**
Number of accounting staff	4	7	12	**23**
Local costs per staff	42	62	70	
Total local standalone costs	168 *(V)*	434 *(c)*	840 *(f)*	**1,442**
in % of sales	*3.4%*	*3.9%*	*4.2%*	***4.0%***

Assume that the centralization of accounting functions in France allows the Group to reduce its total number of accounting staff from 23 to 17, thereby reducing its associated costs from 1,442 prior centralization to 1,190 (= 17 × 70) after centralization; *i.e.*, the benefits arising from economies of scale are therefore 252 or a 17 percent cost reduction compared to pre-centralization levels.

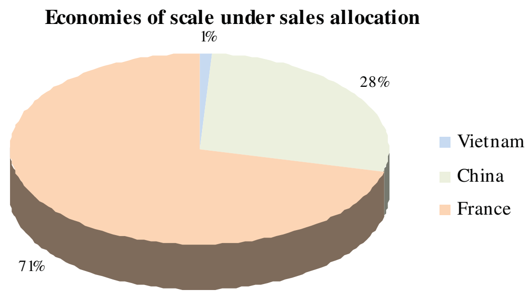
The prevalent transfer pricing practice may allocate the total costs of the centralized accounting function based on some type of allocation key, which intends to be the best available indicator for the estimated benefit arising to each of the subsidiaries. A commonly used allocation key is level of sales. Applied to the above example, the sales based allocation method would result in the following distribution of central accounting costs:

Table 2: Local costs using sales allocation key

	Vietnam	China	France
Allocated costs	165	364	661
in % of total costs	*13.9%*	*30.6%*	*55.6%*

This allocation method implies the following distribution of the benefits from economies of scale among the subsidiaries (obtained by comparing the allocated costs with the standalone costs of each subsidiary):

Figure 2: Distribution of economies of scale using sales allocation method



As illustrated in Figure 2, the benefits arising to the subsidiary in Vietnam from the centralization are marginally positive and the lion's share of economies of scale related benefits accrues to the largest subsidiary, France. While this is an economically possible scenario (*i.e.*, each subsidiary is better off than on a standalone basis), it seems an unlikely outcome for a negotiation among three parties that cooperate in a long-term relationship. Indeed, it is questionable whether three independent parties (in a long-term cooperation) would negotiate the same split and whether the Vietnamese subsidiary would not have a stronger negotiation power given its favorable local standalone costs (BATNA).

It is the latter factor that the allocation key based method generally fails to take into account – *i.e.*, *an allocation key based split of costs typically does not consider the parties' best alternatives*. The results of bargaining processes, however, are heavily determined by the best alternatives available to the parties (*i.e.*, by each party's BATNA).

As outlined in Part I, this is where Shapley Value comes into play: the concept is capable of accounting for the best standalone alternatives of each party as well as considering the alternatives arising to the parties from different constellations of cooperation (sub-coalitions).

Table 1 above already contains the main inputs necessary for the Shapley Value application: It provides the standalone costs (*i.e.*, opportunity costs) of each subsidiary and gives an indication of the shape of the economies of scale (*i.e.*, the relative number of accounting staff decreases with the levels of sales: a quadrupling in sales leads approximately to a tripling in required accounting staff).

Based on these inputs, the associated costs (and implied benefits) can be determined for each sub-coalition of the three subsidiaries:

Table 3: Costs per sub-coalition[17]

(Sub-)Coalitions	*Costs*	*Number of staff*
Vietnam + China *[vc]*	620	10
Vietnam + France *[vf]*	980	14
China + France *[cf]*	1,120	16
Vietnam + China + France *[vcf]*	1,190	17

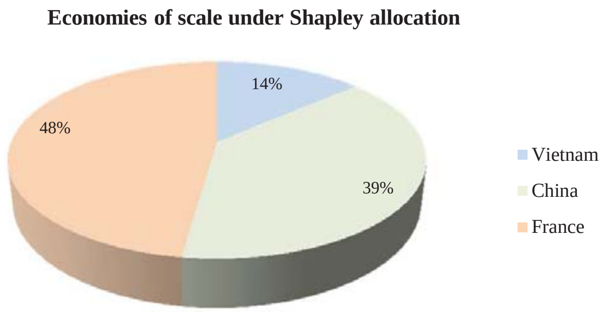
As a final step, the Shapley Value is calculated based on the marginal contributions by each subsidiary to each sub-coalition:

Table 4: Shapley Value[18] *cost allocation accounting for location specific cost advantages*

Marginal contributions	Vietnam	China	France	*Group*
Vietnam	168 *[= v]*			
China		434 *[= c]*		
France			840 *[= f]*	
Vietnam + China	186 *[= vc - c]*	452 *[= vc - v]*		
Vietnam + France	140 *[= vf - f]*		812 *[= vf - v]*	
China + France		280 *[= cf - f]*	686 *[= cf - c]*	
Vietnam + China + France	70 *[= vcf - cf]*	210 *[= vcf - vf]*	570 *[= vcf - vc]*	
Shapley Value	***134***	***337***	***720***	***1,190***

The above Shapley Value outcome lies within the core and is therefore stable (*see also* Figure 4 below). It splits the economies of scale (*i.e.*, the difference between the standalone costs and the Shapley Value cost allocation) among the three subsidiaries as illustrated in Figure 3.

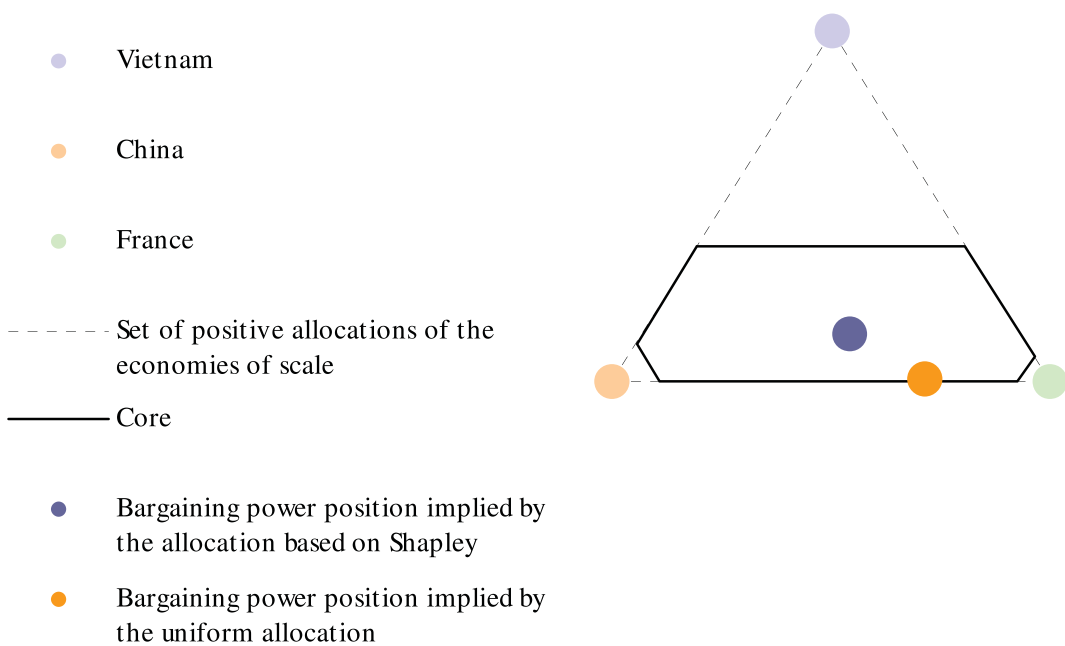
Figure 3: Distribution of economies of scale using Shapley Value



Compared to the split of economies of scale based on a sales allocation key, the subsidiaries in Vietnam and China receive a considerably larger share from the jointly generated synergies – the reason being that the Shapley Value accounts for the best alternative option available to each party which in this case reflects their location specific advantages (*i.e.*, lower personnel costs). As such, the Shapley Value based allocation assigns each party the benefits "in proportion to their contribution to the creation of the synergy"[19] as demanded by the arm's length criteria and the obtained split reflects the outcome of a hypothetical bargaining process between independent parties.

The following chart illustrates the bargaining power implied by the two different allocations as well as the Core.

Figure 4: Illustration of the implied bargaining power of the different allocations



In Figure 4, the respective allocation is closer to the entities with higher bargaining power (*e.g.*, the sales allocation implies a very low bargaining power of Vietnam). Furthermore, it shows that both allocations are within the Core, with the sales allocation almost at the border of the Core due to the marginal benefits the allocation attributes to Vietnam (*see* Figure 2 above). The graph further illustrates the point made above, that simply meeting the Core criteria is not a sufficient condition for an allocation to be considered arm's length. As such, an allocation where Vietnam and China share the entire benefits from economies of scale leaving France no benefit may be an allocation that lies within the Core but it could not be deemed arm's length given the specificities of the case at hand.

Table 5 summarizes the main results of Case Study 1.

Table 5: Overview sales allocation vs. Shapley based allocation – Case Study 1

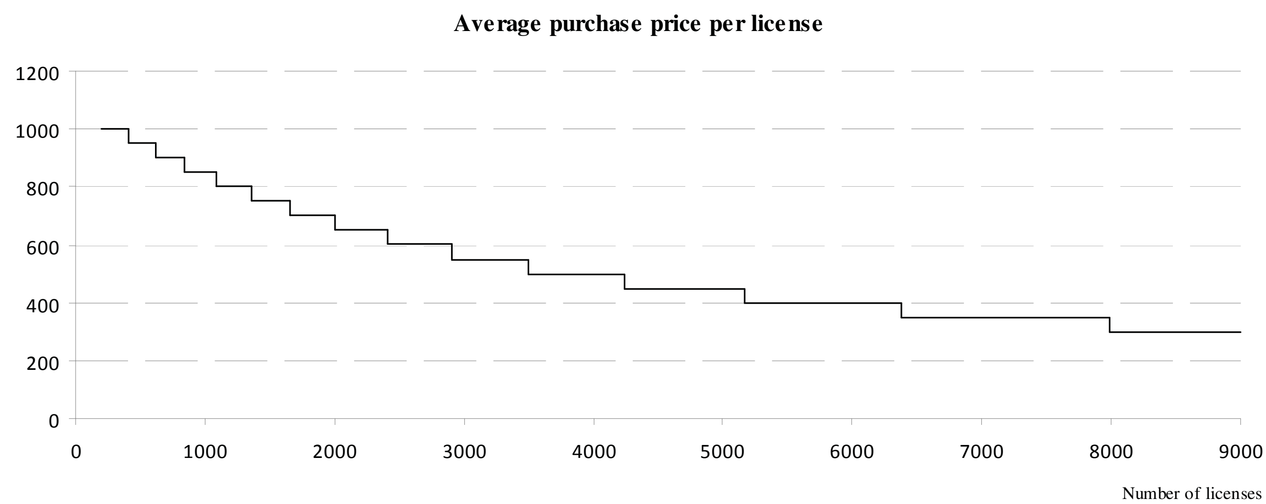
Summary	**Vietnam**	**China**	**France**	***Total pre-centralization***	***Total post-centralization / Economies of scale***
Total local standalone costs	**168**	**434**	**840**	**1,442**	
Costs using sales allocation key	165	364	661		**1,190**
Implied allocation of economies of scale	3	70	179		252
Costs using Shapley based allocation	134	337	720		**1,190**
Implied allocation of economies of scale	34	97	120		252

Case Study 2: Pooling of purchasing power in a centralized procurement entity

Consider three related parties, Entity A, Entity B, and Entity C. The entities decide to bundle their purchasing power and set-up a centralized purchasing function. The aim of this purchasing function is to provide the operations of the three affiliates with lower prices for input factors, in the specific case of software licenses, through bulk purchasing.

The starting point of the analysis is the purchase price function faced by the centralized purchasing center as depicted in Figure 5 (resembling Figure 1).

Figure 5: (Discrete) purchase price function[20]



Please note that the average purchase price applies to the entire quantity of units purchased; hence, the supplier offers an average price of 400 for the purchase of 6,000 software licenses.

For simplicity we assume that all three entities face a similar price function on their local markets in line with the purchase price function faced by the Group (*see* Figure 1). However, it may be that each of the three entities faces different pricing grids on their own local market, which would make the use of Shapley Value the more relevant (*see* Case Study 1). The demand of the three entities and their respective purchasing costs in a standalone case are given in Table 6.

Table 6: Purchase volumes per entity and best available standalone purchasing option

	Entity A	Entity B	Entity C	*Total pre-centralization*
Demand of licenses	500	1,500	4,000	***6,000***
Standalone purchasing costs	475,000	1,125,000	2,000,000	***3,600,000***
Average purchase price per license	950	750	500	***600***

The bundling of purchasing power and the centralized negotiation will enable the entities to purchase the total of 6,000 licenses for 2,400,000 at an average price per license of 400. This implies a total cost synergy resulting from economies of scale of 1,200,000 (*i.e.*, the difference between the standalone and the centralized procurement case).

The knowledge about the purchase price function is sufficient to assess the incremental contributions of each entity to each coalition necessary for the Shapley Value determination. Also, the increase in the number of players will neither require any additional assumptions nor will it increase the complexity of the analysis (see Table 7).

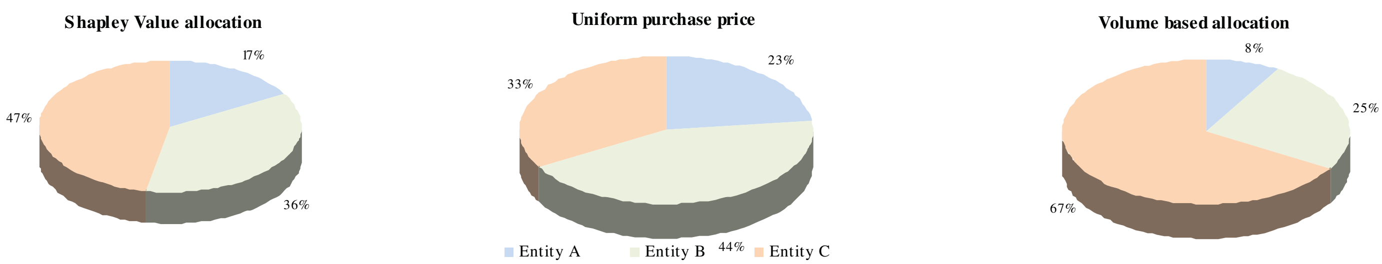
Table 7: Shapley Value calculation accounting for bundling of purchasing power[21]

(Sub-)Coalitions	*Costs*	*Average purchase price*		
A+B (2000 licenses)	*1,400,000*	*700*		
A+C (4500 licenses)	*2,025,000*	*450*		
B+C (5500 licenses)	*2,200,000*	*400*		
A+B+C (6000 licenses)	*2,400,000*	*400*		
Marginal contributions	**Entity A**	**Entity B**	**Entity C**	**Group**
A	475,000			
B		1,125,000		
C			2,000,000	
A+B	275,000	925,000		
A+C	25,000		1,550,000	
B+C		200,000	1,075,000	
A+B+C	200,000	375,000	1,000,000	
Shapley Value	***275,000***	***687,500***	***1,437,500***	*2,400,000*

The Shapley Value indicates the purchase price allocation across the three entities and consequently provides an allocation of the synergies associated with the centralization of the purchasing function in line with the "fair" contribution of each entity to the economies of scale.

The allocation of benefits obtained from Shapley Value compares as depicted in Figure 6 to the two other, most commonly used allocation mechanisms, *i.e.*, (1) the implicit allocation resulting from a uniform purchase price for each entity (400 in above example), and (2) the allocation resulting from the use of purchasing volume as allocation key.

Figure 6: Comparison of different allocation mechanisms of economies of scale (determined as the difference between the standalone costs and the allocated costs resulting from each of the different allocation mechanisms)



The Shapley Value based allocation of synergies lies in between the allocations obtained by the two other systems. While this may be the case for most scenarios, this does not have to be the case.[22] Though, with the exception of cases where all entities face the same purchase price function and have the same procurement demand, the Shapley Value will always lead to a more evenly distributed allocation of synergies (*i.e.*, lower share for "largest" entity) as compared to the volume based allocation system.[23] Furthermore, since the Shapley Value based allocation of synergies deviates from the allocation implied by a uniform purchase price, the average purchase price that each entity needs to pay lies either above or below the uniform purchase price – a point that is also relevant for Case Study 3 below.

Table 8 summarizes the main results of Case Study 2.

Table 8: Overview allocation implied by uniform purchase price vs. sales allocation vs. Shapley based allocation – Case Study 2

Summary	Entity A	Entity B	Entity C	Total pre-centralization	Total post-centralization / Economies of scale
Total local standalone costs	**475,000**	**1,125,000**	**2,000,000**	**3,600,000**	
Costs using uniform purchase price	200,000	600,000	1,600,000		**2,400,000**
Implied allocation of economies of scale	275,000	525,000	400,000		1,200,000
Costs using sales allocation key	375,000	825,000	1,200,000		**2,400,000**
Implied allocation of economies of scale	100,000	300,000	800,000		1,200,000
Costs using Shapley Value based allocation	275,000	687,500	1,437,500		**2,400,000**
Implied allocation of economies of scale	200,000	437,500	562,500		1,200,000

Case Study 3: Pooling of borrowing capacity in a centralized treasury entity

The third case study examines the determination of interest rates to be charged to entities within a centralized group treasury function using Shapley Value. The analysis is very similar to Case Study 2 and, as such, yields similar conclusions regarding the ultimate allocation of the benefits. In the case of bundling purchasing power, this implies effective unit purchase prices which are below the Group average purchase prices for certain entities. The same holds true for the pooling of borrowing capacity and resulting effective interest rates: *Favorable borrowing interest rates obtained by a Group due to mere economies of scale resulting from the bundling of borrowing capacity can result in arm's length interest rates to be paid by certain subsidiaries, which are below the Group interest rate even though no subsidiary can obtain better borrowing conditions on its own.*

Furthermore, the results are in line with "group-wide rules" as proposed by the OECD,[24] *i.e.*, the use of a Shapley Value based allocation ensures that "total net interest deductions within a group [are] the group's actual net third party interest expense." Compared to the allocation approaches currently considered by the OECD (either based on a measure of economic activity or group ratio rules) to achieve this premise, we believe the use of Shapley Value could provide a more precise measure of a given entity's contribution to the overall interest expense of the Group in many circumstances.

To demonstrate this, assume that the three subsidiaries Entity X, Entity Y and Entity Z pool their borrowing capacities to cover their financing needs. By pooling their borrowing capacities, the three entities are able to obtain an interest rate from third-party banks for borrowing debt of 1.89 percent which is based on their combined credit rating assessment of Aa2. The rate applies to the combined debt of the three entities of 950, *i.e.*, 300 from Entity X, 500 from Entity Y, and 150 from Entity Z.

On a standalone basis, each of the three entities has a credit rating below the Group rating, implying higher standalone borrowing rates,[25] as depicted in Table 9.

Table 9: Standalone credit ratings and implied interest rates

	Entity X	**Entity Y**	**Entity Z**
Letter credit rating	Baa1	Baa2	Ba2
Implied stand-alone interest rate	**2.46%**	**2.69%**	**4.22%**

Standalone ratings of subsidiaries that are below the rating of the Group are common given operational and geographical diversification effects influencing favorably the combined rating.[26]

In an intermediary step, it is necessary to assess the interest rates that the different sub-coalitions of Entity X, Entity Y and Entity Z could obtain on the market. In practice, this involves three credit rating assessments (*i.e.*, of X in combination with Y, of X in combination with Z, and of Y in combination with Z). Table 10 presents the results for the letter credit ratings and the implied interest rates for each sub-coalition.

Table 10: Standalone credit ratings and implied interest rates

Sub-coalitions	**X and Y**	**X and Z**	**Y and Y**	**X and Y and Z**
Letter credit rating	A1	A2	A3	Aa2
Implied standalone interest rate in %	**1.97%**	**2.01%**	**2.24%**	**1.89%**

The Shapley Value lies within the core and the cooperation among X, Y and Z is stable, since:

- All sub-coalitions have a better rating than the standalone credit ratings of the single entities; and
- The grand coalition has a better rating than all sub-coalitions.

To determine the Shapley Value, the interest payments as implied by the underlying debt levels of each entity, sub-coalition and grand coalition and their respective levels of interest rates are calculated, as presented in Table 11.

Table 11: Interest payments per entity and coalition

Interest payments		**Total (in absence of economies of scale)**
Entity X	7.4	
Entity Y	13.4	***27.1***
Entity Z	6.3	
Entity X and Entity Y	15.8	
Entity X and Entity Z	9.1	
Entity Y and Entity Z	14.5	
Entity X and Entity Y and Entity Z	17.9	
Interest savings from "Economies of scale"	**9.2** (= 27.1 - 17.9)	

Based on Table 11, the Shapley Value is calculated similarly to Case Studies 1 and 2 above by determining the marginal contributions of each entity to each coalition. The results are presented in Table 12.

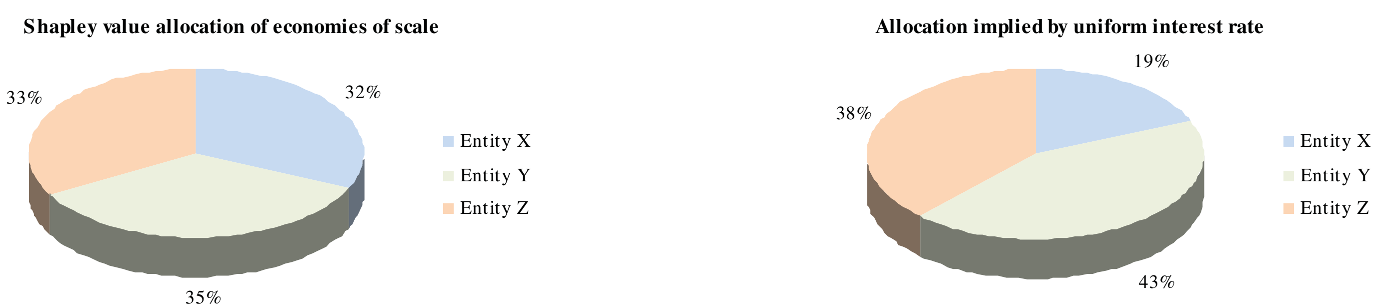
Table 12: Interest payments and implied rates obtained by Shapley Value[27]

	Entity X	Entity Y	Entity Z	*Total (with economies of scale)*
Shapley Value (interest payments)	***4.4***	***10.2***	***3.3***	**17.9** (= 1,89% * 950)
Implied interest rates	**1.48%**	**2.04%**	**2.20%**	**1.89%**

As indicated in the introduction to this case study and in line with the interpretation of the results of Case Study 2 above, certain subsidiaries (*i.e.*, Entity X) pay an interest rate which is lower than the Group borrowing rate, although the rate Entity X can obtain by itself on the market is higher (the arm's length rate of Entity X implies a negative spread on the interest rates paid by the group on the market). In turn this implies that other subsidiaries pay rates above the external borrowing rate of the Group, in line with each entity's contributions to the economies of scale. More specifically, the contributions of each entity relate to the marginal changes of the credit ratings (and the implied interest rates) they "cause" in each (sub-)coalition.

The Shapley Value based allocation of benefits resulting from the pooling of borrowing capacity compares as depicted in Figure 7 to the allocation implied by allowing each subsidiary borrowing at the Group rate of 1.89 percent.

Figure 7: Comparison of different allocation mechanisms of economies of scales



Compared to the allocation implied by the uniform group interest rate, the Shapley Value assigns Entity X a significantly larger share of the total benefits at the expense of Entity Y and Entity Z. Indeed, Entity X receives its larger share of benefits coherent with its relatively larger contribution to the overall improved credit rating of the Group.

Table 13 summarizes the main results of Case Study 3.

Table 13: Overview allocation implied by uniform interest rate vs. Shapley based allocation – Case Study 3

Summary	Entity X	Entity Y	Entity Z	*Total pre-centralization*	*Total post-centralization / Economies of scale*
Total local stand-alone interest costs	**7.4**	**13.4**	**6.3**	**27.1**	
Interest costs using uniform interest rate	5.7	9.4	2.8		**17.9**
Implied allocation of economies of scale	1.7	4.0	3.5		9.2
Interest costs using Shapley Value based allocation	4.4	10.2	3.3		**17.9**
Implied allocation of economies of scale	3.0	3.2	3.0		9.2

Concluding Remarks

Starting from the theoretical foundations of the Shapley Value and the general demonstration of its applicability in the context of economies of scale, this article illustrates the arm's length allocation of resulting synergies in three practical contexts. It shows that Shapley Value generally leads to a different split of synergies than other, most commonly used allocation mechanisms:

- From an economic standpoint, the major arguments for applying the Shapley Value are its capability to take into account the best alternatives available to each entity and to consider the interdependency of contributions of each player in an integrated MNE. Thereby, the Shapley Value simulates the outcome of a negotiation between independent parties in a longer-term cooperative setting.
- Compared to the Shapley Value based allocation, other allocation mechanisms (*i.e.*, key-based or uniform) often fail to take into account the opportunity costs of single entities. Indeed, the obtained sharing of costs and benefits may not always be aligned with the relative contributions of each entity as required by the arm's length principle.
- From a practical standpoint, we think the application of the Shapley Value in the context of economies of scale has the major strength in that it relies only on a minimum number of assumptions. These assumptions are usually readily available in an MNE or can be estimated reliably.

The use of the Shapley Value to share joint costs among contributing parties has been intensively investigated in different fields of management; however, its use in a transfer pricing context is still rare. Given its specific features, the application of the Shapley Value in similar transfer pricing contexts as described in this article can be a powerful mean to determine arm's length cost participations and benefit shares from economies of scale related synergies in accordance with parties' true contributions.

The authors would like to thank Harlow Higinbotham, Emmanuel Llinares and Amanda Pletz for their valuable comments and insights.

Endnotes

[1] OECD, *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*, September 16, 2014, p. 20.

[2] M. Shubik, "Incentives, Decentralized Control, the Assignment of Joint Costs and Internal Pricing," *Management Science*, Vol. 8, No. 3 (1962).

[3] For additional information, *see, e.g.*, E. Friedman and H. Moulin, "Three Methods to Share Joint Costs or Surplus," *Journal of Economic Theory*, Vol. 87 (1999), pp. 275–312.

[4] H. Moulin, *Fair Division and Collective Welfare*, The MIT Press (2004), p. 146.

[5] For a comprehensive introduction to the subject and the practical application in the context of joint value creation of multiple intangibles in a transfer pricing context, *see* article series "Transfer prices determined by game theory" by A. Voegele, S. Gonnet and B. Gottschling, NERA, 2010.

[6] For further reasons and detailed examples, *see, e.g.*, J.M. Perloff and K.T. van 't Veld, *Modern Industrial Organization*, Second Edition, HarperCollins College Publishers (1994), pp. 59ff.

[7] OECD, *supra* note 1, para. 1.99 (pp. 18–19).

[8] See also OECD, *supra* note 1, para. 1.100 (p. 19).

[9] L.S. Shapley, "The Value of an N-Person Game," in *Contributions to the Theory of Games*, edited by H.W. Kuhn and A.W. Tucker, Princeton University Press (1953).

[10] For further information, *see* R.P. Gilles, *The Cooperative Game Theory of Networks and Hierarchies*, Springer-Verlag Berlin Heidelberg (2010), p. 29ff.

[11] While the authors believe that the solutions and results presented in this article based on Shapley Value achieve the stated objective under BEPS, additional work is required to generalize these results and convert them into policy prescriptions.

[12] The illustration of the Shapley Value formula follows Moulin, *supra* note 4.

[13] In the more common surplus-sharing notation, $C(S)$ is often presented as $v(S)$, which describes the total net benefit to the coalition S when those agents cooperate.

[14] OECD, *supra* note 1, para. 1.103 (p. 20).

[15] Despite subadditive costs, the core may be empty. The likelihood of a non-empty core decreases with the significance of economies of scale (*e.g.*, a steeper downward slope of the average cost curve in Figure 1).

[16] In the case at hand, the decision to centralize its functions in the largest entity is driven by operational reasons (*e.g.*, advantage of being close to largest service recipient) and political reasons (*e.g.*, wish to minimize number of relocated staff). Please note that in practice the location of central, shared services centers in the largest entity is often merely the result of the historical development of the Group and less a "conscious/one-time" decision. As

such, in the above example it could also be assumed that the Group under review, which expanded out of its home country France, gradually increased the central staff in France to support its international expansion and now poses itself the question of the arm's length allocation of the underlying cost base.

17 Please note that we assume that the accountants in each sub-coalition would be located in the country with the larger initial accountant's team (again the reasons for the location in these countries are operational and political). Note also that the validity of using Shapley Value to allocate the economies of scale does not change if the location of staff in each sub-coalition would be changed (*i.e.*, if the entire staff would be hosted in the "smaller" country or the location of the staff would be spread across the two countries). In practice, the costs associated to each sub-coalition should be determined based on a realistic assessment of the most likely outcome considering financial, strategic, operational and other management factors impacting the case at hand.

18 Calculated as (rounded values): $(168 + (186 + 140)/2 + 70)/3 = 134$; $(434 + (452 + 280)/2 + 210)/3 = 337$; $(840 + (812 + 686)/2 + 570)/3 = 720$

19 *Supra* note 1.

20 The purchase price grid is based on incremental absolute discounts of 50 for increasingly large intervals of purchased licenses. Intervals grow with 2 percent, starting from the interval between 200 and 400 units. The purchase price function must not necessarily have a concave shape, but may be linear or convex. Similarly, the purchase price function may be continuous.

21 The calculations are performed analogously to the calculations displayed in Table 4.

22 In the above example, a reduction in purchased volumes of Entity A and Entity B to 200 licenses each and an increase in purchased volumes of Entity C to 5,600 (total stays at 6,000) would result in a synergy share for Entity C under the Shapley Value allocation of 62 percent (shares of Entity A and Entity B being equal at 19 percent). This compares to 70 percent for Entity C under an allocation based on a uniform purchase price scenario and a share of 93 percent for Entity C using purchased volumes as an allocation key.

23 Under equal purchase price functions and equal purchasing demands the Shapley Value will lead to the same allocation as a purchase volume based allocation key which will also be in line with the results obtained from using a uniform purchase price (symmetry axiom).

24 OECD, *BEPS Action 4: Interest Deductions and Other Financial Payments* (December 18, 2014 – February 6, 2015), p. 27ff.

25 The interest rates per credit rating in the whole analysis are based on real capital market rates using US industrial bond indices.

26 For detailed information, *see, e.g.*, the special comments of Moody's, Standard & Poor's and Fitch Ratings regarding the rating relation between groups and subsidiaries: Standard & Poor's, "Corporate Criteria--Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link to Parent," October 2004; Moody's Corporate Finance, Special Comment, "Analytical Considerations in Assessing Conglomerates," September 2007; Fitch Ratings, "Parent and Subsidiary Rating Linkage," June 2007.

27 The calculations are performed analogously to the calculations displayed in Table 4.

Topical News Briefing: Tear Down The Barriers!

by the Global Tax Weekly Editorial Team

The unfolding "steel war" between China, the EU, and the US may be dominating the headlines in the mainstream media as far as international trade is concerned. However, other reports point to the world of trade becoming a much more ordered place, with nations more willing to cooperate with one another, and less likely to retaliate against each other.

This hypothesis seems to have been borne out in a recent study by the World Trade Organization (WTO), which found that the number of anti-dumping investigations launched by G20 countries decreased significantly in the period between January and June, 2015, compared with the previous six months. And while the number of new trade restrictive measures didn't go down during the period under review, at least it didn't increase.

Significant progress has also been made recently towards reducing trade taxes and other barriers to trade between key economies: October 2015 saw negotiators reach a final agreement on the text of the expanded Trans-Pacific Partnership (TPP); and later that month the WTO welcomed the receipt of the 50th instrument of acceptance from a member state to bring into force its Trade Facilitation Agreement, which will create binding commitments across all WTO members to expedite the movement, release, and clearance of goods and improve cooperation among WTO members in customs matters.

China is often accused of failing to play by the rules of world trade by using trade policy to achieve domestic economic goals. And it could be argued that until China and other key emerging economies cease "dumping" their products into foreign markets, and raising trade barriers to protect sectors of their own economies, we will never have a truly level and free global trade playing field. That said, China has shown increasing willingness to plug into some important free trade agreements (FTAs), particularly at regional level.

For instance, China, Japan, and South Korea agreed last month to accelerate talks aimed at establishing a tripartite FTA. All three nations are also keen to be on board the Regional Comprehensive Economic Partnership, if and when it materializes. If agreed, this huge free trade area would involve not only the members of the Association of South East Asian Nations (ASEAN, comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), but also ASEAN's six current FTA partners, China, Japan, South Korea, India, Australia, and New Zealand.

More recently, China's President, Xi Jinping, agreed with Singapore's President, Tony Tan, to launch negotiations on an upgrade to the economically significant China–Singapore FTA. And despite China being very conspicuous by its absence from the TPP – an outcome that some analysts conclude was intended by the US, although more on geopolitical than economic grounds – there appears to be some support within China for the country to eventually join this alliance.

Therefore, on balance, if you are a supporter of free trade – as most companies trading cross-border presumably are – perhaps there are more reasons to be optimistic about the future for global trade, rather than pessimistic.

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International Tax Issues In Relation To Cross-Border Investment Funds

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This article will analyze the main international tax issues that arise with regard to cross-border investment funds, such as the entitlement to treaty benefits, the residence for tax purposes and the existence of a permanent establishment in the country in which the investment is made if certain activities are carried out therein. Specific focus shall be dedicated, inter alia, to the international tax issues connected with the provisions of the EU directive on Alternative Investment Funds.

1. Introduction

The lack of legislative cohesion among the EU countries that hinders and limits national and cross-border investment funds has long been discussed. This lack of cohesion can lead to double taxation and characterizes the investment fund market by uncertainty.

In order to facilitate market consolidation, the European Union recently issued the Alternative Investment Fund Manager Directive (the "AIFMD"),[1] which allows Alternative Investment Fund Managers (the "AIFMs") established in Europe to provide their services in the European Union and to market Alternative Investment Funds (the "AIFs") across Europe in compliance with strict regulatory standards. Put briefly, the purpose of the AIFMD is to enhance and facilitate the cross-border investment fund market by introducing a comprehensive and effective regulatory and supervisory framework. By the AIFMD, on a basis of a single authorization (so-called "EU passport regime"), AIFMs may manage and market EU AIFs in member states other than the home member state.

However, while the regulatory aspects have been harmonized, the tax treatment remains unharmonized. Such a situation is highly inefficient and uneconomic as it exposes investment funds to uncertainty and often gives rise to tax litigation.

At present, in the absence of a harmonized tax framework in the world of collective investment and in the absence of specific domestic provisions, the following topical issues which contribute to deterring cross-border investments can be identified:

- Permanent establishment;
- Tax residence;
- Tax treaty entitlement.

2. Permanent Establishment

In general, according to the definition of Article 5 of the OECD Model Convention, a permanent establishment ("PE") may be deemed to exist in two cases:

(i) A fixed place of business through which the business of an enterprise is wholly or partly carried on ("material PE"); or

(ii) When a person (who is not an independent agent) is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise ("agency PE").

According to the OECD Commentary (the "Commentary") on Article 5, paragraph 5 of the OECD Model Convention, a dependent agent is a person having the authority to conclude contracts on behalf of the enterprise, even if those contracts are not actually in the name of the enterprise, being sufficient that such contracts are binding on the enterprise. The Commentary also clarifies that a person who is authorized to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise the authority to conclude contracts even if the contract is signed by another person. Furthermore, according to the Commentary, the mere participation of a person in negotiations is not sufficient *per se* to conclude that an authority to conclude contracts has been exercised, although it can be a relevant factor in determining the exact functions performed by that person.

Pursuant to the Commentary on Article 5, paragraph 6 of the OECD Model Convention, an agent does not constitute a PE of the enterprise on whose behalf he acts only if: (i) he is independent of the enterprise both legally and economically; and (ii) he acts in the ordinary course of business when acting on behalf of the enterprise. Moreover, the Commentary on Article 5, paragraph 6 of the OECD Model Convention mentions several features to be considered in determining whether an agent qualifies as independent:

- The agent bears the entrepreneurial risk;
- The agent is not subject to detailed instructions from the principal;
- The provision of substantial information is not a sufficient criterion to determine that an agent is independent unless such information is provided in the course of seeking approval from the principal for the manner in which the business is to be conducted;
- Number of principals represented by the agent;
- A person is not acting in the ordinary course of its business if the activities performed belong to the sphere of the principal rather than that of their own business.

Having said that, in general terms, with specific reference to cross-border investment funds, it should be noted that the activities of the fund manager or of an agent (advisor) of the fund manager in the country in which the investment is made could, under certain circumstances, give rise to a PE of the fund or the investors.

As a consequence, the typical income realized by cross-border investment funds (dividends, interest and capital gains) would be taxed in the state in which the investment is made according to the same rules as for resident companies. Therefore, a double taxation may arise if such income is then taxable at the level of the fund or the investors.

A very relevant contribution to such aspects derives from the *Report of the Expert Group on removing tax obstacles to cross-border Venture Capital Investment* issued on April 30, 2010 (the "Report of the Expert Group"), which made concrete and detailed proposals on the issue.[2] In particular, the report aims at identifying cases of double taxation and tax obstacles and considers possible solutions to them.

As noted in the Report of the Expert Group, one of the main concerns of fund managers when managing a cross-border investment fund is to ensure that its activities (or those of an advisor) do not create a PE for the fund or the investors in order to prevent double taxation. In particular, it is noted that there is no general public acceptance that the activities of the fund manager would constitute an "independent" agency.

In the absence of specific indications from the tax authorities, the fund manager typically uses an advisory company in the country of the investment, whose activities are generally limited to advisory services. In particular, advisory companies would not be granted authority to conclude contracts and their participation in negotiations would be subject to detailed reporting to the fund manager that would be solely responsible for approval and decisions. In light of the PE uncertainty, in fact, the managerial authority is reserved to and exercised by the fund manager. This practice gives rise to process inefficiency and higher costs, thereby leading to lower returns.

According to the Report of the Expert Group, the optimum solution would be to obtain the recognition from the local tax authorities that the activities carried out by a fund manager can be classified as activities of an independent agent with regard to the fund and the investors and therefore as non-constituting a PE of the fund or its investors in the country where it carries out its management functions. In this respect, the key factors to support such treatment are that the fund manager:

- Is acting in the ordinary course of its business making use of special skills;
- Is remunerated on an arms' length basis for its services;
- Is not subject to detailed instructions from the investors;
- Bears the risk of its business activity.

Provided that the fund manager satisfies the above-listed criteria, the state in which the investment is made should agree that the activities of the fund manager do not create a PE of the fund or the investors in its jurisdiction. Such state would still retain full taxing rights over any income/gains arising to the fund in its jurisdiction under its domestic legislation and any applicable tax treaty. Moreover, the fund manager should receive and be subject to tax in the state of the investment in which it has a presence on an arms' length level of fees remunerating the services provided there.

As is common knowledge, on November 2012, the OECD published the Base Erosion and Profit Shifting Report (BEPS) so as to approach base erosion and profit shifting as a global comprehensive issue. Following BEPS, Action Plans have been issued to provide countries with instruments aimed at identifying concrete solutions. For present purposes, on October 31, 2014, the OECD released the discussion draft on *Preventing the artificial avoidance of PE status* – BEPS Action 7. In general terms, the discussion draft clarified the need to change the definition of agency PE in order to avoid that *commissionaire* structures and similar arrangements were put in place to erode the taxable base of the State where sales/investments took place. It is clear that such amendments could affect alternative funds/private equity funds which operate through advisory entities in the country in which the investment is made.

3. Tax Residence

An issue of great importance concerning cross-border investment funds is the tax residence of the fund and the corporate vehicles used in cross-border investment structures.

It is to be noted that each country has its own criteria to determine whether an entity is resident in its territory for tax purposes, and these criteria may differ from country to country (*e.g.*, country A may adopt the criterion of registration while country B may adopt the criterion of the place of effective management). As a result, an entity can be considered a resident of two countries under the respective domestic rules leading to a conflict of residence.

According to Article 4, paragraph 3 of the OECD Model Convention, in case of conflict of residence, the entity shall be deemed to be a resident only of the state in which its place of effective management is situated. Therefore, the place of effective management is the key criterion to resolve conflict of residence under the tax treaties.

With reference to cross-border funds, whether the cross-border investment activity meets the residence criteria provided in the country where the investment is made, thereby determining the residence of the fund or the controlled vehicles in that country, needs to be investigated. In particular, the activity carried out in the country where the investment is made could qualify the investment fund as a resident of such country according to its domestic rules. The conflict of residence could be resolved by applying the criterion of the place of effective management if a tax treaty is in force. In particular, it should be verified whether the activity of the fund manager carried out where the investment is made meet the place of effective management criteria (*e.g.*, the criteria is met if the decisions in relation to the investment are taken in the country where the investment is made).

The issue has become more delicate following the implementation of the AIFMD. The most relevant purpose of the AIFMD is to allow an AIFM based in an EU member state to manage an AIF in another EU member state. Such an event could have certain tax implications. In particular, an AIF located in country A managed by an AIFM resident in country B could qualify as a resident also in country B by the virtue of effective management exercised in country B.

This conflict of residence could be resolved by coordinating tax issues relating to cross-border AIFs with regulatory aspects. Therefore, an AIFM that manages an AIF in a country other than the country in which the AIFM is resident would not qualify the AIF as resident in the country in which the investment is made.[3] It is to be noted that as part of the AIFMD implementation into domestic laws, certain countries have already provided for specific preliminary provisions for investment funds.[4] In particular, the Dutch legislator amended the residency principles by introducing a tie-breaker rule in Article 4(5) of the General Tax Act providing for a specific exemption for AIFs considering them to be resident only in the State of origin (where the AIF has a license or has given notification); the Luxemburg legislator amended its Law issued on 4 December 1967, by introducing Article 214 which provides for a specific exemption for AIFs established abroad, but having the place of effective management in Luxemburg; on September 27, 2012 the French tax authorities sent a letter to the French Private Equity Association "AFIC" (*Association Française des Investisseurs pour la Croissance*) stating that: (i) the management from France of an AIF constituted abroad does not imply that the AIF is carrying out a business activity in France for the purposes of the French tax code and (ii) the cross-border management of a foreign AIF with a French AIFM does not therefore lead to taxation of gains of the AIF in France; in the Circular Letter No. 21/E issued on July 1, 2014, the Italian tax authorities clarified that, as a general principle, the tax residence of an undertaking for the collective investment should be identified in the place in which the AIF is established without taking into account the place in which the AIFM is established.

4. Tax Treaty Entitlement

Whether a "person" qualifies as a treaty subject depends on whether or not it is considered as a "person resident of a Contracting State" for the purposes of the OECD Model Convention.

According to Article 1, paragraph 1 of the OECD Model Convention, in order to be eligible for treaty benefits, a "person" shall be a resident of one or both Contracting States. The term "resident" is defined in Article 4 of the OECD Model Convention. In particular, "a resident of a Contracting State" means any person who, under the domestic laws, is "liable to tax." The Commentary on Article 4 clarifies that many States qualify a person as liable to tax even if the Contracting State does not in fact impose tax (*e.g.*, pension funds or charities which are exempt if they meet certain requirements specified in the law otherwise, they are also required to pay tax). Thus, they are liable to tax according to the law of the Contracting State. In contrast with such view, other States adopt a different approach, considering these entities as not liable to tax if they are exempt from tax under domestic tax laws. In the latter case, the entity would not be considered as liable to tax unless such entities are expressly covered by the OECD Model Convention (and by the relevant tax treaty).

Additionally, the application of the OECD Model Convention also depends on the tax transparency approach. The OECD analyzed the consequences in the application of the tax treaty benefits to transparent entities in the report *The application of the OECD Model tax Convention to partnership* issued in 1999 (the "OECD Partnership Report").[5] In particular, where a partnership is treated as fiscally transparent in a State, the entity is not liable to tax therein and so it cannot qualify as a resident for the purposes of the OECD Model Convention. In such a case, the application of the OECD Model Convention could be granted for partners of such an entity with respect to the extent that the partnership's income is allocated to them for the purpose of taxation in their State of residence. However, where a partnership is treated as a tax-opaque entity, whether or not there is actual tax liability needs to be investigated. Should the entity be qualified as a company or taxed in the same way (even if it benefits from a reduced tax base/rate), the entity is deemed to be a resident of a Contracting State and therefore entitled to the benefits of the Convention. Should the entity not qualify as having a tax liability, the treaty benefits could be denied.

With reference to investment funds, it is to be noted that the majority of tax treaties do not have provisions expressly dealing with funds.[6] Therefore, in order to determine whether an investment fund is entitled to tax treaty benefits it is to be investigated as whether the "liable to tax" criterion is met in domestic countries. First, it is to be noted that the tax classification and tax treatment of the funds varies within the European Union (an investment fund can be qualified as tax transparent or tax opaque, subject to tax or not subject to tax, resident or not resident). Moreover, being involved in three countries, it is very likely that in a cross-border investment fund market a potential double taxation (or non-taxation) may arise. In particular, double taxation may arise if one State considers the investment fund as non-transparent while the other State considers it as transparent, taxing individual investors instead. Moreover, the first State will attribute income and gains to the fund and the fund would be entitled to the tax treaty benefits, while the other State will attribute the income to the investors and would deny the treaty benefits to the fund, applying them to the investors instead. In order to avoid uncertainty, legal entities (such as holding companies) may be used, thus leading to an increase in the costs of the structure.

It is to be stressed that the OECD considered the issue of tax treaty entitlement with respect to collective investment vehicles ("CIVs") and summarized the outcome of the analysis in the report *The Granting of Treaty Benefits with respect to the income of Collective Investment Vehicles* (the "OECD

CIV Report") issued on April 23, 2010.[7] In particular, the OECD CIV Report analyzed the ability of CIVs to access to treaty benefits, investigating how a CIV can claim the benefits of tax treaties on its own behalf. The OECD CIV Report noted that whether a CIV is a "resident" of a Contracting State depends on its tax treatment in the State in which is established. Furthermore, it noted that the tax qualification of CIVs varies from country to country, being considered in some states as fiscally transparent or as a separate taxable entity. Therefore, in States which qualify a person as liable to tax even if the Contracting State does not in fact impose tax or if the person benefits from a reduced tax base/rate, the CIV would be treated as a resident of such States. In contrast, in those States that adopt the alternative approach, according to which a person that is exempt from tax is not liable to tax, may not qualify CIVs as residents of the States in which are established. In such cases, the OECD CIV Report suggested to highlight the issue in the bilateral negotiations. In the light of such analysis, the OECD CIV Report suggested changes to the Commentary, which have been incorporated in the 2010 update to the Commentary on Article 1 (paragraphs 6.8 to 6.34).[8]

Following the OECD CIV Report, the work on CIVs was carried on by The Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors, which issued the *Report of the Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors: Implementation Package (the public discussion draft)* in which are drafted a number of model mutual agreements on CIVs to be used by states to allow CIVs to claim tax treaty benefits with respect to income arising in the other Contracting State. Three variations of model mutual agreements are drafted in order to provide alternative wording depending on whether the agreements are bilateral or multilateral and whether they provide benefits with respect to residents of the State in which the CIV is established, or with respect also to equivalent beneficiaries (an owner of a beneficial interest in the CIV) in third states.[9]

Another highly relevant contribution to such aspects derives from the above-mentioned Report of the Expert Group. In particular, it indicates that the optimum solution would be the acceptance by all states of the tax treatment of an investment fund in its state of establishment (*i.e.*, its treatment for tax purposes as transparent/non-transparent, resident/non-resident, subject to tax/not subject to tax, trading/non-trading). Furthermore, according to the Report of the Expert Group such mutual recognition should also be implemented in domestic tax laws. The Report of the Expert Group noted that the principal of mutual recognition is not applied by EU member states and the tax treaties do not include any provisions in this regard. Therefore, it suggests including such a concept in an EU Directive.

If a mutual recognition cannot be achieved, as an alternative solution, the Report of the Expert Group proposed that EU member states could agree on certain common classification of some specific legal forms used for investment funds (either transparent or non-transparent) issuing a list of such vehicles (on the lines of the list of companies contained in the EU Parent-Subsidiary Directive).

Following on from BEPS, on November 21, 2014 the OECD released a discussion draft reporting the *Follow up work on BEPS Action 6*. With reference to private equity funds, the OECD noted that alternative funds/private equity funds generally do not meet the conditions provided for CIV funds as they typically have a limited number of institutional investors, may not hold a diverse portfolio, and are not subject to the same investor-protection regulation. However, the OECD noted that under the LOB provision, issues related to the treaty entitlement of CIV funds may also be encountered by private equity funds. Therefore, the discussion draft, as currently formulated, seems to lead to a restriction of tax treaty benefits in respect of private equity funds which will not be able to fully enjoy the above benefits, with the consequent risk of double taxation in the hands of the investors.

5. Conclusion

The economic influence of investment funds is undisputable. However, cross-border investments are not meeting their potential due to a lack of cohesion in the tax laws of the EU countries, which restrict rather than expand investments. The AIFMD aims at addressing regulatory aspects through the introduction of tightened provisions without harmonizing and coordinating the relevant tax provisions of EU member states. Therefore, double taxation and tax treatment uncertainties still represent tax barriers that characterize cross-border investments.

In the current economic climate, fundraising and investing across borders should be incentivized, even in a tax perspective which needs a positive integration. Therefore, the action at EU level should be also aimed at consolidating both regulatory and tax laws in line with the OECD and doctrine's recommendations in order to avoid the above-mentioned possible tax distortions.

Endnotes

1 Directive 2011/61/EU of the European Parliament and of the Council of June 8, 2011.

2 For a comment, *see* B. Terra and J. Kajus, *Questions and Answers on Removing Tax Obstacles to Cross-Border Venture Capital*, EVD News, May 10, 2010.

3 According to P. Borsjé and W. Specken, "Tax Implication of the Amended UCITS and the AIFM Directives: A General Overview from a Dutch Perspective," in *Derivatives & Financial Instruments*, July/August 2012: "some EU Member States have taken the initiative to provide for a legislative amendment to establish that the place of effective management doctrine does not apply to UCITS." According to the author, such initiative shall be implemented also to AIFs.

4 For a comment of how EU countries have implemented AIFMD, *see* M.J. Peters, "AIFM Directive and Tax Issues," in *Derivatives & Financial Instruments*, November/December 2012; H. Vermeulen and J.H. Elink Schuurman, "Netherlands, The implementation of the AIFMD in Dutch Tax Law," in *Derivatives & Financial Instruments*, May 2014; J. Grabbe, M. Simonis and

S. Behrens, "Draft Legislation Amending Germany's Investment Tax Law in Line with the AIFM Directive," in *Derivatives & Financial Instruments*, May/June 2013; P. Eckl, "The Proposed Draft AIFM Implementation Tax Act," in *European Taxation*, February/March 2013; G. Scardoni and S. Baranger, "Modernization of the Luxembourg Partnership: Luxembourg's Completion of Its Arsenal of Investment Vehicles," in *European Taxation*, December 2012; J. Afakir and P. Dukmedjian, "Implementation of the Alternative Investment Fund Managers Directive (2011/61) into Luxembourg Law: A Full Legal and Tax Beneficial Package," in *Bull. Intl. Taxn.* (2013).

5 For a comment, *see* J. Barenfeld, *Taxation of Cross-Border Partnerships* (2005).

6 As an exception, *see*, *inter alia*, United States–Ireland tax treaty (Art. 4, para. 1, lett. d).

7 According to the OECD CIV Report, the term "CIV" is limited to funds that are widely held, hold a diversified portfolio of securities, and are subject to investor-protection regulation in the country in which they are established. For an analysis of the document, *see* D. Langkemper, "OECD Report on the Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles," in *Derivatives & Financial Instruments*, September/October 2010; B. da Silva, "Granting Tax Treaty Benefits to Collective Investment Vehicles: A Review of the OECD Report and the 2010 Amendments to the Model Tax Convention," 39 Intertax.

8 As a result of the amendments, the following countries, among others, amended their tax treaties: additional protocol to the Germany–Ireland tax treaty (as in force from January 1, 2013); additional protocol to Germany–Luxembourg tax treaty (as in force from January 1, 2014); additional protocol to Liechtenstein–United Kingdom tax treaty (as in force from April 6, 2013); additional protocol to the Belgium–Mexico tax treaty (not yet in force).

9 For an analysis, *see* N. Johnston, "Collective Investment Vehicles," in *Bulletin for International Taxation*, July 2012.

The Low-Down On The Common Reporting Standard

by Stuart Gray, Senior Editor, Global Tax Weekly

Few will have heard of the Common Reporting Standard (CRS). Yet it is a major development in the area of international tax compliance, and with almost 100 jurisdictions having committed to implement it, this tax information exchange program could potentially affect millions of taxpayers without their knowledge. The key points of the new standard are summarized here.

Introduction

Traditionally, information about an individual or business has been sent from one tax authority to another on request, based on evidence that tax fraud or some other crime had taken place. However, countries that have committed to the CRS will exchange information "automatically," representing something of a step change in international tax enforcement.

In some ways, the automatic exchange of information for the purposes of enforcing national tax laws is not new. The EU could be said to have led the way in 2005, when the Savings Tax Directive came into force. More recently, the US unleashed the Foreign Account Tax Compliance Act (FATCA) on the world, representing the first global program for the automatic exchange of individual financial account information for tax purposes.

In fact, FATCA was the inspiration behind the OECD's CRS – hence, the CRS has acquired the moniker "GATCA."

While the CRS sounds like a fresh initiative, and is a major breakthrough for the OECD in its fight against tax evasion, it uses existing information exchange protocols as its legal basis, namely the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[1] Thus, by joining the recently formulated Multilateral Competent Authority Agreement (MCAA) under Article 6 of the Convention, jurisdictions commit to automatically exchange tax information with other nations' tax authorities.

This method was chosen for the CRS as it is seen to be the most efficient way to facilitate global exchange of information, rather than using the existing framework of information exchange provisions contained in double tax avoidance agreements, tax information exchange agreements, and other bilateral and multilateral tax agreements.

As the introduction to the Standard for Automatic Exchange of Financial Account Information states: "The advantage of standardization is process simplification, higher effectiveness, and lower costs for all stakeholders concerned. A proliferation of different and inconsistent models would potentially impose significant costs on both government and business to collect the necessary information and operate the different models. It could lead to a fragmentation of standards, which may introduce conflicting requirements, further increasing the costs of compliance and reducing effectiveness. Finally, because tax evasion is a global issue, the model needs to have a global reach so that it addresses the issue of offshore tax evasion and does not merely relocate the problem rather than solving it."[2]

Therefore, the Multilateral Convention was chosen as the vehicle for the CRS because it provides for all forms of administrative cooperation, contains strict rules on confidentiality and proper use of information, and permits automatic exchange of information. Another of its advantages is that it has global reach. Nevertheless, while the CRS is a multilateral agreement, information exchange will still take place bilaterally.

A Brief History Of The CRS

Against a backdrop of rising public anger about tax avoidance and evasion, G20 finance ministers endorsed automatic exchange as the new tax transparency standard on April 19, 2013. In June that year, the G8 welcomed the OECD Secretary General report as "a step change in tax transparency"[3] which set out the concrete steps that needed to be undertaken to put a global model of automatic exchange in practice. This report states:

> "Vast amounts of money are kept offshore and go untaxed to the extent that taxpayers fail to comply with tax obligations in their home jurisdictions. Jurisdictions around the world, small and large, developing and developed, OECD and non-OECD, stand united in calling for further action to address the issues of international tax avoidance and evasion.
>
> And change is taking place. A major breakthrough towards more transparency was accomplished in 2009 with information exchange upon request becoming the international standard and the restructured Global Forum on Exchange of Information and Transparency for Tax Purposes starting to monitor the implementation of the standard through peer reviews.
>
> Now, there is another step change in international tax transparency driven by developments around the globe, including in the United States and Europe, with unprecedented political support for automatic exchange of information. In April 2013 the G20 Finance Ministers and Central Bank Governors endorsed automatic exchange as the expected new standard."

The report analyzed how jurisdictions could build on the recent developments to implement automatic exchange in a multilateral context, and it set out the key success factors for an effective model for automatic exchange. Four concrete steps were proposed:

- Enacting broad framework legislation to facilitate the expansion of a country's network of partner jurisdictions;
- Selecting (or where necessary entering into) a legal basis for the exchange of information;
- Adapting the scope of reporting and due diligence requirements and coordinating guidance; and
- Developing common or compatible IT standards.

The report goes on to state:

> "With more and more jurisdictions joining the Convention on Mutual Administrative Assistance in Tax Matters, there exists a clear legal basis for comprehensive automatic exchange with strict safeguards protecting confidentiality. Bilateral tax treaties also provide such a legal basis, and within the European Union, directives provide a specific legal framework for automatic exchange of information regarding interest income and certain other types of income between its [28] members. This report notes that a global solution also means a global standard to minimize costs for businesses and governments, while at the same time enhancing effectiveness, maintaining confidence in open markets, and best serving society at large. A proliferation of inconsistent models is in nobody's interest."

The G20 leaders committed to automatic exchange of information as the new global standard in September 2013, and on February 23, 2014, the group's finance ministers endorsed the CRS as the standard for automatic exchange of tax information. In May 2014, the OECD Declaration on Automatic Exchange of Information in Tax Matters was rubber-stamped by all 34 member countries along with several non-member countries. More than 65 jurisdictions publicly committed to implementation, with more than 40 having committed to a specific and ambitious timetable leading to the first automatic information exchanges in 2017 (known as "early adopters").

The OECD released the full version of the Standard for Automatic Exchange of Financial Account Information in Tax Matters on July 21, 2014. This calls on governments to obtain detailed account information from their financial institutions and exchange that information automatically with other jurisdictions on an annual basis. The standard was approved by the OECD Council on July 15, 2014.

On September 22, 2014, the Global Forum on Transparency and Exchange of Information for Tax Purposes delivered a Roadmap to the G20 Development Working Group to develop country participation in the new OECD Standard on the automatic exchange of financial account information. This Roadmap is part of the efforts to curb multinational tax avoidance and offshore tax evasion in developing countries.

The Standard And The Model Competent Authority Agreement

The standard consists of two components: the CRS, which describes the due diligence procedures that must be followed by financial institutions to identify reportable accounts; and the Model Competent Authority Agreement (CAA), which contains the detailed rules on the exchange of information. The CRS will need to be translated into domestic law, whereas the CAA can be executed within existing legal frameworks such as Article 6 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters or the equivalent of Article 26 in a bilateral tax treaty.

The Model CAA consists of a number of whereas clauses and seven sections, and provides for the modalities of the exchange. The 'whereas clauses' contain representations on domestic reporting and due diligence rules, confidentiality, safeguards, and the existence of the necessary infrastructure for an effective exchange relationship. The Model CAA also covers the type of information to be exchanged, and the time and manner of exchange.

The CRS shares certain technical similarities with FATCA, but there are some key differences, mainly that US-specific rules have been removed from the CRS. For instance, FATCA is based on US citizenship, a concept fundamental to the US tax system, whereas the CRS is based on residence. Also, unlike FATCA, the CRS does not provide for thresholds for pre-existing individual accounts, but it includes a residence address test, building on the EU Savings Directive. Additionally, the CRS has special rules dealing with certain investment entities where they are based in jurisdictions that do not participate in automatic exchange under the standard.

The standard calls for the technical reporting format to be standardized so that information can be captured, exchanged, and processed "quickly and efficiently in a cost effective manner and secure and compatible methods of transmission and encryption of data must be in place."

Information Exchange

Under the standard, jurisdictions obtain financial information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. This information will cover various categories of income and/or assets.

The CRS has broad scope to limit opportunities for taxpayers to circumvent the model by shifting assets to places that it can't reach. As such, the financial information to be reported with respect to reportable accounts includes interest, dividends, account balances, income from certain insurance products, sales proceeds from financial assets, and other income generated with respect to assets held in the account, or payments made with respect to the account. Reportable accounts include accounts held by individuals and entities (including trusts and foundations), and the standard includes a requirement that financial institutions "look through" passive entities to report on the relevant controlling persons.

The financial institutions covered by the standard include custodial institutions, depository institutions, investment entities, and specified insurance companies, unless they present a low risk of being used for evading tax and are excluded from reporting.

The specific information to be exchanged by financial institutions includes the following:

- The name, address, tax identification number (TIN), and date and place of birth (in the case of an individual) of each reportable person and, in the case of any entity that is an account holder and that, after application of due diligence procedures is identified as having one or more controlling persons that is a reportable person, the name, address, and TIN of the entity, and the name, address, TIN, and date and place of birth of each reportable person;
- The account number (or functional equivalent in the absence of an account number);
- The name and identifying number (if any) of the reporting financial institution;
- The account balance or value (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year or period, the closure of the account;
- In the case of any custodial account:
  - The total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and
  - The total gross proceeds from the sale or redemption of property paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution acted as a custodian, broker, nominee, or otherwise as an agent for the account holder;
- In the case of any depository account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period; and
- In the case of any account not described in the sections covering custodial or depository accounts, the total gross amount paid or credited to the account holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution is the obligor or debtor, including the aggregate amount of any redemption payments made to the account holder during the calendar year or other appropriate reporting period.

Confidentiality Concerns

Naturally, given the potentially huge amount of sensitive personal information that is about to be transmitted around the world, concerns about privacy are running high. The OECD has given its assurances that the standard contains specific rules on the confidentiality of the information exchanged and that the underlying international legal exchange instruments already contain safeguards in this regard. Where these standards are not met (whether in law or in practice), countries will not exchange information automatically. However, as the list of data breaches against major public and private sector organizations seems to grow by the week, the OECD's assurances in this regard have not convinced all, especially as so many agencies will be involved in the transmission and receipt of the relevant information when the CRS is rolled out globally.

Conclusion

Despite the scale of the task and the concerns surrounding privacy, the OECD and about half of the world's governments remain undaunted. At the meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes in Barbados on October 27–28, the number of jurisdictions that have committed to automatically exchange information under the CRS grew to 96, and it is envisaged that the first automatic information exchanges under the CRS will begin, for some territories, in 2017.

Still, like all the best-laid plans, not everything is likely to run smoothly. It is stated in the preface to the standard that, before entering into a reciprocal agreement to exchange information automatically with another country, "it is essential that the receiving country has the legal framework and administrative capacity and processes in place to ensure the confidentiality of the information received and that such information is only used for the purposes specified in the instrument." However, the OECD itself admits that the current timetable for the CRS to become operative is "ambitious."

Many countries, especially in the developing world, do not currently have the administrative and technical mechanisms in place to meet the standard, or the resources to build them, which could hinder the effectiveness of the new standard without considerable extra investment by richer nations. What's more, while countries routinely exchange information with each other via bilateral and other agreements, there is no precedent for an automatic information exchange mechanism on a global scale, apart from FATCA of course. But even FATCA is in its infancy, and it will probably take many years before its performance can be assessed. However, despite the misgivings, the OECD and the G20 have firmly nailed their colors to the mast of automatic exchange of information, and it will take a considerable setback to disrupt the consensus.

Endnotes

1 http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters_9789264115606-en#page1

2 http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf

3 http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf

The Government Giveth, The Government Taketh Away: Proposed Regulations Would Tax Outbound Transfers Of Goodwill And Going Concern Value

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Introduction

On September 14, 2015, the Department of the Treasury and the Internal Revenue Service released proposed regulations under Section 367 that would dramatically change the treatment of goodwill and going concern value transferred by a US person to a foreign corporation in what would otherwise be a tax-free transaction in a purely domestic context. If finalized as proposed, the regulations would be effective (retroactively) for transfers occurring on or after September 14.

Under existing Section 367 regulations, the transfer of goodwill and going concern value to a foreign corporation can qualify for non-recognition of gain or loss if it is transferred for use in the active conduct of a trade or business outside the United States. Under the proposed regulations, the outbound transfer of goodwill and going concern value would no longer qualify for non-recognition of gain.

The proposed change reflects the Obama administration's views on the proper policies for Section 367, but is diametrically opposed to the policy views of Congress expressed in the legislative history to Section 367. Because of this conflict with legislative intent, there is reason to believe that if they are finalized as proposed, the regulations may be determined to be invalid if challenged in court (*i.e.*, a *Chevron* analysis).

The proposed regulations present difficult choices for taxpayers now considering the incorporation of foreign operations that are now conducted in pass-through (*i.e.*, branch or partnership) format; and they may change the calculus for taxpayers contemplating the choice of entity for start-up operations outside the US.

US tax law contains certain non-recognition rules that generally permit the transfer of property to a corporation on a tax-free (actually tax-deferred) basis in connection with the formation or reorganization of a corporation. Code Section 367 provides a set of rules that override non-recognition treatment, to some extent, where the transferor is a US person and the transferee is a foreign corporation (so-called "outbound transfers").

Ever since its enactment in 1976, Section 367 has been interpreted to permit the tax-free transfer of goodwill and going concern value to a foreign corporation for use in the active conduct of a trade or business outside the United States. The Obama administration has made no secret of the fact that it disagrees with the policy views of Congress regarding the favorable treatment of goodwill and going concern value, as expressed in the legislative history to Section 367. The administration's budget proposals to Congress have consistently called for the elimination of that favorable treatment of goodwill and going concern value, citing the present treatment as a source of abuse of the US tax system. Apparently unwilling to wait any longer for Congress to act, the administration has taken it upon itself to make this change.

Under the proposed regulations, taxpayers would have two options for the treatment of outbound transfers of goodwill and going concern value:

1. They could opt for immediate recognition of gain under Section 367(a); or
2. They could treat goodwill and going concern value as being subject to the rules for intangible property covered in Section 367(d). Under Section 367(d), a US taxpayer who contributes intangible property to a foreign corporation is treated as though it sold the intangible to the foreign corporation for a stream of contingent payments over the useful life of the intangible, with the hypothetical contingent amounts being "commensurate with the income attributable to the intangible."

In addition to making outbound transfers of goodwill and going concern value ineligible for non-recognition treatment, the proposed regulations would also eliminate a rule in the existing regulations that limits the useful life of intangible property to 20 years for purposes of Section 367(d). As a result of that change, the hypothetical contingent payments created by Section 367(d) would continue on for the entire period during which the exploitation of the intangible property was reasonably anticipated to occur, as of the time of the outbound transfer (which could be far longer than 20 years).

These proposed regulations come on the heels of Notice 2015-54, issued on August 6, indicating that the Treasury and the Internal Revenue Service (IRS) will be issuing regulations, based on similar policy concerns, that will reduce the possibilities for non-recognition treatment of transfers of property to partnerships that have foreign partners.[1]

Alvarez & Marsal Taxand Says:

Taxpayers considering a transfer of business operations to a foreign corporation (either an actual transfer or a deemed transfer resulting from an entity classification election) will need to make a decision as to the likelihood that the proposed regulations will be finalized in their present form and, if so, whether they are likely to withstand a challenge in court. For public companies, this will be a difficult issue to address for FIN 48 purposes and any required disclosures in the Schedule UTPs (Uncertain Tax Positions).

Assuming that the proposed regulations take (and remain in) effect, they may make it undesirable to transfer operations to a foreign corporation. Alternatively, if the taxpayer decides to proceed with an outbound transfer, it will need to decide whether to elect immediate gain recognition under Section 367(a) or deferred/periodic gain recognition under Section 367(d) for goodwill and going concern value. For many taxpayers, the latter choice is likely to be more desirable. But for some, who may have expiring tax credits, the option of immediate gain recognition may represent a tax planning opportunity.

To make informed choices as to whether to transfer operations to a foreign corporation and whether to elect immediate or deferred/periodic gain recognition for goodwill and going concern value, the prudent thing would be to model out the projected after-tax consequences of those decisions.

For new foreign operations, the proposed regulations will tend to make it more desirable to operate through a foreign corporation from inception, rather than through a branch of a US corporation with the possibility of incorporating a foreign subsidiary later.

Alvarez & Marsal Taxand is planning a webinar on the proposed regulations and their tax planning implications at or near the end of the comment period (December 15, 2015).

Endnotes

1 For more on this subject, *see Tax Advisor Weekly*, Issue 32, https://www.alvarezandmarsal.com/and-then-there-were-two-one-less-way-efficiently-migrate-ip-offshore-impact-notice-2015-54-ip (September 29, 2015).

Topical News Briefing: Consumed By VAT

by the Global Tax Weekly Editorial Team

The International VAT/GST Guidelines endorsed by more than 100 countries and territories on November 6 seek to establish a "coherent and efficient" framework for the application of consumption tax on international trade. However, as with the wider BEPS project, coherence in this area is proving difficult to achieve.

The main thrust of the OECD's Guidelines is that electronic services provided by suppliers to consumers located in other jurisdictions should be taxed under the VAT laws in the destination country so as to level the playing field with local suppliers. However, it is an idea that some governments have already put into practice.

South Africa led the way when it implemented legislation in June 2014 that requires VAT to be levied on certain electronic services supplied by foreign companies to South African consumers in the location of the consumer.

A major development in this area took place when the European VAT law changed on January 1, 2015, so that business-to-consumer (B2C) supplies of telecommunications, broadcasting and electronic (TBE) services were taxed at the point of consumption rather than the point of supply.

South Korea has also introduced VAT on foreign operators' supplies of electronic services, a measure which was effective from July 1, 2015. The change means that services supplied from abroad via ICT networks, including game files, voice files, video files, electronic documents, and software, must register for and charge VAT in South Korea.

Other countries are well on the way to introducing similar measures. In Australia, the Government is finalizing draft legislation to apply goods and services tax to currently untaxed cross-border supplies of digital products and services imported by consumers from July 1, 2017.

Israel's tax authority also said recently that it is considering changing the way that digital firms are taxed, and has indicated that companies that do considerable business in Israel will be required to register and account for VAT, regardless of whether they have physical operations in the country.

Certainly, the list of countries that have made changes to their VAT place of supply rules, or are considering such measures, is still quite small. But in a sense this is beside the point. For what the recent developments at jurisdictional level do demonstrate is that for companies operating predominately in the digital realm, the world of taxation is changing rapidly, and the penalties for those companies transgressing national VAT laws, innocently or otherwise, can be severe. So corporate tax planning is not the only area that multinational entities should approach with a degree of caution anymore.

Nevertheless, perhaps there are some positives to take from this rapidly changing tax environment for taxpayers. If nothing else, we get to observe how the new place of supply rules work in practice in the few countries that have moved early on this issue. And perhaps the early conclusion to be drawn from the changes is that they will need refining, possibly over a period of years, before they are really workable.

In its observations on the workings of South Africa's "digital tax" earlier this year, PwC said that "still many suppliers remain outside the scope of South African VAT" and that further work needs to be done to ensure foreign suppliers operating in the South African market place are taxed in line with local businesses. "Furthermore the legislation is, in some instances, not clear, and opportunities exist for National Treasury to strengthen the effectiveness of the law," observed Charles de Wet, Head of Indirect Tax, PwC Africa.

However, it is the EU that is probably the biggest laboratory for these sorts of changes, and early indications show that the new place of supply rules for TBE services and the VAT mini one-stop-shop scheme established to simplify compliance with the new rules are not operating smoothly. Indeed, anecdotal evidence suggests that small businesses in particular have been hit hard by the requirement to effectively account for VAT in up to 28 member states, with many small traders having already gone to the wall or simply given up selling their services to other member states altogether to avoid being entangled in a VAT spider web.

In releasing its new international VAT Guidelines, the OECD acknowledged the importance of the digital economy, noting that, according to estimates, B2C e-commerce sales exceeded USD1.4 trillion in 2014, and are set to reach USD2.4 trillion by 2018. With the average OECD VAT rate at 19.1 percent (2014), this potentially represents a consumption tax windfall for governments running into the tens of billions. But a new international VAT framework that threatens to stifle e-commerce, which may already be happening in the EU, is ultimately going to benefit nobody. Governments will therefore have to approach such changes with caution, although whether they do so remains to be seen.

G20 States Launching Fewer Anti-Dumping Probes

The number of anti-dumping investigations launched by G20 countries decreased significantly in the period between January and June 2015 compared with the previous six months, according to a new World Trade Organization (WTO) report.

G20 members launched 78 anti-dumping investigations, compared with 115 in the prior six months, according to the WTO's latest *Report on G20 Trade Measures*.

New anti-dumping investigations during July 2014 to June 2015 declined by about 20 percent year-on-year, the WTO said. The number of investigations launched by Argentina, Australia, Brazil, the Republic of Korea, and the US significantly decreased, while the number of investigations started by the EU, India, Mexico, and Turkey increased.

The report also noted that the number of trade-restrictive measures in place in G20 nations remained unchanged between mid-May and mid-October 2015. In this period, G20 economies introduced 86 new trade-restrictive measures. This equates to an average of just over 17 new measures per month, the same as in the previous reporting period (mid-October 2014 to mid-May 2015).

However, because countries have removed these measures at a slower rate, the overall stockpile of restrictive measures grew. Of the 1,441 trade-restrictive measures introduced by G20 economies since 2008 and recorded by the WTO, only 354 had been removed by mid-October 2015; 1,087 trade restrictive measures remained in place, up 5 percent compared with the last report.

The report also found that, during the reporting period, a total of 62 measures aimed at facilitating trade were implemented – a monthly average of 12 measures and the fewest since November 2013.

President Obama Gives TPP Notice To Congress

US President Barack Obama notified US Congress of his intention to sign the Trans-Pacific Partnership (TPP) agreement, immediately after the release of the deal's text on November 5.

To be consistent with the Trade Priorities and Accountability Act of 2015, which set up Trade Promotion Authority (TPA) for the President, Obama will sign the deal no earlier than 90 days after this notification. He said he "looks forward to working with the Congress in developing appropriate legislation to approve and implement [it]."

On release of the text of the agreement, US Trade Representative Michael Froman called the TPP the "largest tax cut on American exports in a generation, slashing over 18,000 individual taxes on the products American manufacturers make, American farmers grow, and American innovators create. By selling more Made-in-America products around the world, we'll support more high-paying jobs here at home."

It has been calculated that the TPP should eliminate tariffs on around 98 percent of trade between the participating countries over 30 years. However, the overall position on market access is complicated by each country having tariff schedules that are the result of bilateral negotiations, particularly on ultra-sensitive products such as Japanese agricultural products.

Regarding the TPP's prospects in obtaining congressional approval, Senate Finance Committee Chairman Orrin Hatch (R – Utah) warned President Obama that "the Administration should expect the agreement to undergo rigorous review … to determine whether [it] meets the high-standards set by the TPA and whether it should be enacted into law."

Concerns have been expressed by US lawmakers over other sectors in the agreement, rather than the detail of its proposed tariff reductions. Its provisions on intellectual property, currency manipulation, and environmental law have all been cited as particularly problematic.

US Commerce Planning New Duties On Imported Steel

On November 6, the Department of Commerce (Commerce) announced its preliminary determinations that US industries are being materially injured by imports of corrosion-resistant steel (CORE) from China, India, Italy, and South Korea, but rejected similar charges against imports from Taiwan.

In its countervailing duty (CVD) investigations, it found that the US steel industry had suffered from the unfair subsidization of CORE exporters in the four countries. Subsidy rates of between 26.26 percent and 235.66 percent have been preliminarily decided with regard to exporters from China, and rates of between 2.85 percent and 7.71 for Indian exporters. Italian exporters were assigned a rate of 38.41 percent, and South Korean exporters were assigned a 1.37 percent rate.

As a result of its determinations, Commerce will instruct US Customs and Border Protection to require cash deposits against CORE imports based on these preliminary subsidy rates. With regard to certain exporters, CVDs will be applied retroactively to August 2015.

James Wainscott, AK Steel's Chairman, President, and CEO, said: "AK Steel is pleased that the Commerce Department has made a preliminary ruling that imports of CORE are being unfairly subsidized. Action is urgently needed to counteract the significant injury that is being caused by unfairly traded imports."

Commerce is scheduled to announce its final CVD determinations on or about January 19, 2016, and the US International Trade Commission is scheduled to make its final injury determinations in March 2016.

Commerce is also expected to make preliminary anti-dumping (AD) determinations with respect to all five countries on or about December 21 this year. AK Steel and the other petitioners have alleged AD duties ranging from 71.09 to 120.20 percent.

The CVD determinations on CORE by Commerce have furthered the ongoing trend for trade disputes in the global steel sector. For example, late last year, CVDs and AD duties were confirmed on imports into the US of non-oriented electrical steel from China, Germany, Japan, South Korea, Sweden, and Taiwan.

This year, the EU put provisional AD duties on Chinese, Japanese, South Korean, US, and Russian imports of grain-oriented flat-rolled electrical steel (GOES) in May, while China announced in July the start of its own AD investigation into GOES imported from Japan, South Korea, and the EU.

July also saw a filing by AK Steel and the other US steel producers of AD and CVD petitions against imports of cold-rolled steel from Brazil, China, India, Japan, South Korea, Netherlands, Russia, and the UK, while China lost a World Trade Organization decision last month regarding its AD duties on certain steel tubes from Japan and the EU.

China, Singapore To Enhance FTA

On November 6, during his visit to Singapore, China's President Xi Jinping agreed with Singapore's President Tony Tan to launch negotiations on an upgrade to the China–Singapore Free Trade Agreement (CSFTA).

The CSFTA was signed in September 2008 after two years of negotiations. It went into effect on January 1, 2009, and was the first comprehensive bilateral FTA that China signed with another Asian country. According to Chinese data, China has now become Singapore's biggest trading partner with almost USD80bn in total trade between the two countries last year.

Negotiations on its upgrade are planned to be concluded next year. Within the present CSFTA, Singapore has already eliminated tariffs on all its imported goods from China, while China cancelled 97.1 percent of its duties on Singaporean exports. It is expected that Singapore's services sector will obtain major gains from the new agreement.

In remarks during the visit, President Tan noted that, apart from enhancing bilateral economic cooperation, the CSFTA upgrade "will also serve as a pathfinder for our countries' participation in regional economic frameworks such as the Regional Comprehensive Economic Partnership agreement as well as the ASEAN–China FTA upgrade." Negotiations on the upgrade are expected to be concluded next year.

Hong Kong Explains Its FTA Agenda

Hong Kong's Secretary for Commerce and Economic Development, Gregory So, discussed the territory's free trade agreement (FTA) strategy on November 4.

Answering a question before the Legislative Council, So stressed that the Government's primary goal is to enter into FTAs with its major services trading partners, as the services industry constitutes 93 percent of the city's gross domestic product.

Hong Kong's first trade treaty was signed with Mainland China, its largest services trading partner. Through the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), signed in 2003 and supplemented ten times, Hong Kong service suppliers can now access most services sectors in the Mainland.

So noted that Hong Kong is actively participating in the Trade in Services Agreement (TISA) negotiations between 23 participating economies, which commenced in 2013. Of these participants, eight are among the city's ten largest markets for services. Hong Kong's exports of financial services and business services to them account for 80 percent and 70 percent of total exports, respectively.

He also pointed to the commencement of FTA negotiations with the Association of South East Asian Nations (ASEAN) in July 2014. Collectively, the ten ASEAN member states are Hong Kong's fourth-largest trading partner for services. The Government's target is to conclude these negotiations next year.

So confirmed that the three trade deals will benefit 95 percent of Hong Kong's trade flows in services.

After the conclusion of the FTA negotiations with ASEAN, the Government will seek to join the Regional Comprehensive Economic Partnership (RCEP), currently being negotiated between ASEAN and its six FTA partners – the Mainland, Japan, South Korea, Australia, New Zealand, and India.

So also confirmed that the Government has been closely monitoring the development of regional FTAs, including the Trans-Pacific Partnership (TPP), the RCEP, and proposals for a pan-Asia Pacific Free Trade Area.

Replying to a question with regard to the TPP, he disclosed that the Government is "watching closely its development. [However,] a concrete assessment of the impact of TPP on Hong Kong could only be possible after more information is made available."

Countries Agree Common VAT Rules For Digital Services

Representatives from more than 100 countries and jurisdictions have endorsed new OECD International VAT/GST Guidelines, which are intended to establish international standards for the "coherent and efficient" application of value-added tax (VAT)/goods and services tax (GST) to the international trade in services.

The countries endorsed the new guidelines at the OECD Global Forum on VAT on November 5–6, 2015, in Paris. They in particular look to establish a global approach on the taxation of electronic services provided by online retailers to consumers, in new B2C Guidelines.

The Guidelines recommend that foreign sellers register and remit tax on sales of e-books, apps, music, videos, and other digital goods in the jurisdiction where the final consumer is located. The Guidelines also include a recommended mechanism to ensure the effective collection of VAT by tax authorities from foreign sellers.

Commenting on the Guidelines, the OECD's Deputy Secretary-General, Rintaro Tamaki, said: "The effective and consistent implementation of the recommended approaches for collecting the VAT on these digital sales will help jurisdictions to protect their VAT revenues and level the playing field between domestic and foreign suppliers. It is very encouraging to see that a number of jurisdictions have already implemented the rules and the mechanism recommended by these Guidelines, or have expressed their intention to do so. They expect that these reforms will contribute considerable revenues to government budgets."

The decision to draft new OECD Guidelines on VAT responds to growing concern from governments worldwide over the ever-rising volume of cross-border services and online downloads on which no VAT is paid, particularly on products bought by private consumers from e-vendors outside their home jurisdiction. In 2014, B2C e-commerce sales were estimated to exceed USD1.4 trillion, an increase of nearly 20 percent from 2013. B2C sales are estimated to reach USD2.4 trillion by 2018.

The OECD had committed to release the Guidelines in its BEPS Action 1 paper on tackling issues associated with taxing the digital economy, as part of the base erosion and profit shifting project.

EU May Drop Plan For Uniform VAT Return

The European Commission has indicated that it may drop a plan announced in 2013 to introduce a standard VAT return across all EU member states.

The Commission recently released its 2016 Work Programme. It announced that, during next year, it will release an action plan on VAT return, to create an efficient, fraud-proof and definitive regime. In addition, it will launch initiatives on VAT rates and the VAT treatment of e-commerce in the context of the Digital Single Market agenda.

Thereafter, it announced: "We also intend to withdraw a number of VAT proposals on the table that have made little progress in the Council or where their significant simplification potential has been unacceptably watered down, as is the case for the standard VAT declaration."

In October 2013, the Commission had announced the launch of a project to develop a standard VAT return for adoption by all member states to cut the cost of compliance by approximately EUR15bn (USD16.4bn) annually, based on projections that year.

The proposal for the standard return, which has yet to be formally withdrawn, would have seen national VAT returns replaced for a standardized return. This would require businesses to provide the same basic information with the same deadlines regardless of their location within the EU.

The standard VAT return would have had only five compulsory boxes for taxpayers to fill in. Member states would have been allowed to request a number of additional standardized elements, up to a maximum of 26 information boxes. This would have been a vast improvement on the current situation, whereby some member states require up to 100 information boxes to be completed.

The proposal for a standard VAT return across the EU was introduced as part of the European Commission's work to create a more efficient and fraud-proof VAT system, as set out in its December 2011 Communication on the future of VAT. The Commission has provided no indication of the issues that appear to have scuppered its implementation.

Italy To Extend Reverse Charge VAT To Tablets, Laptops

At a Cabinet meeting on November 6, the Italian Government approved a draft decree that will apply the reverse charge value-added tax (VAT) mechanism to sales of laptops, tablet PCs and gaming consoles on a temporary basis for two years until December 31, 2018.

The decree would activate in Italy the provisions of EU Directives 2013/42/EU and 2013/43/EU, which established a "quick reaction mechanism" (QRM) against VAT fraud by means of the optional and temporary application of reverse charges. The reverse charge shifts the obligation to account for VAT to the recipient, instead of the supplier.

The temporary QRM option provided by Directive 2013/42/EU is subject to notification to the European Commission. In order to ensure the exercising of the option is proportionate to the problem, the Commission has one month in which to appraise the notification and confirm whether it objects to the QRM special measure.

Directive 2013/43/EU issued an updated list of goods and services to which the reverse charge mechanism could apply. Supplies of tablet PCs, laptops and game consoles were then added to the list.

EU Calls For Progress From G20 On BEPS Response

European Council President Donald Tusk and European Commission President Jean-Claude Juncker hope to take forward progress on the OECD base erosion and profit shifting (BEPS) project at the G20's next meeting in Antalya on November 15–16, 2015.

The two Presidents are representing the EU at the G20 summit. They will be accompanied by Tax Commissioner Pierre Moscovici.

Ahead of the meeting, Tusk and Juncker said: "In Antalya, there should be an ambitious agreement to take further global actions necessary to tackle cross-border tax avoidance and tax evasion, including on the finalization and implementation of the [BEPS action plan]."

They added that "the G20 should in particular show political leadership on the issue of harmful tax competition and the exchange of information on cross-border tax rulings to enhance transparency. The EU has shown leadership with its June Action Plan on Corporate Taxation and its proposal on the exchange of information on cross-border tax rulings of March 18 on which EU Finance Ministers have reached agreement on October 6."

Further US Democrat Bills Take Aim At Tax Inversions

Spurred by reports of talks between Pfizer Inc. and Allergan Plc, Mark Pocan (D – Wisconsin) has introduced two bills into the House of Representatives to discourage US multinational companies from undertaking corporate tax inversions.

Tax inversion techniques have been used by some US multinationals to move their tax residences abroad – away from the high 35 percent US headline federal corporate tax rate – and to unlock unrepatriated earnings held offshore, even if their management and operations remain in the US.

Pocan said: "This legislation will eliminate a major incentive for corporations to leave the United States and ensure that companies pay their taxes on overseas profits immediately."

The Putting America First Corporate Tax Act would cancel the provision in the current US tax code that allows corporations to defer paying corporate tax on foreign profits until that money is repatriated back to the US. It would require corporations to pay US taxes on all future domestic and foreign active income beginning from December 31, 2014.

The intention of Pocan's second bill, the Corporate Fair Share Tax Act, is to curb the practice of "earnings stripping" whereby domestic subsidiaries borrow from their new foreign parent company to increase their interest payments and reduce their US taxable income. Specifically, the legislation limits the US tax deductions a corporation may claim to a level at which the US entity's share of interest on debt is proportionate to the US entity's share of a financial reporting group's earnings.

Pocan's proposed legislation takes a different approach to the Stop Corporate Inversions Act, which was introduced by other Democrat lawmakers earlier this year. That Bill would change the current law, under which a company that merges with an offshore counterpart can move its residence abroad so long as at least 20 percent of its shares are held by the foreign company's shareholders after the merger. It would restrict corporate inversions by putting the minimum foreign shareholding cap at 50 percent.

However, all of the bills appear to have little chance of progressing through Congress at the present time, as there remains a political divide about the right course of action to tackle inversions. Other leading Democrat and Republican lawmakers appear to have decided that tax reform, to cut the corporate tax rate and change the way the US taxes foreign earnings, will be the only real long-term solution for halting inversions.

Senate Committee Okays Australia's MNE Anti-Avoidance Bill

An Australian Senate inquiry committee has recommended that the Government should enact the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015.

In a report handed down on November 9, the Senate Economics Legislation Committee said: "The committee considers that the provisions of the Bill strike the right balance between addressing tax avoidance and not placing excessive compliance burdens on business, particularly small and medium enterprises. Further, the committee is satisfied that the measures are consistent with the G20/OECD proposals."

"Australia has some of the strongest tax integrity rules in the world and the measures in this Bill, along with other budget measures, will strengthen the tax system even further," the report states.

The Committee however recommended the Government to undertake a post-implementation review of the measures contained in the Bill within three years of enactment.

The Senate in September 2015 referred the provisions of the Bill to the committee.

The Bill would implement a package of measures announced in Budget 2015/16 to combat multinational tax avoidance, including a new multinational anti-avoidance law (MAAL); increased penalties for large companies engaging in tax avoidance and profit shifting; and the OECD's proposed country-by-country (CbC) reporting regime for companies that are considered to be "significant global entities."

The report states that "the provisions of the MAAL will operate in harmony with existing tax avoidance measures and will not place undue compliance burdens on the 'significant global entities' affected. [The committee] is also satisfied that concerns about the operation of the MAAL with tax agreements and treaties will be resolved with the development of a multilateral instrument on tax treaty measures to tackle BEPS."

The committee noted that the measure to increase the penalties is appropriate for any "significant global entity" that does not have a reasonably arguable position. It also noted that it is satisfied that the annual income threshold of AUD1bn is appropriate for the purposes of defining a "significant global entity."

Finally, the committee noted that the proposed CbC reporting requirements are consistent with those outlined in Action 13 of the BEPS Action Plan, and that the provisions underscore the important lead role that Australia can play in implementing the recommendations of the BEPS project. It however urged the Australian Taxation Office (ATO) to provide clarity and guidance through the implementation period and as CbC reporting is adopted by other countries, including on transitional arrangements and exemptions.

Commenting on the committee's recommendation, Labor MP Andrew Leigh said: "With Treasury unable to say how much revenue the Government's plan might return to Australia, and no other country having successfully implemented Australia's approach, it is right that the tax Bill should be subject to serious evaluation in the future. … Treasurer Morrison should make a public commitment to carry out this review and name the date by which it will be completed."

Leigh said that a review of the tax Bill should address the following questions: how many successful tax avoidance cases has the ATO concluded under the new rules; how much additional revenue has been collected in Australia because of the new rules; how much time and money has the ATO spent in court pursuing cases under the new rules; and how many disputes or conflicts with foreign tax laws have occurred as a result of the new rules.

MNEs Agree To Exchange Views With TAXE Committee

Representatives from ten multinational enterprises (MNEs) have confirmed they will appear before an upcoming meeting of the European Parliament's Special Committee on Tax Rulings (the "TAXE committee").

The TAXE committee is holding an extraordinary meeting on November 16, 2015, with various MNEs so as to hear their views on recent developments in the area of corporate taxation in the EU and beyond. These include, among other things, the OECD's base erosion and profit shifting Action Plan, and the ongoing European Commission consultation on the common consolidated corporate tax base.

Of those invited, senior representatives from the following companies have confirmed they will attend: Anheuser-Busch InBev, Barclays Bank Group, Coca-Cola Company, Facebook, Google, HSBC Bank plc, IKEA Services BV, McDonald's Europe, Philip Morris International, and The Walt Disney Company. The TAXE committee is awaiting replies from Amazon and Fiat Chrysler Automobiles.

The committee was set up by Members of the European Parliament on February 12, 2015, in the wake of a series of investigations launched by the Commission into tax rulings granted by EU tax authorities. The TAXE committee is reviewing the way the Commission treats state aid in member states; how transparent member states are about their tax rulings; and the impact of aggressive tax planning on member states' tax revenues.

Chile's 'Fair' Tax Reform A Success: World Bank

Chile's tax reform has had a positive impact on income redistribution and has improved the "fairness" of the tax system, according to a new report from the World Bank.

The report, entitled *Chile: Distributive Effects of Tax Reform 2014*, said the tax reform package, approved last year and effective since the beginning of this year, has substantially increased the effective tax burden on the country's highest earners. Meanwhile, 75 percent of taxpayers were unaffected.

The report said that the richest 20 percent of the population will contribute about 30 percent of the additional revenue generated by the tax reform, while the poorest 40 percent will contribute 20 percent.

Chile's Finance Minister, Rodrigo Valdés, welcomed the findings of the report. He said that the study's results are fully in line with the objectives of the reform.

The reform package included a number of measures, such as a hike in the corporate tax rate, to raise revenue by 3 percent of gross domestic product, reduce the deficit, and fund free education for all.

Abe Suggests Additional Corporate Rate Cuts In 2016

Japanese Prime Minister Shinzo Abe has indicated that he would like to cut Japan's corporate tax rate further than expected next year, as part of his Government's efforts to boost business investment and productivity.

The Government has a target of reducing the country's corporate tax rate to well below 30 percent over the next few years, so as to reach a more internationally competitive level. As the first step in that plan, the headline corporate tax rate was cut by 2.51 percent to 32.11 percent in the 2015 fiscal year.

It had previously been proposed that the corporate tax rate should be reduced to 31.33 percent in 2016. In a speech to a meeting of the Yomiuri International Economic Society in Tokyo, Abe confirmed that a rate cut next year would take place. However, he also expressed a wish to go further and find the way to make an additional reduction to below 31.33 percent.

Australian Firms Call For Balanced Tax Reform

"Australia's tax system is too reliant on taxes that sap incentives to work, invest, and take risks at a time of weak growth," Jennifer Westacott, Chief Executive of the Business Council of Australia (BCA), has said.

Westacott's intervention in the ongoing debate over tax reform came after Opposition Leader Bill Shorten accused the Government of having "an undeclared plan to put goods and services tax (GST) on everything and to increase the cost of the GST." He said that the Government "should focus on the existing unfairness in the tax system rather than slugging people who go to work every day and asking them to pay more taxes."

Shorten's comments were echoed by Victorian Premier Daniel Andrews, who said he would oppose any proposal to increase the GST from its current rate of 10 percent. A spokesperson said: "Simply jacking up the GST to 15 percent is not genuine reform. The GST is not a fair tax, it has no regard for a person's capacity to pay."

According to Westacott, comments such as these "grossly underestimate the community's understanding of what needs to be done to grow the Australian economy and create jobs." She said that Andrews was "right in saying that simply changing the GST is not real tax reform, but he is throwing the baby out with the bath water when he rules out changing it."

Westacott urged that GST reform "must be part of a package of comprehensive tax changes that encourage economic growth and underpin a stable revenue base for the future. Looking after households on low incomes is another important focus of comprehensive reform."

Westacott also criticized Shorten for advocating "a simplistic solution of cracking down on multinational tax avoidance and superannuation concessions." She said his measures fail to address the fundamental need for the tax system to promote growth.

"Politicians need to respect the Australian community enough to let them have an informed conversation about the optimum tax reform package. For the sake of the nation, it's time to stop treating people like mugs for purely political reasons," Westacott concluded.

The Coalition Government is currently consulting on proposals for the application of the GST to currently untaxed cross-border supplies of digital products and services imported by consumers from July 1, 2017. The federal, state, and territory governments have also agreed in principle to apply the GST to imported goods valued at or below AUD1,000 (USD720) from July 2017.

Former Coalition Treasurer Joe Hockey had insisted that GST reform would only be possible if the federal, state, and territory governments were in unanimous agreement and there was bilateral support in the federal parliament.

His successor, Scott Morrison, was asked during a November 2 interview with national broadcaster ABC whether he could confirm that the Government was modeling scenarios around a 15 percent GST. He responded: "The Government wants a better tax system, we have made no secret of that. There's been work been done with the states and territories at their request now for some period of time."

"At the last meeting of state Treasurers we responded to a range of questions that they put around these issues and at our next meeting of state Treasurers we will be looking at a whole range of issues around state taxes. I have described it as being in a discovery phase and we are all working collaboratively together because we want to see a tax system that grows our economy and supports jobs."

US Accountants Consider New Revenue Standards

The Financial Reporting Executive Committee (FREC) of the American Institute of Certified Public Accountants (AICPA) has released working drafts on issues relating to the new accounting standard on the recognition of revenue from contracts with customers.

The AICPA notes that the Financial Accounting Standards Board's (FASB's) new accounting standard will eliminate the transaction- and industry-specific revenue recognition guidance under current US Generally Accepted Accounting Principles, and replace it with a principle-based approach for determining revenue recognition.

This standard, it points out, "has the potential to affect every entity's day-to-day accounting and, possibly, the way business is executed through contracts with customers."

The core principle of the new standard is for companies to recognize revenue in their accounts only when goods and services are transferred to or performed for their customers, and in amounts that reflect the payment to which the company is then entitled in exchange for those goods or services. This should be achieved by: identifying the contract(s) with a customer; identifying the performance obligations in the contract; determining the transaction price; allocating the transaction price to the performance obligations in the contract; and recognizing revenue when (or as) the entity satisfies each performance obligation.

The FREC has released for comment working drafts of revenue recognition implementation issues it has identified for the aerospace and defense industry and the investment asset management industry. Interested parties are to submit their informal feedback on implementation issues by December 31, 2015.

The aerospace and defense industry implementation issues include the application of the new guidance for costs typically incurred in aerospace and defense contracts, including pre-contract costs and learning or start-up costs; amortization and impairment; and estimates of variable consideration (incentive fees, award fees, economic price adjustments).

The working draft also discusses how the requirement for regulatory approvals impacts the determination of whether an executed/signed contract meets the criteria for existence of a contract.

Implementation issues for the investment asset management industry are said to include considerations of when a contract exists between an asset manager and a customer, and identifying who the customer is (the investor or the fund). They also include the issue of when to recognize revenue from management fees under the new standard, and how incentive or performance revenue, excluding carried interest, should be included.

The FASB and the International Accounting Standards Board, responsible for International Financial Reporting Standards, have decided to defer the effective date of the new standard until 2018. Early adoption by companies is allowed, but not before the original effective date (annual periods beginning after December 2016).

Final revenue recognition implementation issues will be included in a new Revenue Recognition Guide that the AICPA is developing.

Financial Reporting Council Proposes Improvements To FRS 102

The UK's Financial Reporting Council (FRC) has proposed "limited scope" improvements to Financial Reporting Standard (FRS) 102, which is applicable in the UK and Ireland.

According to the FRC, FRS 102 is "designed to apply to the general purpose financial statements and financial reporting of entities, including those that are not constituted as companies and those that are not profit-oriented."

The proposals are included in an exposure draft (FRED 62) published this week.

The FRC said its proposals are intended to simplify the process for the preparation of disclosures about financial instruments for financial institutions and retirement benefit plans. They are also said to be aimed at improving consistency with the disclosures required under International Financial Reporting Standards (IFRS).

Melanie McLaren, Executive Director of Codes and Standards at the FRC, said: "We are issuing FRED 62 to respond to stakeholders' concerns that certain disclosures required from financial institutions and retirement benefit plans could be made both more cost-effective and more consistent with IFRS. The changes proposed in FRED 62 will not affect the majority of entities applying FRS 102 and therefore should not delay or disrupt their implementation plans."

The proposed improvements are intended to be effective for accounting periods beginning on or after January 1, 2017, with early application permitted.

Hong Kong Rejects Cap On Electric Vehicle Tax Break

Hong Kong's Secretary for the Environment, Wong Kam-sing, has said that limiting the first registration tax (FRT) waiver for electric vehicles (EVs) could hinder efforts to promote their use.

Hong Kong has exempted EVs from the payment of FRT since 1994. The tax break is currently available until end-March 2017.

The FRT is imposed at an increasing rate, depending on a vehicle's value. A tax rate of 40 percent is applicable on the first HKD150,000 (USD19,350) of a car's value; 75 percent on the next HKD150,000; 100 percent on the next HKD200,000; and 115 percent on any remainder.

On November 4, Wong responded to a question on whether that tax break is being misused, as sales of luxury sports EVs have increased in recent years.

Wong stated the Government believes that "the high research and development costs, and low production volume of EVs, have resulted in their prices being higher than those of conventional vehicles. … We are of the view that a cap on the tax waived in respect of the FRT of EVs should not be set at this stage so as not to hinder the promotion of the use of EVs."

He also confirmed that, "since the waiver of FRT for EVs is time-limited, the Government will carefully examine relevant factors such as technological development of EVs, the latest EV market situation, and the drivers' attitude towards EVs when considering whether the waiver arrangement should be continued."

Toll Booths Refuse To Collect Indian Green Tax

Road toll collectors on routes into the Indian capital Delhi are reportedly refusing to collect a new environmental levy in defiance of a recent ruling by the country's Supreme Court.

The Supreme Court gave the go ahead last month for a four-month trial of the additional charge on certain vehicles entering Delhi, with authorities seeking to improve the capital's notoriously bad air quality.

Under the pilot scheme, which was due to commence on November 1, light commercial vehicles headed for Delhi are charged an additional INR700 (USD11) on top of the regular toll fee, while large trucks are charged an extra INR1,300.

However, it quickly became apparent that the new system had fallen down on the first day. According to local media reports, the contractor responsible for the toll booths in question blamed a lack of guidance by the Supreme Court or government agencies on how the levy should be collected, and inadequate systems to enable the levy to be paid and accounted for correctly in the first place. It has also been suggested that toll booth workers are refusing to collect the levy anyway, due to fears that they will end up in confrontations with angry drivers.

The environmental authorities held a meeting with the contractors on November 4 in a bid to resolve the issue, but it may be that the Supreme Court will need to intervene, and a hearing is already scheduled for November 16.

OECD Urges Brazil To Increase Use Of Green Taxes

Brazil should more widely use green taxes, the OECD said in a new report.

According to the recently published *OECD Environmental Performance Review* for Brazil, the environment related tax burden was 0.7 percent of the country's gross domestic product (GDP) in 2013, below the level observed in most OECD countries.

The OECD welcomed the Government's decision to raise the federal fuel tax rate on petrol and diesel in early 2015; the tax rate had been zero since mid-2012. However, it pointed out that tax rates are low in international comparison and are not linked to the carbon content of fuels. Furthermore, fuels used in sectors other than road transport go largely untaxed, it said.

The report recommended maintaining positive rates for the federal CIDE tax on petrol and diesel and adjusting them to reflect carbon content. It also called for the CIDE tax to be applied to fuels used for aviation and stationary purposes (*e.g.*, for industry).

The Government was also urged to introduce taxes on pollution, waste, and resource use, and to align vehicle taxation with environmental performance.

In addition, the report called on the authorities to ensure that water abstraction and pollution charges reflect scarcity and pressures on the environment and are consistently applied across river basins and throughout the country. At present, these charges, which are implemented in a few states, are the only form of levies on natural resource use and pollution.

ARGENTINA - MEXICO

Signature

Argentina and Mexico signed a DTA on November 4, 2015.

BARBADOS - GREECE

Negotiations

Barbados and Greece discussed the possibility of signing a DTA on November 4, 2015.

BARBADOS - SLOVAKIA

Signature

Barbados and Slovakia signed a DTA on October 28, 2015.

CHILE - JAPAN

Draft

Chile and Japan have agreed the wording for a new DTA, it was announced on October 19, 2015.

ETHIOPIA - SWITZERLAND

Negotiations

The Ethiopian Government announced on October 27, 2015, that it has agreed with the Swiss authorities to expedite negotiations towards a DTA.

GERMANY - CHINA

Forwarded

Germany's upper house of Parliament approved draft law 396/15 on October 16, 2015, which would ratify the pending DTA signed with China.

GERMANY - JERSEY

Forwarded

Germany's upper house of Parliament approved a DTA with Jersey on October 16, 2015.

HONG KONG - ITALY

Into Force

The DTA between Hong Kong and Italy will become effective in Hong Kong for years of assessment beginning on or after April 1, 2016, Hong Kong's Inland Revenue Department has announced.

HONG KONG - VARIOUS

Ratified

Hong Kong issued six Orders ratifying TIEAs with the Nordic countries –Denmark, the Faroe Islands, Greenland, Iceland, Norway, and Sweden – on October 2, 2015.

ISLE OF MAN - ROMANIA

Signature

The Isle of Man signed a TIEA with Romania on November 4, 2015.

ITALY - CHILE

Signature

Italy and Chile signed a DTA on October 23, 2015.

JAPAN - CHILE

Negotiations

Japan announced that it had completed negotiations with Chile on a DTA on October 19, 2015.

NETHERLANDS - GERMANY

Ratified

The Netherlands and Germany completed their domestic ratification procedures on October 20, 2015, in respect of a new DTA that will enter into force on December 1, 2015.

QATAR - LATVIA

Ratified

Qatar ratified a pending DTA with Latvia on October 27, 2015.

SWITZERLAND - VARIOUS

Forwarded

The Swiss Government on October 28, 2015, approved a DTA with Liechtenstein and a DTA Protocol with Norway, and forwarded legislation to Parliament for approval.

UNITED ARAB EMIRATES - CUBA

Negotiations

The United Arab Emirates and Cuba are engaged in DTA negotiations, it was confirmed on October 25, 2015.

UNITED ARAB EMIRATES - DENMARK

Signature

The United Arab Emirates and Denmark signed a TIEA on November 5, 2015.

UNITED ARAB EMIRATES - MACEDONIA

Signature

The United Arab Emirates and Macedonia signed a DTA on October 26, 2015.

UNITED ARAB EMIRATES - SENEGAL

Signature

According to preliminary media reports, the United Arab Emirates signed a DTA with Senegal on October 24, 2015.

UNITED ARAB EMIRATES - SWEDEN

Signature

The United Arab Emirates and Sweden signed a TIEA on November 6, 2015.

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

THE AMERICAS

PRINCIPLES OF INTERNATIONAL TAXATION

Bloomberg BNA

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

Key Speakers: TBC

11/16/2015 - 11/18/2015

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

ANNUAL CONFERENCE ON TAXATION

National Tax Association

Venue: Boston Park Plaza Hotel, 50 Park Plaza, Boston, MA 02116, United States

Key Speakers: TBC

11/19/2015 - 11/21/2015

http://ntanet.org/events.html

INTERNATIONAL TAX PLANNING

IBFD

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

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

11/25/2015 - 11/27/2015

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

INTRODUCTION TO US INTERNATIONAL TAX – ARLINGTON, VA

Bloomberg BNA

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

Chairs: TBC

11/30/2015 - 12/1/2015

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

US INTERNATIONAL TAX COMPLIANCE WORKSHOP

Bloomberg BNA

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

Key speakers: TBC

11/30/2015 - 12/1/2015

http://www.bna.com/intlcomp_nyc/

THE NEW ERA OF TAXATION

International Bar Association

Venue: TBC, Mexico City, Mexico

Key speakers: TBC

12/3/2015 - 12/4/2015

http://www.ibanet.org/Article/Detail.aspx?ArticleUid=bf91caa6-9df6-454b-a682-8b57c7bf9209

ACCOUNTING FOR INTERNATIONAL OPERATIONS

ACS

Venue: Hyatt Santa Clara, 5101 Great American Parkway, Santa Clara, CA 95054, USA

Key Speakers: Cody Smith (Radius), John Benedetti (PricewaterhouseCoopers), Usha Francis (Deloitte & Touche), Ron Kiima (Kiima Inc.), Mark Webster (Treasury Alliance Group LLC), Steve DiPietro (Deloitte & Touche), among numerous others

12/8/2015 - 12/9/2015

http://www.acslive.com/events/international_santaclara_2015.html

2015 CORPORATE TAX DEVELOPMENTS – THE YEAR IN REVIEW – CHICAGO

BNA

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

Key speakers: TBC

12/14/2015 - 12/15/2015

http://www.bna.com/2015yearinreview/

2015 CORPORATE TAX DEVELOPMENTS – THE YEAR IN REVIEW – SAN FRANCISCO

BNA

Venue: Morgan Lewis LLP, 1 Market Street, Spear St Tower, San Francisco, CA 94111, USA

Key speakers: TBC

12/16/2015 - 12/17/2015

http://www.bna.com/yearend_sf/

INTERNATIONAL TAX ISSUES 2016

PLI

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

Chair: Michael A. DiFronzo (PwC)

2/9/2016 - 2/9/2016

http://www.pli.edu/Content/Seminar/International_Tax_Issues_2016/_/N-4kZ1z11j97?ID=259129

AMERICAS TRANSFER PRICING SUMMIT 2016

TP Minds

Venue: Eden Roc Resort, 4525 Collins Ave, Miami Beach, FL 33140, USA

Key speakers: Garry Stone (PwC), Mike Danilack (PwC), David Varley (IRS), Kenneth W. Wood (IRS), Michael Lennard (United Nations), Mayra Lucas (OECD), Carlos Perez-Gomez (SAT), George Georgiev (Siemens Corporation), among numerous others

2/23/2016 - 2/24/2016

http://www.iiribcfinance.com/event/Americas-Transfer-Pricing-Conference

THE 5TH OFFSHORE INVESTMENT CONFERENCE PANAMA 2016

Offshore Investment

Venue: Hilton Panamá, Avenida Balboa and Aquilino de la Gua, 00000, Panama

Chair: Derek Sambrook (Trust Services)

3/9/2016 - 3/10/2016

http://www.offshoreinvestment.com/pages/index.asp?title=The_5th_Offshore_Investment_Conference_Panama_2016&catID=12383

8TH REGIONAL MEETING OF IFA LATIN AMERICA

IBFD

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

Key speakers:TBC

5/4/2016 - 5/6/2016

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

ASIA PACIFIC

JUBILEE CONFERENCE

Foundation for International Taxation

Venue: ITC Maratha Hotel, Sahar Tower, Andheri East, Mumbai, Maharashtra 400099, India

Chairs: Sohrab Dastur, Girish Vanvari (KPMG), Dinesh Kanabar (Dhruv Advisors), Nishith Desai (Nishith Desai Associates), Vipul Jhaveri (Deloitte), Kiran Umrootkar (Jacobs Engg.), V. Lakshmikumaran (Lakshmikumaran & Sridharan), Mukesh Butani (BMR Legal), Pranav Sayta (E & Y), Rohan Shah (ELP), Ajay Vohra (Vaish Associates), Gautam Mehra (PwC), Richard Vann (Challis Professor)

12/3/2015 - 12/5/2015

http://www.fitindia.org/downloads/FIT_flier.pdf

THE 4TH OFFSHORE INVESTMENT CONFERENCE SINGAPORE 2016

Offshore Investment

Venue: Raffles Hotel, 1 Beach Rd, 189673, Singapore

Chair: Nicholas Jacob (Wragge Lawrence Graham & Co)

1/20/2016 - 1/21/2016

http://www.offshoreinvestment.com/pages/index.asp?title=The_4th_Offshore_Investment_Conference_Singapore_2016&catID=12382

INTERNATIONAL TAX PLANNING – POST BEPS

IBFD

Venue: Conrad Centennial Singapore, Two Temasek Boulevard, 038982 Singapore

Key speakers: TBC

2/24/2016 - 2/26/2016

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

CENTRAL AND EASTERN EUROPE

THE OFFSHORE INVESTMENT CONFERENCE CYPRUS 2015

Offshore Investment

Venue: Amathus Beach Hotel, Amathountos St, Mesa Geitonia 4005, Cyprus

Chair: Christos Mavrellis (Chrysses Demetriades)

11/18/2015 - 11/19/2015

http://www.offshoreinvestment.com/pages/index.asp?title=The_Offshore_Investment_Conference_Cyprus_2015&catID=12288

MIDDLE EAST AND AFRICA

TRANSFER PRICING SUMMIT AFRICA

IIR & IBC

Venue: TBC, Cape Town, South Africa

Key Speakers: Mayra Lucas (OECD), Ian Cremer (WCO), Ilka Ritter (United Nations), Samuel Ogungbesan (Federal Inland Revenue Service of Nigeria), Lucia Hlongwane (Barclays), among numerous others

11/24/2015 - 11/25/2015

http://www.iiribcfinance.com/event/TP-Minds-Africa-conference

INTERNATIONAL TAX ASPECTS OF CORPORATE TAX STRUCTURES

IBFD

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

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

4/13/2016 - 4/15/2016

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

TREATY ASPECTS OF INTERNATIONAL TAX PLANNING

IBFD

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

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

5/22/2016 - 5/24/2016

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

UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – GATWICK

CCH

Venue: Sofitel London Gatwick, Gatwick Airport North Terminal, Crawley, West Sussex, RH6 0PH, UK

Key Speakers: Chris Burns, Louise Dunford, Paul Gee, Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others

11/17/2015 - 11/18/2015

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

2ND ANNUAL CORPORATE TAX SUMMIT

Uniglobal

Venue: TBC, Vienna, Austria

Key speakers: Georg Gam-Jensen (Lego), Peter Hordijk (Unilever), Clive M. Baxter (Maersk), Sabine Bernegger (KPMG), Rod Sayers (Petrofac Services Limited), among numerous others.

11/19/2015 - 11/20/2015

http://www.ibfd.org/sites/ibfd.org/files/content/pdf/Corporate_Tax_Summit_2015.pdf

19TH CROSS ATLANTIC AND EUROPEAN TAX SYMPOSIUM

CIOT

Venue: Auditorium Deloitte, 2 New Street Square, London, EC4A 3BZ, UK

Chairs: Liesl Fichardt (Clifford Chance), Anne Fairpo (CIOT European Branch)

11/20/2015 - 11/20/2015

https://www.regonline.co.uk/builder/site/Default.aspx?EventID=1711857

UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – BIRMINGHAM

CCH

Venue: Marriott Forest of Arden, Maxstoke Lane, Meriden, Birmingham, CV7 7HR, UK

Key Speakers: Chris Burns, Louise Dunford, Paul Gee, Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others

11/24/2015 - 11/25/2015

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

EU FINANCIAL ACCOUNTING IN INTERNATIONAL COOPERATION AND DEVELOPMENT PROJECTS

European Academy

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

Key Speakers: TBC

11/26/2015 - 11/27/2015

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

UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – GLASGOW

CCH

Venue: Hilton Glasgow Hotel, 1 William St, Glasgow, G3 8HT, Scotland

Key Speakers: Chris Burns, Louise Dunford, Paul Gee, Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others

12/1/2015 - 12/2/2015

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

UPDATE FOR THE ACCOUNTANT IN INDUSTRY AND COMMERCE – LONDON

CCH

Venue: Jumeirah Carlton Tower Hotel, On Cadogan Place, London, SW1X 9PY, UK

Key Speakers: Chris Burns, Louise Dunford, Paul Gee, Toni Trevett, Dr. Stephen Hill, Kevin Bounds, among others

12/8/2015 - 12/9/2015

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

INTERNATIONAL TAXATION OF OIL AND GAS AND OTHER MINING ACTIVITIES

IBFD

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

Key speakers:TBC

12/9/2015 - 12/11/2015

http://www.ibfd.org/Training/International-Taxation-Oil-and-Gas-and-Other-Mining-Activities-0#tab_program

5TH ANNUAL IBA TAX CONFERENCE

IBA

Venue: TBC, London, UK

Key speakers: TBC

2/8/2016 - 2/9/2016

http://www.ibanet.org/Article/Detail.aspx?ArticleUid=e4f0bf6f-997e-470b-971f-c884539fb93b

21ST ANNUAL INTERNATIONAL WEALTH TRANSFER PRACTICES CONFERENCE

IBA

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

Key speakers: TBC

2/29/2016 - 3/1/2016

http://www.ibanet.org/Article/Detail.aspx?ArticleUid=db061854-33d1-4297-b9bc-6058df392231

PRINCIPLES OF INTERNATIONAL TAXATION

IBFD

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

Key speakers: Bart Kosters (IBFD), Carlos Gutiérrez (IBFD), Boyke Baldewsing (IBFD)

2/29/2016 - 3/4/2016

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

ITPA LUXEMBOURG MARCH 2016

International Tax Planning Association

Venue: Le Royal, 12 Boulevard Royal, 2449 Luxembourg

Chair: Milton Grundy

3/13/2016 - 3/15/2016

https://www.itpa.org/?page_id=10132

INTERNATIONAL TRANSFER PRICING SUMMIT 2016

TP Minds

Venue: Millennium Gloucester Hotel, London Kensington, 4-18 Harringdon Gardens, Kensington, London, SW7 4LH, UK

Key Speakers: TBC

3/15/2016 - 3/16/2016

http://www.iiribcfinance.com/event/International-Transfer-Pricing-Summit/dates-venue

CURRENT ISSUES IN INTERNATIONAL TAX PLANNING

IBFD

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

Key speakers: TBC

5/25/2016 - 5/27/2016

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

THE AMERICAS

United States

The US Tax Court has ruled against a taxpayer who had structured the sale of a C corporation through a "Midco" transaction in an effort to unlock gains tax efficiently.

"Midco" transactions, a type of tax shelter, were widely promoted during the late 1990s and early 2000s. These transactions were chiefly promoted to shareholders of closely held C corporations that had large built-in gains.

The Court of Appeals for the Second Circuit has described one variation of a Midco transaction as follows:

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

> "'Midco transactions' or 'intermediary transactions' are structured to allow the parties to have it both ways: letting the seller engage in a stock sale and the buyer engage in an asset purchase. In such a transaction, the selling shareholders sell their C Corp stock to an intermediary entity (or 'Midco') at a purchase price that does not discount for the built-in gain tax liability, as a stock sale to the ultimate purchaser would. The Midco then sells the assets of the C Corp to the buyer, who gets a purchase price basis in the assets. The Midco keeps the difference between the asset sale price and the stock purchase price as its fee.
>
> "The Midco's willingness to allow both buyer and seller to avoid the tax consequences inherent in holding appreciated assets in a C Corp is based on a claimed tax-exempt status or supposed tax attributes, such as losses, that allow it to absorb the built-in gain tax liability. If these tax attributes of the Midco prove to be artificial, then the tax liability created by the built-in gain on the sold assets still needs to be paid. In many instances, the Midco is a newly formed entity created for the sole purpose of

facilitating such a transaction, without other income or assets and thus likely to be judgment-proof. The IRS must then seek payment from the other parties involved in the transaction in order to satisfy the tax liability the transaction was created to avoid."

In this case, the taxpayer, Mr. Tricarichi, who was the sole shareholder of West Side (a C Corp), engaged in a Midco transaction with an affiliate (the intermediary company) of Fortrend International LLC (the promoter).

Summarizing the facts of the case, the Tax Court explained that: "The Petitioner engaged in a Midco transaction with a Fortrend shell company; the shell company merged into West Side and engaged in a sham transaction to eliminate West Side's corporate tax; the IRS disallowed those fictional losses and assessed the corporate-level tax against West Side; but West Side, as was planned all along, is judgment proof. The IRS accordingly seeks to collect West Side's tax from petitioner as the transferee of West Side's cash" – that is, from the taxpayer, Mr. Tricarichi.

In its argument, the IRS sought to rely on section 6901 of the Tax Code, which permits the Commissioner to assess tax liability against the transferee of assets of a taxpayer who owes income tax. However, to impose that liability on a transferee, a court must first determine whether the party is substantively liable for the transferor's unpaid taxes under state law, and whether that party is a "transferee" within the meaning of section 6901.

The Court found that the transaction had no economic substance, had no *bona fide* business purpose, and was entered into solely to evade West Side's federal and Ohio tax liabilities. It therefore disregarded the form of the transaction and concluded that since Tricarichi was a direct recipient of West Side's cash, in substance, he is liable under Ohio law for the full amount of West Side's tax deficiency (with penalties and interest), and that the IRS may collect this aggregate liability from him as a "transferee" under section 6901.

In addition, the Court ruled that the transaction satisfied all of the three elements set out under section 1336.05(A) of the Ohio Uniform Fraudulent Transfer Act. Under that section, a transfer is fraudulent with respect to a creditor where: the creditor's claim arose before the transfer; the transferor did not receive "a reasonably equivalent value in exchange for the transfer"; and the transferor became insolvent as a result of the transfer.

This judgment was delivered on October 14, 2015.

http://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=10577

US Tax Court: *Tricarichi v. Commissioner of Internal Revenue (T.C. Memo. 2015-201)*

ASIA PACIFIC

Australia

The Federal Court of Australia has delivered a ruling in favor of the tax authority in relation to a transfer pricing dispute with energy giant Chevron worth over AUD250m (USD176m).

Central to the ruling was a Credit Facility Agreement between Chevron Australia Holdings Pty Ltd (CAHPL) and ChevronTexaco Funding Corporation (CFC) through which CFC agreed to make certain advances to CAHPL from time to time, with interest payable at an agreed monthly rate.

The Court found that CAHPL "did not give security or operational and financial covenants, which would have affected that part of the consideration which was the interest rate: the interest rate was higher in the absence of those promises or covenants." Justice Robertson observed: "If the property had been acquired under an agreement between independent parties dealing at arm's length with each other, I find that the borrower would have given such security and operational and financial covenants and the interest rate, as a consequence, would have been lower."

Ruling in favor of the tax authority, the Court argued that "the limited scope of the consideration given or agreed to be given by CAHPL resulted in the consideration which CAHPL did give, the promise to pay the interest rate, exceeding the arm's length consideration in respect of the acquisition."

The Court concluded that "but for the conditions operating between CAHPL and CFC which differ from those that might be expected to operate between independent parties dealing wholly independently with one another, an amount of profits might be expected to have accrued but has not so accrued. It follows that the applicant has failed to show that the assessments under the Income Tax Assessment Act 1997 were excessive."

The Court rejected CAHPL's contention that the dominant purpose of the scheme was refinancing and not obtaining a "scheming benefit." Justice Robertson said: "I accept the Commissioner's submission that refinancing was not the dominant purpose of the scheme as refinancing could be achieved by borrowing at an arm's length interest rate, which CAHPL did not. To limit the scope of matters to be taken into account merely to refinancing is artificially to exclude from consideration the circumstances of that refinancing."

The company is expected to seek to appeal the decision.

This judgment was released on October 23, 2015.

http://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2015/2015fca1092#_Ref433351470

The Federal Court of Australia: *Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation*

WESTERN EUROPE

Bulgaria

The European Court of Justice (ECJ) has ruled that the excise duty exemptions provided for in Council

Directive 92/83/EEC, on the harmonization of the structures of excise duties on alcohol and alcoholic beverages, should be available for ethyl alcohol used to sterilize facilities for the manufacture of medicines.

The appellant, Biovet, manufactures medicinal products and markets veterinary medicinal products, agricultural products, and medicinal products for human use. In its manufacturing of medicinal products, Biovet uses ethyl alcohol, in the form of a 70 percent water-based solution of ethanol, to clean and disinfect technical equipment, production facilities, and working areas and surfaces.

In September 2012, Biovet applied for a refund of excise duty paid on 271 liters of ethyl alcohol, which had been used for those purposes in Bulgaria between August 1 and 31, 2012. The Head of the Plovdiv Customs Office refused to refund the excise duty.

Biovet brought an action against that decision before the Administrative Court in Sofia, which held that cleaning and disinfection constitute different activities which form part of the process for the manufacture of a final product which does not contain alcohol, with the result that the excise duty that was paid on the acquisition of the alcohol used for disinfectant purposes was to be refunded pursuant to the relevant articles of domestic law (Article 22(4)(4) and Article 22(7) of the Law on excise duties and tax warehouses (ZADS)).

The Customs Agency Director appealed against this judgment to the Supreme Administrative Court (SAC), which referred questions to the ECJ.

By its first and second questions, the SAC asked, in essence, whether Article 27(1)(d) of Directive 92/83 must be interpreted as meaning that the obligation to exempt laid down in that provision applies to ethyl alcohol used by an undertaking for cleaning or disinfecting equipment and facilities used in the production of medicines.

Article 27(1) of Directive 92/83 provides that:

> "Member states shall exempt the products covered by this Directive from the harmonized excise duty under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any evasion, avoidance, or abuse:
>
> (a) when distributed in the form of alcohol which has been completely denatured in accordance with the requirements of any member state, such requirements having been duly notified and accepted in accordance with paragraphs 3 and 4 of this Article;
>
> (b) when both denatured in accordance with the requirements of any member state and used for the manufacture of any product not for human consumption; … and

(d) when used for the production of medicines defined by [Council Directive 65/65/EEC of 26 January 1965]."

The ECJ said that the Administrative Court had been right to rule in favor of the taxpayer. It said that the exemption provided for in Directive 92/83 is not subject to conditions relating to whether they are used directly in the production of medicines or whether they form part of the composition of medicines.

"In accordance with the settled case-law of the [ECJ], the objective of the exemptions contained in Directive 92/83 is, in particular, to neutralize the impact of excise duties on alcohol used as an intermediate product in other commercial or industrial products," the ECJ said, explaining further:

"It is apparent from the file submitted to the [ECJ] that the disinfection of material, equipment, and facilities used for the production of medicines constitutes a necessary stage in the process of that production and that the use of ethyl alcohol is indispensable to such disinfection operations. In that regard, medicines have the peculiarity that, in comparison to other products, their production process is subject to compliance with very strict health rules. As the [SAC] notes, the disinfection operations at issue in the main proceedings seek in particular to eradicate pathogenic microorganisms, which are not permitted to be present in terms of the requirements regarding the germ content of medicinal products.

It follows therefrom that, in so far as that disinfection is inherent in the production process for medicines, the ethyl alcohol used for that purpose must be regarded as being used 'for the production of medicines' within the meaning of Article 27(1)(d) of Directive 92/83.

Consequently, in accordance with that provision, that alcohol must be exempt from the harmonized excise duty on the conditions laid down by the member state concerned for the purpose of ensuring the correct and straightforward application of the exemption laid down in that provision and of preventing any evasion, avoidance, or abuse."

This judgment was released on October 15, 2015.

http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d2dc30dd13590a008f264340a1a5a721b1913b1c.e34KaxiLc3qMb40Rch0SaxuRbxn0?text=&docid=169821&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=311672

European Court of Justice: *Bulgarian Customs Agency Director v. Biovet AD (Case C-306/14)*

Poland

Poland's Constitutional Tribunal has ruled against the Polish Government for failing to ensure that the personal income tax-exempt threshold is adjusted upwards automatically, such that low-income earners have borne too much tax.

A challenge was brought against Poland's individual income tax law and specifically provisions that set the tax-exempt threshold, currently at more than half the income required for a taxpayer (or household) to be above the poverty line.

The Tribunal found that the provision was unconstitutional in failing to recognize taxpayers' propensity to pay, and criticized the lack of a mechanism to revise the threshold upwards each year. The threshold was last revised in 2006.

The Tribunal ruled that the tax system must be subject to principles of social solidarity.

The Polish Government will be required to amend the threshold before the provision ceases to have effect, based on the Tribunal's ruling, from November 30, 2016.

This judgment was released on October 28, 2015.

(*Judgment not yet available in English*)

http://trybunal.gov.pl/rozprawy/komunikaty-prasowe/komunikaty-po/art/8667/

Poland's Constitutional Tribunal: *Ombudsman v. Polish Government (K 21/14, 28.X.2015)*

Sweden

The European Court of Justice (ECJ) has ruled that taxpayers that exchange traditional currencies for units of "bitcoin" virtual currency should be exempt from value-added tax (VAT), in a long-awaited ruling that will create greater certainty regarding the tax treatment of using and trading in virtual currencies in the EU.

In its ruling on October 22, the ECJ said that "purchases" of bitcoin should fall under provisions in the EU VAT Directive that provide that member states must exempt, among other things, transactions relating to "currency, bank notes, and coins used as legal tender."

David Hedqvist, a Swedish taxpayer, had earlier received a favorable ruling from the Revenue Law Commission, but its decision that bitcoin transactions should be exempt was challenged by the Swedish Tax Agency (*Skatteverket*) before the Swedish Supreme Administrative Court.

The Swedish Government had argued that the transactions that Hedqvist intended to effect were not covered by the exemptions provided for in the VAT Directive. The Swedish court then referred the matter to the ECJ.

In its judgment, the ECJ agreed that transactions to exchange traditional currencies for units of bitcoin (and vice versa) constitute a supply of services for consideration within the meaning of the Directive, since they consist of the exchange of different means of payment and there is a direct link between the service to be provided by Hedqvist and the consideration received by him, namely the margin created by the difference between, on the one hand, the price at which he purchases currencies, and, on the other hand, the price at which he sells them to his clients.

The ECJ also held that those transactions are exempt from VAT under the provision concerning transactions relating to "currency, bank notes and coins used as legal tender." To exclude transactions such as those envisaged by Hedqvist from the scope of that provision would deprive them of part of their effects having regard to the aim of the exemption, which is to alleviate the difficulties connected with determining the taxable amount and the amount of VAT deductible which arise in the context of the taxation of financial transactions, the ECJ concluded.

This judgment was released on October 22, 2015.

http://curia.europa.eu/juris/document/document.jsf?text=&docid=170305&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=457327

European Court of Justice: *Skatteverket v. David Hedqvist (Case C-264/14)*

Dateline November 12, 2015

Clearly, no single nation is going to tackle climate change alone. Which is why heads of state from around the world met ahead of the Paris climate talks last month to urge countries and companies to put a price on carbon. However, pricing carbon sounds fine in principle, but how do you do it in practice?

Different countries have chosen different ways to go about this, from straight taxes on carbon emissions to more complex market-based mechanisms. And nobody really knows yet what the optimum carbon pricing system should look like, including me, because there just isn't enough data to assess the various schemes.

But I'm going to stick my neck out and say that the ideal system won't look like South Africa's proposed carbon tax, the draft legislation for which I had the pleasure of reading the other day as part of another project. All I can say is, if your company is likely to be caught up in the carbon tax, and you've been given the thankless task of working out your firm's carbon tax liability, you better brush up on your math! The following is taken from section 6 of the draft Carbon Tax Act: "The amount of tax payable by a taxpayer in respect of a tax period must be calculated in accordance with the formula: $X = \{(E - D - S) \times (1 - C) \times R\} + \{P \times (1 - J) \times R\} + \{F \times (1 - K) \times R\}$." See what I mean? I'm not sure what's more baffling: the equation itself, or how the Government thought it was a good idea in the first place.

Hong Kong is one of the world's most open economies, if not *the* most open – the Heritage Foundation hasn't named it the world's freest economy for the past 20 years for nothing. This makes the territory one of the world's better-behaved citizens in the global trading arena, for it doesn't apply any tariffs to its imports, non-tariff barriers to trade are low, and the Government tends not to retaliate against trade barriers in other countries, or restrict certain imports.

Unfortunately, the same cannot be said for many of Hong Kong's trading partners, with some readily resorting to protectionist measures against other nations to shelter certain industries from foreign competition. Despite its vulnerability in this sense, the Hong Kong Government has traditionally eschewed the idea of entering into free trade agreements.

But the Government is now rethinking its place in the world trade arena having formulated a free trade strategy, probably out of fear of being marginalized in a world of regional super-FTAs, including the Trans-Pacific Partnership and the soon-to-be-formed Regional Comprehensive Economic Partnership. With the world trading environment evolving at a relatively fast pace, no nation can really afford to get left behind as new regional trade alliances form, especially Hong Kong. So trying to figure out where it fits into this new world seems like a wise move.

Bill Clinton's famous 1992 election campaign catchphrase was: "It's the economy, stupid." He meant that any leader or aspiring leader who neglects key economic issues is likely to be given a bit of a kicking by voters. And with Canada's economy grinding to a halt, outgoing Prime Minister Stephen Harper and his Conservative administration surely know what it feels like to get a good electoral kicking. And this is despite the fact that, until recently, the previous Government's track record on the economy was actually pretty good, in so far as it avoided the worst of the financial crisis, delivered a budget surplus, and maintained public debt at low levels in comparison to other G8 countries. The corporate tax rate was also slashed to 15 percent, putting Canada among the Hong Kongs and Singapores of this world in corporate tax terms.

But these things don't really excite voters that much, even though most people would probably agree, given what's happening in the eurozone, that balanced budgets and general all-round fiscal prudence are desirable things. Fiscal prudence is boring. As a political platform it lacks personality and pizzazz, and sounds rather staid and technocratish.

Enter Justin Trudeau, the 42-year-old Liberal Party leader, sworn in as Canada's second-youngest Prime Minister ever last week, who has promised to inject some youthful vigor into proceedings. He started as he meant to go on by appointing a relatively youthful cabinet with no member over the age of 50. Then, the PM-elect, his wife, and the cabinet all trooped off to the swearing-in ceremony in a bus – presumably his point being that this is a form of transport that the last Conservative cabinet wouldn't have been seen dead in, perhaps preferring instead the privilege and isolation of the ministerial limousine. Indeed, Trudeau is promising a more open, informal kind of government all-round. But what's he got to offer on the economy?

Well, he wants to invest in infrastructure, and that will mean running a deficit for three years. He also wants to reduce income inequality. But all he's offering on that front is a modest tax cut for middle-income earners. I'm afraid it all sounds a bit gimmicky to me – a bit style-over-substance. The cynic in me wonders how long it will be before the limousines emerge from their garages, or before taxes begin to rise. It all comes across a bit Tony Blair circa 1997, a bit "Cool Britannia." Trudeau will no doubt be hoping he doesn't suffer the same "hero to zero" decline in popularity that Blair did.

The Jester