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International Tax Course – International Tax Planning

Agenda

- Introduction.
- General remarks on International Tax Planning.
- Analysis of International Tax Planning Models and Indicators within corporate finance.
- Some thoughts on tax consequences of the digitalization of the economy.

Introduction

- **CORIT Advisory**
 - Ambition of being top quality boutique firm.
 - Emphasis on high-end, international and complex tax matters.
 - Fully credible and independent alternative to traditional service providers.
 - Tax advisory based on:
 - Academic ties.
 - Business and framework understanding.
 - True advisory approach (Not a cross disciplinary sales agenda).
 - Strict focus on quality and technical competences.
 - International perspective.
- **Providing services to leading public and private organisations.**

International Tax Planning

- What is international tax planning?
 - *"International tax planning is a multifaced discipline and may be defined as the lawful structuring (through the legally acceptable use of domestic tax law and tax treaties) of cross-border investments or activities with the objective of optimizing the overall tax burden and maximizing net income."*
 - *See Hoor & Bock in Tax Notes International 2013, p. 913.*
- Includes optimization of effective tax rate (ETR) and mitigation of risks and uncertainty.
- What is aggressive international tax planning?
 - *"Taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability."*
 - *See Commission Recommendation of 6.12. 2012 on Agressive Tax Planning.*

International Tax Planning

- Nothing wrong in carrying out tax planning.
 - Avoid double taxation.
 - Direct opportunities in existing tax legislation (e.g. depreciations).
 - Succession on business transactions.
 - Effective Tax Rate in competition.
- This presentation excludes tax evasion and illegal tax avoidance (this is not ATP).

International Tax Planning

- Which techniques are generally used internationally?
 - Guarding against different position from authority side:
 - Tax clauses in agreements, binding rulings, APAs etc.
 - General overview:
 - Corporate structures, holding companies etc.
 - Avoidance of withholding taxes.
 - Double tax relief.
 - Tax effective supply tax chain management.
 - Placement of production, sales and services.
 - Migration and relocation of companies, including head quarters.
 - Transfer pricing.
 - Financing structures and financing terms.
 - Mobile income.
 - Treaty shopping.
 - Hybrid entities .
 - Hybrid financial instruments.
 - Loss utilization, including tax consolidation.
 - Double dips.
 - Leasing.
 - IP tax planning.

The Models - ATP Structures

- Model ATP structures serve as a means of identifying a set of ATP indicators against which the risk exposure of tax systems can be tested.
 - Cf- Study on Structures of Aggressive Tax Planning and Indicators – 2015 (Ramboll Management Consulting and CORIT Advisory).
- OECD Models:
 - A hybrid financing structure.
 - A one-tiered IP and cost contribution arrangement.
 - A two-tiered IP structure with a cost contribution-arrangement.
- Four additional ATP structures:
 1. An offshore loan structure.
 2. A hybrid entity ATP structure.
 3. An interest free loan.
 4. A patent box ATP structure.

The Models - ATP Structures

1 Offshore loan

2 Hybrid financing

3 Hybrid entity

4 Interest free
loan

IP models

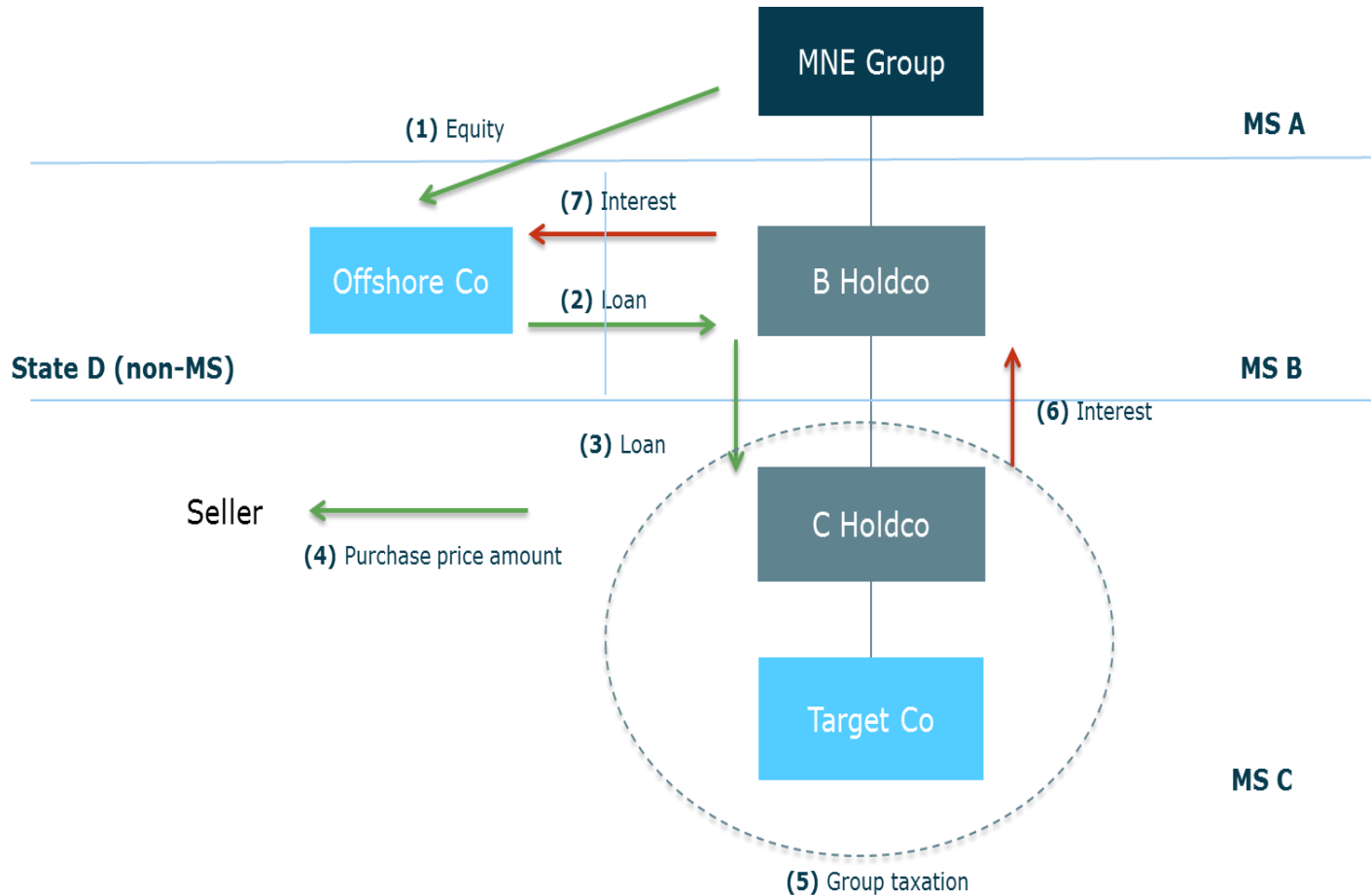
5 Patent box

6 Two-tiered IP

7 IP and CCA

- Model ATP-structures were selected from OECD BEPS reports, other tax literature and the authors' professional knowledge.

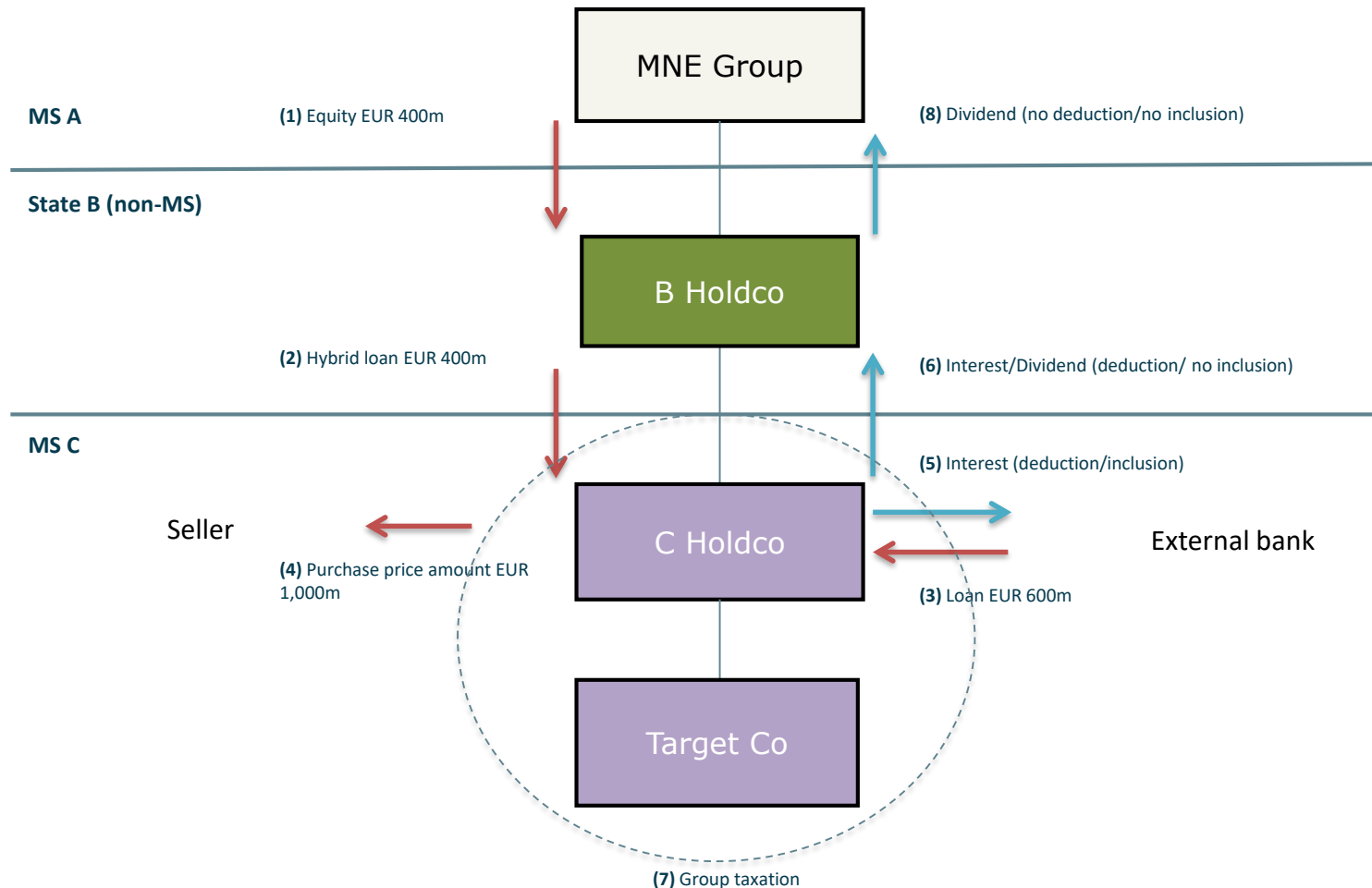
Model 1 – Offshore Loan



Model 1 - Indicators

MS A	MS B	MS C	State D
No taxation of dividends received.	Tax deduction for interest costs.	Tax deduction for interest costs.	No withholding tax on dividends paid.
No CFC Rules.	Tax deduction does not depend on the tax treatment in the creditor's state.	No thin cap/interest limitation-rules.	Absence of corporate income taxation.
	No thin cap/interest limitation-rules.	No withholding tax on interest payments.	
	No withholding tax on interest payments.	No beneficial owner-test for reduction of withholding tax.	
	Unilateral ruling on interest spread.	Group taxation with acquisition holding company allowed.	
	No general or specific anti-avoidance rules to counter the structure.	No general or specific anti-avoidance rules to counter the structure.	

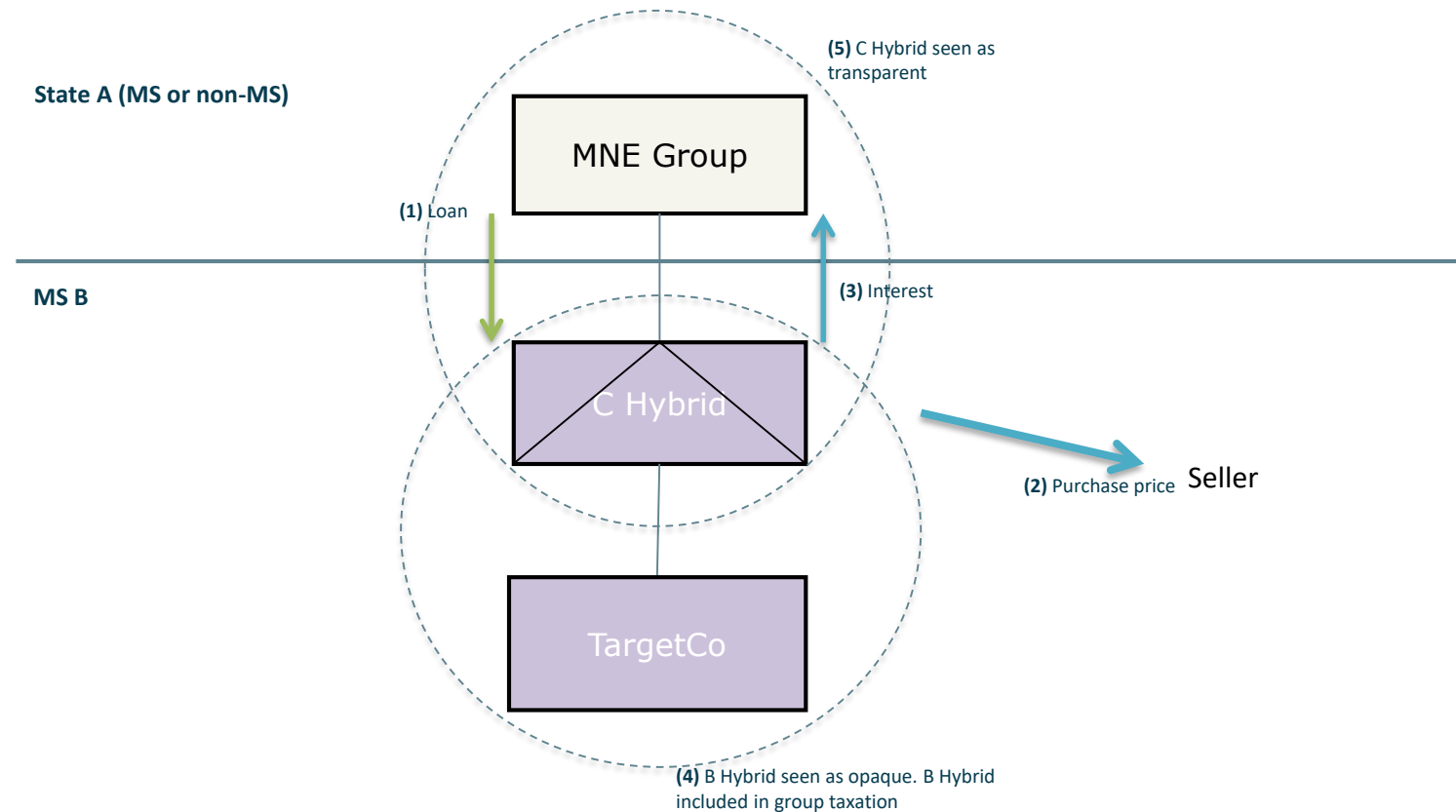
Model 2 – Hybrid Financing



Model 2 –Indicators

	State A	State B	State C
	<ul style="list-style-type: none"> • No taxation of dividends received. • No CFC Rules. 	<ul style="list-style-type: none"> • No withholding tax on dividends paid. • Income from certain hybrid instruments can be treated as tax free dividend or similar. • No taxation of dividends received regardless of deduction by the distributing company (hybrid loan). 	<ul style="list-style-type: none"> • Tax deduction for interest costs. • Tax deduction does not depend on the tax treatment in the creditor's state. • No interest limitation-rules. • No withholding tax on interest payments. • No effective beneficial owner-test for reduction of withholding tax. • Group taxation with acquisition holding company allowed. • No general or specific anti-avoidance rules to counter the model ATP structures.

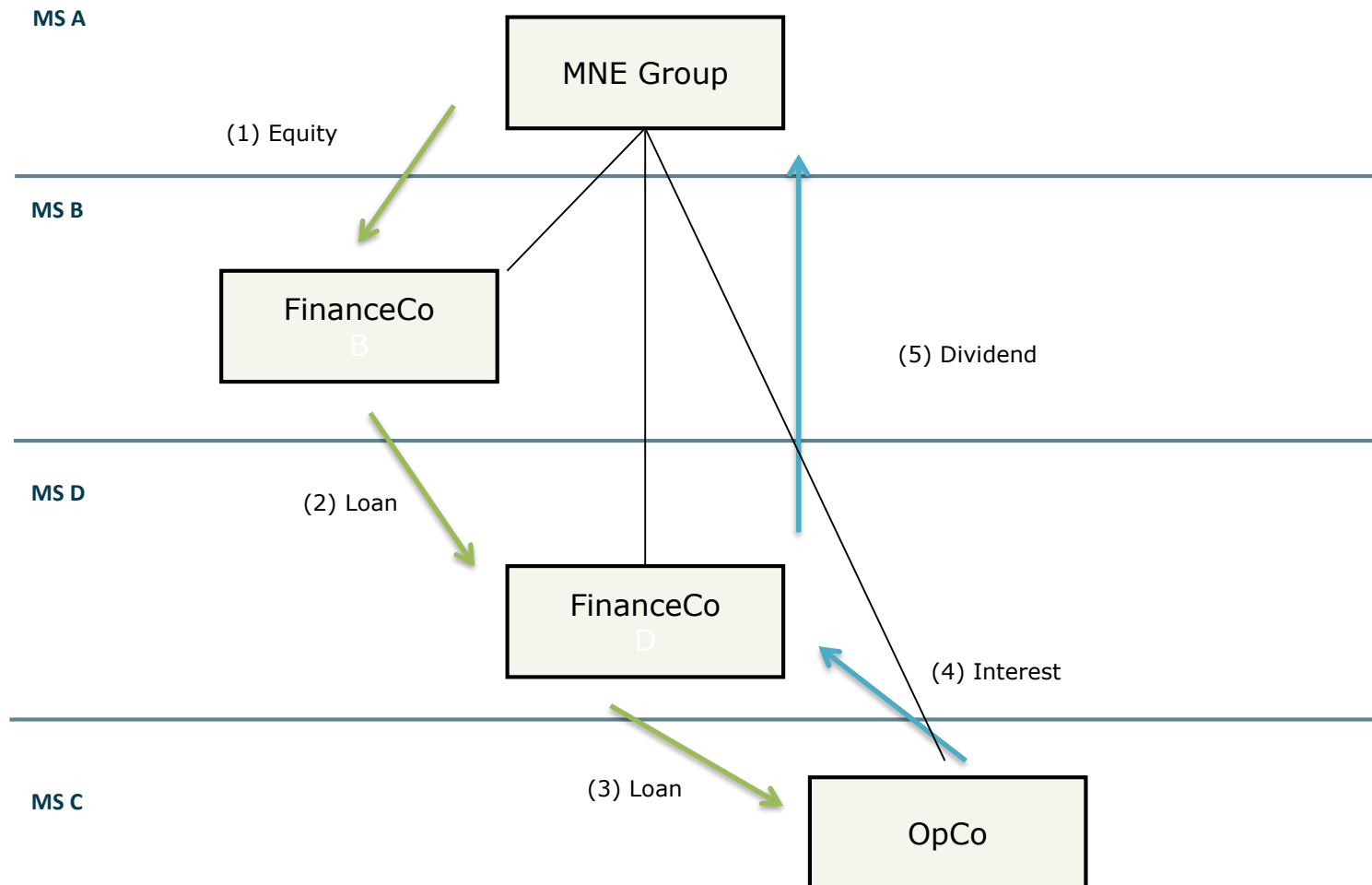
Model 3 – Hybrid Entity



Model 3 –Indicators

	State A	State B
	<ul style="list-style-type: none"> • No rule to counter a qualification mismatch of entities. • No general or specific anti-avoidance rules to counter the model ATP structures. 	<ul style="list-style-type: none"> • Tax deduction for interest costs. • Tax deduction does not depend on the tax treatment in the creditor's state. • No interest limitation-rules. • No withholding tax on interest payments. • Group taxation with acquisition holding company allowed. • Tax qualification of foreign partnership does not follow that of the foreign state. • No rule to counter a qualification mismatch of entities. • No general or specific anti-avoidance rules to counter the model ATP structures.

Model 4 – Interest-free Loan



Model 4 –Indicators

State A	State B	State C	State D
<ul style="list-style-type: none"> • No taxation of dividends received. • No CFC-rules. • No general or specific anti-avoidance rules to counter the model ATP structures. 	<ul style="list-style-type: none"> • No deemed income from interest-free loan (non-arm's length-transactions). 	<ul style="list-style-type: none"> • No withholding tax on dividends paid. • Tax deduction for interest costs. • Interest deduction allowed for deemed interest costs on interest-free debt. • No taxation of benefit from interest-free debt. • No interest limitation-rules. • No withholding tax on interest payments. • No general or specific anti-avoidance rules to counter the model ATP structures. 	<ul style="list-style-type: none"> • No withholding tax on dividends paid. • Tax deduction for interest costs. • No interest limitation-rules. • No withholding tax on interest payments. • No effective beneficial owner-test for reduction of withholding tax. • No general or specific anti-avoidance rules to counter the model ATP structures.

EU Anti Tax Avoidance Package

- On 28 January 2016 the European Commission presented its Anti Tax Avoidance Package.
- Includes a proposal for directive on BEPS, which includes the following provisions:
 - Interest deduction.
 - Exit tax.
 - GAAR.
 - Switch over clause.
 - CFC rules.
 - Hybrid mismatches.
- Impact?

Background and introduction

- The international tax policy environment – alignment.
- EU Anti-Tax-Avoidance-Package presented the 28. January 2016:
 - Package:
 - Recommendation on Tax Treaties.
 - Amended Directive on mandatory exchange of information (CbC).
 - External Strategy for Effective Taxation.
 - Anti-Tax-Avoidance Directive (ATA-Directive).
 - Policy objective:
 - Effective taxation: Ensuring tax is paid where the value is created.
 - Transparency: Ensuring effective access to tax information.
 - Addressing the risk of double taxation.
- Relation to OECD Base Erosion and Profit Shifting project (BEPS).
 - ATA-Package is the joint European Union's coordinated answer to BEPS:
 - Ensuring EU-law conformity of ATA-rules.
 - Creation of a better/fairer business environment?

Background and introduction

- Final adoption by the Council on 12 July 2016.
- Contains significant changes compared to the draft version.
 - Implementation no later than 1. January 2019.
 - Exit rules by 1. January 2020.
 - Existing interest limitation rules may be applied until the OECD agrees on a minimum standard no later than 1. January 2024.
 - Review 4 years after entry into force.
 - ATA-Directive is partially a carve out of the anti-tax-avoidance rules of the CCCTB.

Minimum Directive

- The ATA-directive is a minimum directive – de minimis approach.
 - Multiple options.
 - MS are obliged to ensure at least the level of protection as described in the directive.
 - However, MSs cannot offer less restrictive rules.
 - Consequently, MSs are allowed to apply more restrictive rules (Article 3).
 - *"This Directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding level of protection for domestic corporate tax bases".*

Subjective and Geographical Scope of the Directive (Article 1)

- Applicable to all taxpayers subject to corporate tax (entities and PEs).
 - Includes more taxable entities than the current EU company tax directives, including PEs of third country entities.
 - Variations between MSs.
 - E.g. entities in principle subject to tax, although objectively exempt from corporate income tax.

Interest Limitation Rule (Article 4)

- International trend towards EBITDA-based rules.
- 30% of EBITDA (tax).
 - Option to apply an EBIT-test in an equivalent way (undefined).
- The taxpayer may be given the right.
 - To deduct exceeding borrowing costs up to a minimum of 3 million EUR.
 - To fully deduct exceeding borrowings costs for a stand alone entity.
- Financial undertakings are exempt.
- Exempt loans.
 - Concluded before 17 June 2016 (and remain unchanged).
 - Long term public infrastructure projects within the EU.

EU ATAD GAAR (Article 6)

- For the first time a real GAAR has been introduced aiming at all non-genuine arrangements ***domestically and in cross border situations.***
 - Applies to all taxpayers that are subject to corporate tax in one or more MS, including PEs in a EU MS.
- Function: “to fill in gaps which should not affect the applicability of specific anti-abuse rules”
- Cumulative requirements:
 - *Arrangement or series thereof.*
 - *Having been put in place for the main purpose or one of the main purposes (subjective).*
 - *Of obtaining a tax advantage (objective).*
 - *That defeats the purpose or object of the otherwise applicable tax provision.*
 - *Non-genuine.*

GAAR (Article 6)

- Legal effect:
 - Arrangements etc. shall be ignored for the purposes of calculating the corporate tax.
 - Including WHT?
 - Left to MSs to decide - depending on the role of WHT in their jurisdiction – some discretion to determine the scope.
 - What does “ignored” mean?
 - Fully set aside, but not re-classification? – “disregard, refuse to recognize – abusive transactions must simply be left out.
 - Tax liability should be calculated in a way that is in accordance with the object and purpose of the provision that was circumvented.

GAAR (Article 6)

- Arrangement or series thereof.
 - Broadly defined: transaction, plan, action, operation, agreement, understanding, promise, understanding or undertaking.
- Having been put in place for the main purpose or one of the main purposes (subjective).
 - Not required that sole purpose. Not even a “dominant, principal, essential or main purpose”.
 - No guidance regarding main and partial purpose..
 - *“a given purpose is to be considered essential where any other purpose that is or could be attributed to the arrangement or series of arrangements appears at most negligible, in view of all the circumstances of the case.”*
- Of obtaining a tax advantage (objective).
 - Applicable even to minority investors.
 - Tax advantage: comparison of tax payable without the arrangement in place.
 - Obtaining a tax advantage is not per se non-genuine – taxpayer has the right to choose the most efficient structure for its commercial affairs.

GAAR (Article 6)

- That defeats the purpose or object of the otherwise applicable tax provision.
 - Reference to domestic law and the purpose and object of the part of domestic law in question.
 - Not always easy to determine (unclear or ambiguous purpose).
- “Non-genuine”.
 - Not put into place for valid commercial reasons, which reflect economic reality.
 - Designed to reflect the artificiality test of the ECJ.
 - Preamble: “GAARs should be applied to arrangements that are not genuine: **otherwise the taxpayer should have the right to choose the most efficient structure for its commercial affairs**”.
 - **Not genuine = artificial?** Why not using the wholly artificial terminology?

GAAR (Article 6)

- Tax authorities should carry the burden of proof.
 - Impression that this will be somewhat underemphasized.
 - Unfortunate that tax administrations should make such assessments on the basis of unclear notions.
 - Risk of arbitrary and varying practice among MS.

CFC-Legislation (Article 7)

- Legal effect:
 - Parent company shall include the specifically mentioned non-distributed income OR income arising from non-genuine arrangements.....
 - Inclusion, in accordance with the parent's entitlement to profit.
 - Applicable to subsidiaries and Pes.
- Common Requirements:
 - (1) Wide control test: > 50% of voting right, capital or profits.
 - (2) Low tax requirement: Actual corporate tax paid is lower than the difference that would have been charged under the applicable corporate tax system of the taxpayer and the actual corporate tax paid.
 - In effect a 50% low tax threshold.

CFC-Legislation (Article 7)

- Included CFC income:
 - Option (a):
 - Interest or any other income generated by financial assets.
 - Royalties + any other income from IP.
 - Dividend income and income from disposal of shares.
 - Income from financial leasing.
 - Income from insurance, banking and other financial activities.
 - Income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little value.
 - MS option to exempt if 1/3 or less of the income falls within the above categories.
 - EU/EEA exemption.
 - Option (b):
 - The non-distributed income of the entity or PE arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

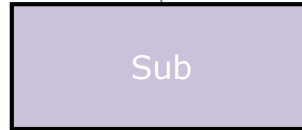
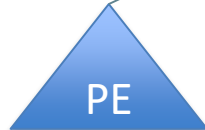
CFC legislation

EU MS



Parent taxed at e.g.
22%

EU MS/third
country



- Control?
- Low taxed ? (actual tax paid less than 11%)
- 1/3 of income is CFC income?
- Carries out substantive economic activity?

CFC-Legislation (Article 8)

– Comment:

- Significant impact: 14 EU MS do not have CFC rules.
- Difficult to assess the implications due to two different options.
- Broad scope:
 - Control (based on profit participation).
 - CFC income (invoicing companies, all IP income).
 - Double tax relief specifically mentioned.
 - Possible multiple application in multiple MS?
 - New forms of tax planning – routing investments through MS with lower tax rates fulfilling the substantive economic activity test + the GAAR?

Hybrid Mismatches (Article 9)

- Definition (article 2(9)).
 - A situation between a taxpayer in one MS and an associated enterprise in another MS OR.
 - A structured arrangement between parties in MS.
 - Where double deduction or deduction non-inclusion is caused by differences in the legal characterization of a financial instrument or entity.
 - ATAD II: expanded scope (2020).
 - 3rd countries.
 - Hybrid entity mismatches.
 - Hybrid financial instrument mismatches.
 - Imported mismatches.
 - Disregarded PEs.
 - Hybrid transfers.
 - Reverse hybrids.
 - Dual resident Mismatches.
- Neutralization (primary or secondary response).

New book on hybrid finance





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Taxing Digital Business Activities

Taxing Digital Business Activities

- **Defining the digital economy.**
 - The result of a transformative process brought by information and communication technology (ICT).
 - Has made technologies cheaper, more powerful, and widely standardized, improving business processes and bolstering innovation across all sectors of the economy.
 - Digital economy is simply embedded in the economy.
 - Difficult to ring-fence from the rest of the economy.
- **Digital Economy Business Models.**
 - Key features.
 - Mobility with respect to intangibles, users and business functions.
 - Reliance on data.
 - Network effects (decisions by other users may have a direct impact on the benefit received by others).
 - The spread of multi-sided business models (intermediaries/platforms).
 - Tendency towards monopoly or oligopoly.
 - Volatility.
 - Examples.
 - Online Retailer model (Amazon, Zalando, Alibaba).
 - Social media model (Facebook, Xing etc.).
 - Subscription model (Netflix, Spotify).
 - Collaborate platform model (AirBnb, Uber etc.).

Taxing Digital Business Activities

- Is the digital economy causing problems for the tax system and is there a need for fixing?
 - The rise of business on the internet tests many traditional tax principles.
 - Increase in remote activities create problems for tax authorities, that may have difficulties imposing (or enforcing) their taxes on economic activities that takes place outside their geographic jurisdictions (Taxing Global Digital Commerce, 2013, p. 27).
 - Tax rules continue to focus primarily on the physical world and have yet to address many of the challenges posed by this new world ((Taxing Global Digital Commerce, 2013, p. 27)).
 - OECD and all EU MS agree that there is a problem with the taxation of the digital economy.
 - Exacerbating ATP since more mobile and IP dependent.
 - Digital business often MNE from birth.

Taxing Digital Business Activities

- OECD actions
 - Some of the key features exacerbate BEPS risks (BEPS #1, p. 144).
 - Importance of IP.
 - Centralized infrastructure at a distance from a market jurisdiction and conduct substantial sales of goods and services into that market from a remote location, combined with increasing ability to conduct substantial activity with minimal use of personnel => fragmenting physical operations to avoid taxation.
 - Partially handled by other BEPS initiatives (PE, TP, CFC etc.).
 - Other tax policy challenges
 - Nexus – current rules appropriate?
 - Data (valuation, nexus, profit attribution as well as characterization).
 - Characterisation of income from new business models.
 - BEPS highlighted comprehensive responses (not recommended):
 - Significant economic presence.
 - Gross WHT on digital transactions.
 - Equilization levy (excise duty).
 - Comprehensive OECD report expected by early 2018.

Taxing Digital Business Activities

- EU actions
 - Talinn Summit sept. 2017: Communication from the Commission – COM(2017)547 final.
 - Currently no consensus among EU MS.
 - *"The underlying principle for corporate tax is that profits should be taxed where value is created. However, in a digitalized world, it is not always very clear what the value is, how to measure it, or where it is created?", p. 7.*
 - Two main policy challenges identified:
 - Where to tax? (nexus) – how to establish and protect taxing rights in a country where businesses can provide services digitally with little or no physical presence despite having commercial presence; and
 - What to tax? (value creation) – How to attribute profit in new digitalized business models driven by intangible assets, data and knowledge.
 - EU aims at coordinated approach.
 - Awaiting the 2018 OECD interim report.

Taxing Digital Business Activities

- EU actions (continued)
 - The way ahead:
 - Embed the taxation of the digital economy in the general international corporate tax framework.
 - New international rules are needed to determine where the value of businesses is created and how it should be attributed for tax purposes:
 - Concept of PE; alternative indicators for significance presence.
 - Transfer pricing: Requires alternative methods for attributing profit than better capture value creation in the new business models.
 - Anti abuse rules.
 - CCCTB – The Commission believes that the CCCTB provides for an EU framework for revised PE rules and for allocating profit of MNEs using the formula apportionment approach that should better reflect where value is created.
 - Short term alternative solutions:
 - Equilization tax on turnover of digitalized companies.
 - WHT on digital transactions.
 - Levy on revenues generated from the provision of digital services or advertising activity.

Taxing Digital Business Activities

- Unilateral initiatives
 - Absent conclusive guidance in the BEPS report – countries show themselves eager to raise additional revenues through innovative tax tooles (Teijeiro Oct. 4., 2017, Kluwer Tax Blog).
 - UK DPT.
 - Indian Equilazation levy.
 - Will national conflicting experiments lead to severe consequences to the industry in terms of multiple layers of taxation?

Taxing Digital Business Activities

- Tax policy considerations
 - Is there an “unfair” competition between old companies and tech companies?
 - Scientific basis for such conclusions?
 - ECIPE Occational Paper – No 4/2014, Lee-Makiyama and Verschelde:
 - Are bases eroding?- CIT has remained stable.
 - There is no causal relationship between the relatively recent rise of e-commerce as a sales platform and the corporate income tax base.
 - The political economy of taxation is such that profitable internet companies are easy targets – the link between the internet and base erosion and profit shifting is simply counterfactual.

Taxing Digital Business Activities

- Tax policy considerations.
 - Overall tax policy guidelines and questions.
 - The Ottawa declaration: Principle of "technology neutrality".
 - The digital economy cannot be covered by a separate regime.
 - Some of the proposals may actually achieve exactly that.
 - Conformity with EU law and WTO law?
 - Should country of consumption have income taxing rights? (what will happen if the US follows suit as a massive net importer?).
 - Is value created by consumption as opposed to production? Deviation from concept of value creation?
 - Is value creation really a general underlying principle for corporate income taxation?
 - A new principle rooted in BEPS and ATAD etc, but with no actual theoretical or legal basis.
 - Is market/data collection a factor?
 - Ability to engage in services without physical presence: does that provoke base erosion?
 - Digital presence:
 - Violation of function asset risk approach?
 - Does data in itself have value? Ability to monetize market data is not the same as having a presence.



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JAKOB BUNDGAARD

MANAGING DIRECTOR
HONORARY PROFESSOR, M.SC., PH.D.

CORIT ADVISORY P/S
LYNGBY HOVEDGADE 17, 2. SAL
2800 KONGENS LYNGBY
DENMARK

WWW.CORIT-ADVISORY.COM

P: +45 40 42 22 84
E: JB@CORIT.DK