

International Tax Training 2020
Part I

WORLD TAX
TOP TIER FIRM
2020

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Agenda

- Overview
- Status on the OECD work on Pillar 1 and 2 – Blueprints
- Tax treaty developments
- Case law developments – emphasizing GAARs
- Specific EU developments
- On the horizon and take-aways

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Overview of global developments

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Overview

- Global crisis
  - Short term: recovery/stimulus
  - Long term: global reform of tax system (capital income, digitalization, greening of the economy).

- The current landscape – ”The age of international taxation”
  - Tendency towards global uniformity and even harmonization (in principle)
  - Increased level of disputes and risks of double taxation.

- Key tendencies
  - Responsible tax and strategic tax
  - Anti BEPS measures
  - Transparency (Mandatory disclosure, CBCR, Tax reporting standards etc.)
  - Market state taxation – digitalization issues

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Responsible and strategic tax

- Tax matters are increasingly moving up the public agenda.
- International business has become increasingly exposed.
  - Severe reputational damages.
  - Lost public and private costumers.
  - Significant drops in share prices.
  - Top management can be held publicly accountable and be forced to explain in public.

- Responsible tax is now considered a standard requirement among investors.
  - May become parameter of competition.
  - New reporting initiatives (e.g. GRI 207).
  - Significantly increased interest in tax strategies and strategic thinking about tax matters – moving beyond uninformative public tax policies.
  - More and more MNEs are engaging in the tax policy discussions, in order to tell their side of the story and to impact the policy design of new legislation.

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Where has BEPS taken us so far?

- BEPS was basically designed to combat aggressive tax planning relying on formalistic legal concepts.
  - "Value creation", DEMPE, Commissionaire structures etc.
  - Push for new distribution structures, but seemingly not enough changes have been made?
  - Transparency measures

- BEPS introduced a lot more complexity (in an already complex system).



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New Taxing Right - Proposal for a ”Unified Approach” under Pillar One

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Unified Approach

- Unofficial Blueprint has been leaked – final Blueprint is expected in October 2020
  - Significant progress – proposals to bridge divergences
  - Still uncertainty regarding the likelihood of agreement – Role of the US?
- New revenue-based nexus
  - Not per se dependent on physical presence
- Three new profit allocation rules → need to deliver the agreed quantum of profit to market jurisdictions
  - Amount A: Residual profit split and fractional proportion method
    - Only where new local revenue-based nexus is created
  - Amount B: Distribution-based method for marketing and distribution activities
    - Only where local sub or PE according to current rules
  - Amount C: If too low taxable revenue under Amount B (i.e. if Amount B ≠ ALP)
    - Only where local sub or PE according to current rules

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New Revenue-based Nexus

- Scope:
  - Policy: *Focused on large consumer-facing businesses, broadly defined, e.g. businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element*
    - Automated Digital Services (ADS)
    - Consumer Facing Businesses (CFB)
    - »Not only create nexus for business models involving remote selling to consumers, but also business models where sale is done through un-/related distributors
    - Introduced as a standalone rule on top of the PE rule
  - Political decisions
    - Phased implementation?
    - Quantum (amount of profit to be allocated)?
    - Extent of tax certainty?

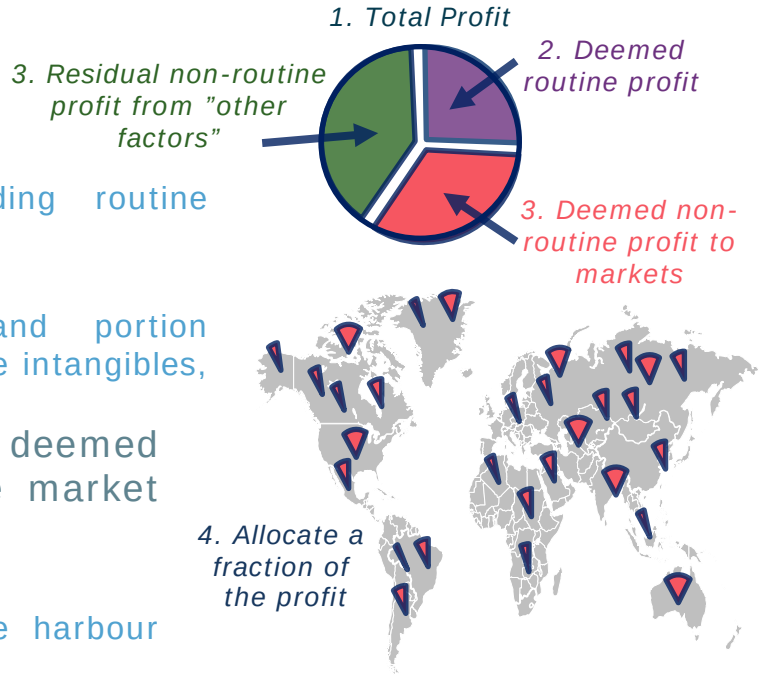
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New Profit Allocation Rules

Amount A: A deemed residual profit representing the value created by non-routine function in a market jurisdiction

1. Determine total profit to be split
   - Local GAAP or IRFS
2. Determine the deemed routine profit
   - Agreed level of profitability rewarding routine functions
3. Split of deemed non-routine profit
   - Portion attributable to markets and portion attributable to “other factors”, e.g. trade intangibles, capital and risk
4. Allocate the relevant portion of the deemed non-routine profit among the eligible market jurisdictions
   - Based on agreed allocation key
   - Marketing and distribution profits safe harbour (adjust the quantum)

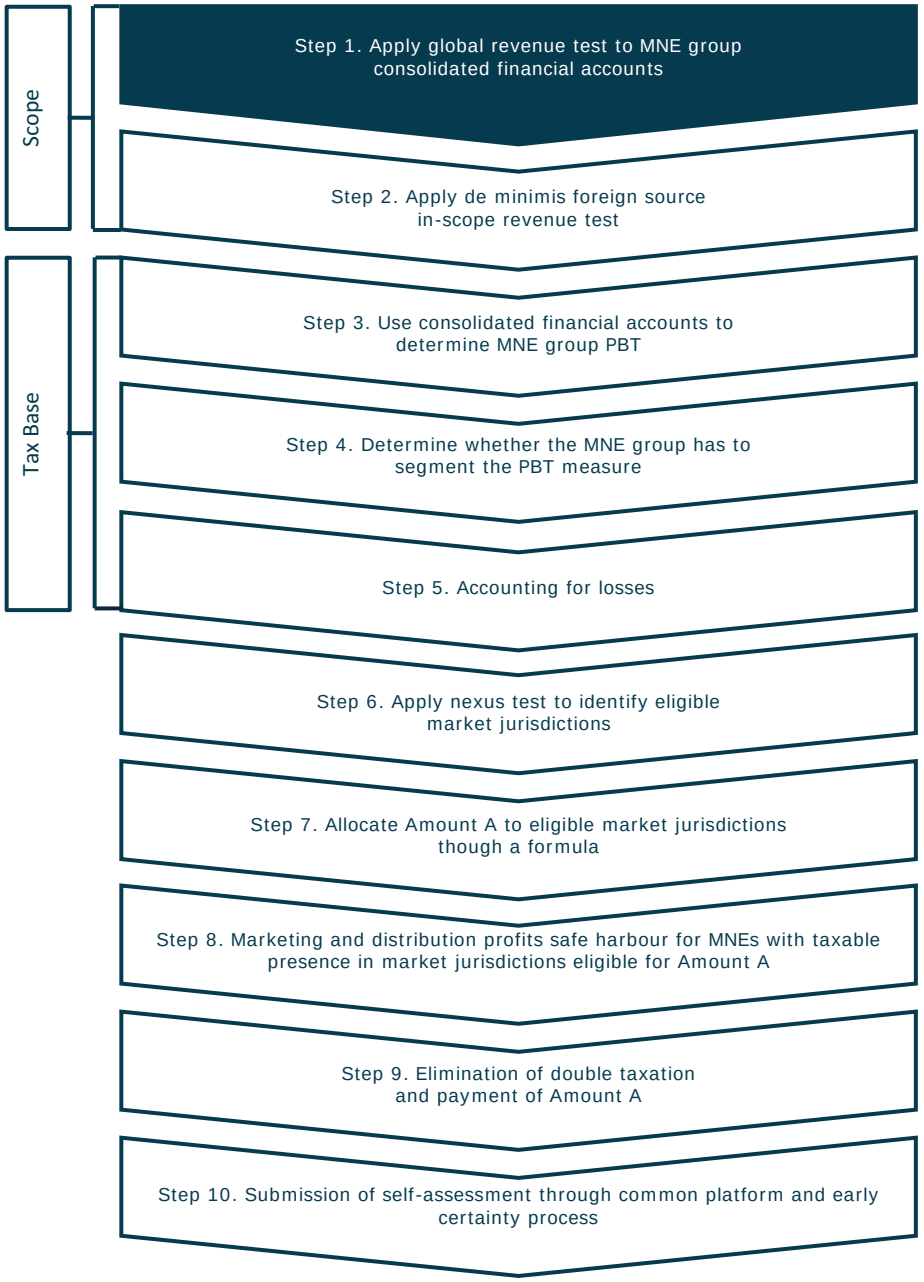


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Application of Amount A

- Overview



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New Profit Allocation Rules

- Amount B: A fixed return for certain baseline or routine marketing and distribution activities
  - Only applicable if there is a nexus following current rules (PE or subsidiary) and not in case of a new revenue-based nexus
  - Possibility of using fixed remuneration should be explored, reflecting an assumed baseline activity
    - Seek to reduce disputes
  - Aiming to standardize the remuneration for "routine distributors" – in accordance with the ALP
  - TP adjustments in home state to eliminate double taxation

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New Profit Allocation Rules

- Amount C: An additional amount allocated to the market jurisdiction exceeding Amount B if in accordance with the ALP
  - If marketing and distribution activities go beyond the baseline level of functionality, *or*
    - E.g. where a local distribution company owns and controls all the risks for highly profitable marketing intangibles
  - If the MNE performs other business activities in the market jurisdiction unrelated to marketing and distribution activities
  - Requires robust measures to resolve disputes and prevent double taxation
    - Mandatory and effective mechanisms
    - Panel mechanism knows from International Compliance Assurance Programme (ICAP)

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Issues

- Amount of profits reallocated (modest?)
- Ring fencing
- Challenges associated with the determination of the location of sales
- Defining in-scope activities, assets, return and expenses
- Determining allocation keys
- Interaction between amounts
- Treatment of losses – Blueprint contains Losses Carried Forward system (only real economic profit)
- Elimination of double taxation and disputes
- Enforcement and collection (WHT?)
- Implementation – MLI and domestic law



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Global Anti-Base Erosion Proposal (GloBE) – Pillar 2

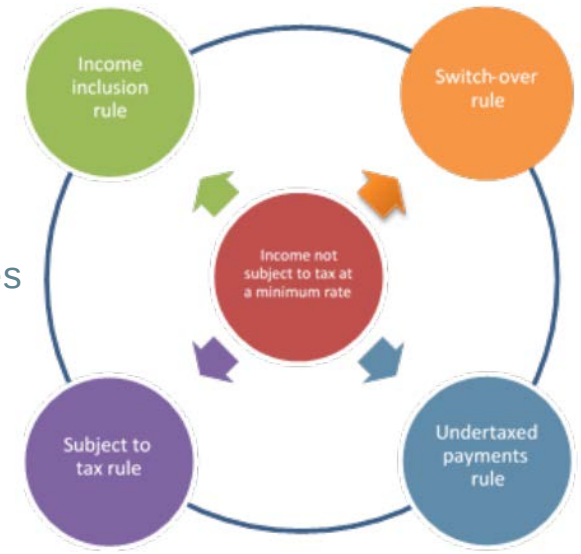
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Introduction

- Developing a long-term consensus-based co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

- Pillar 2 – GloBE
  - Seeks to address remaining BEPS challenges by establishing a floor under CIT
    I. Income inclusion rule
    II. Switch-over rule
    III. Undertaxed payments rule
    IV. Subject to tax rule
  - Implemented in domestic law and tax treaties



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Pillar II – GloBE

Rule	Mechanics	Details from blueprint
Minimum tax	1) Income inclusion rule: Taxation at parent company level of income in controlled entities locally subject to low taxation 2) Switch-over rule: Taxation at HQ of income in branches locally subject to low taxation	• A top-up tax to reach a minimum level of tax • Draws heavily on definitions and concepts used in BEPS 13 (CbCR) • Euro 750 million threshold • Reliance on financial accounting standards • A jurisdictional blending approach • Top-down coordination rule
Tax on base eroding payments	1) Undertaxed payments rule: No deduction for payments to a related party if payments are not subject to sufficient taxation. 2) Subject-to-tax rule: Treaty benefits only granted if the income is sufficiently taxed in the other state.	• Should compliment the income inclusion rule • Applies many of the same definitions and concepts as the income inclusion rule • But the subject to tax rule should apply to individual payments and the low-tax trigger should rely on the nominal CIT

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Pillar II – GloBE

- Still no decision on the minimum rate to be applied
- How to co-exist with US GILTI-rules and existing CFC regimes?
- Carveouts that reduces the GloBE tax base continue to be a point of discussion
- The leaked blueprint focuses on a formulaic substance-based carveout based on payroll and tangible assets
- Discussions on whether the rules could be implemented in a staggered manner (one at a time)
- The report leaves the door open to development of specific dispute prevention and resolution rules
- If agreement on Pillar I fails → Unclear whether countries mainly interested in Pillar I would agree to Pillar II on a stand-alone basis

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Tax treaty developments

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Tax Treaty developments

- UN Model Tax Convention – Discussion draft for new Article 12B
  - Income from Automated Digital Services
    - Broadly defined: Any payment in consideration for any service provided on the internet or an electronic network requiring minimal human involvement for the service provider
      - » Includes: Digital content services
  - Split taxing right
    - Taxation in the state of the digital service provider
    - However, may also be taxed in the state in which the income arises
    - But if Beneficial owner is a resident of the other contracting state the withholding tax shall not exceed a negotiated percentage
    - Does not apply, if the service provider has a PE in the state where the service is carried out and where the automated digital services are effectively connected to such a PE
    - Automated digital service deemed to arise in a state of the payer.
    - Arm's length reservation

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Tax Treaty developments

- UN Model Tax Convention – Discussion draft for new Article 12B
  - A gross WHT as a starting point
    - Possible for tax payer to opt for net taxation
      - » May require for the source state to subject the payment to the tax rate provided in the domestic laws of that state.
      - » Qualifying profits: 30% of the amount resulting from applying the beneficial owner's profitability ratio or the profitability ratio of its automated digital business segment to the gross annual revenue from automated digital services derived from the state where such income arises.
      - » MNE: apply profitability ratio of whole MNE or of the business segment of the whole group.
        - Loss making?

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Tax Treaty developments

- UN Model Tax Convention – Discussion draft for new Article 12 (3)
  - Broadening of the definition of software
    - Inclusion of the word “computer software” in the definition of royalty
  - Increasing engagement with state where the software is used justifies the allocation of taxing rights to that state.
  - Emphasize the ongoing market state discussions
    - Software depend on source state protection, infrastructure etc.
  - Pros and cons are presented in the Discussion draft.

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Covid 19 – Treaty interpretation

- The OECD has provided guidelines for interpretation of tax treaties during the pandemic

- Background – Many cross-border workers are unable to physically perform their duties in their country of employment during the pandemic → Raises a number of tax issues

- Initiative: Guidelines on treaty interpretation in certain areas

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Covid 19 – Treaty interpretation

Permanent establishments (PEs)

- Home office: ”*Considering the extraordinary nature of the COVID-19 crisis, and to the extent that it does not become the new norm over time, teleworking from home (i.e. the home office) would not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or because, except through that one employee, the enterprise has no access or control over the home office...*”

- Agency PE: “*An employee's or agent's activity in a State is unlikely to be regarded as habitual if he or she is only working at home in that State for a short period because of force majeure and or government directives extraordinarily impacting his or her normal routine…*”

- Construction site PE: “*It appears that many activities on construction sites are being temporarily interrupted by the COVID-19crisis. The duration of such an interruption of activities should however be included in determining the life of a site and therefore will affect the determination whether a construction site constitutes a PE…*”

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Covid 19 – Treaty interpretation

Place of effective management

- *"A temporary change in location of the chief executive officers and other senior executives is an extraordinary and temporary situation due to the COVID-19 crisis and such change of location should not trigger a change in residency, especially once the tie breaker rule contained in tax treaties is applied…"*

Cross-border workers

- *"Where a government has stepped in to subsidise the keeping of an employee on a company's payroll during the COVID-19 crisis, the income that the employee receives from the employer should be attributable… to the place where the employment used to be exercised…"*

Residence status of individuals

- *"… it is unlikely that the COVID-19 situation will affect the treaty residence position…"*

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Case law developments regarding GAARs

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GAAR

- Global trend to introduce GAARs
- EU-wide GAAR introduced aiming at all abusive arrangements *domestically and in cross border situations:*
  - Largely similar to BEPS action 6 (Principle Purpose Test)
- Legal effect:
  - Arrangements etc. shall be ignored for the purposes of calculating the corporate tax
    - Calculated by reference to substance in accordance with national law
- Requirements:
  - *"Arrangement or series thereof"*
    - An arrangement may comprise more than one step or part
  - *Having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage*
  - *That defeats the purpose or object of the otherwise applicable tax provision*
  - *"Non-genuine"*
    - Not put into place for valid commercial reasons, which reflect economic reality
- Tax authorities should carry the burden of proof

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GAAR (Article 6)

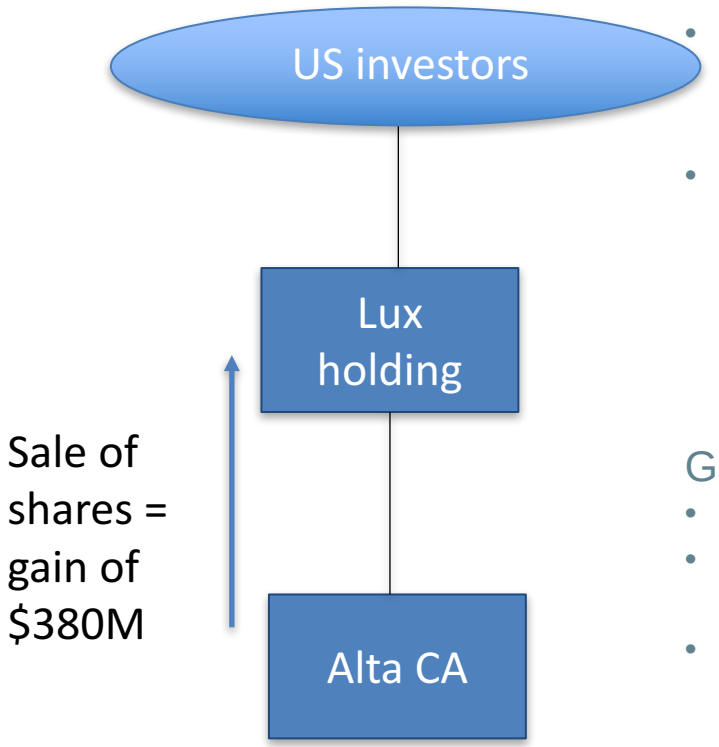
– Practical scenarios:
  - Classic conduit/flow through structure – Are holding companies genuine?
  - Determining the location of production facilities?
  - Determining the location of Joint venture entities?
  - Application of beneficial provisions through increase of ownership/shares. E.g. increase from 9% to 10% or from 24% to 25%, new share classes etc.
  - Mismatches not covered by other SAARs? (e.g. tax credit, timing mismatches etc.)

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Developments regarding GAARs

Canada v. Alta Energy Luxemboug Sarl. – Canadian Federal Court of Appeal, 2020



- CRA tried to use the domestic Canadian GAAR to deny treaty relief.
- GAAR has considerable similarity to the PPT on article 7 of the MLI

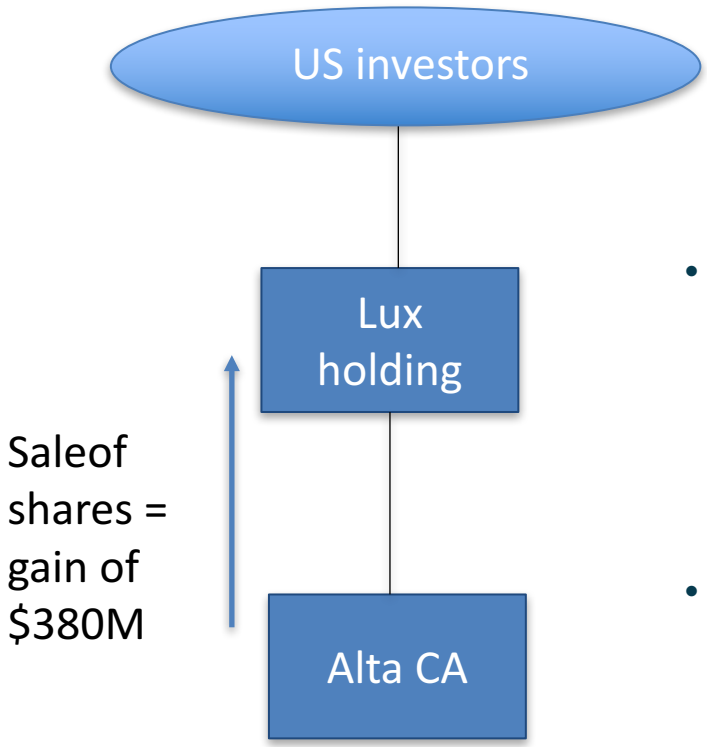
- Facts
  - Restructuring – interposition of Lux holding
  - Article 13(5) prevented Canada from taxing the capital gain - unlike under the US-Canada treaty
  - Luxembourg did not tax the gain

GAAR test

- *A tax benefit (accepted by the tax payer)*
- *An avoidance transaction (accepted by the tax payer); and*
- *An abuse of the provisions of the Income Tax Act or a treaty (disputed)*

Developments regarding GAARs

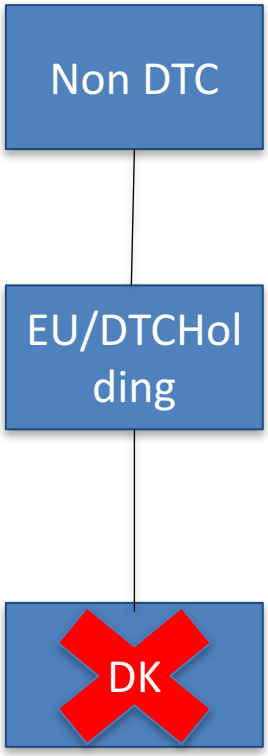
Canada v. Alta Energy Luxemboug Sarl.



- Abuse
  - Determination of the object, spirit and purpose of the provisions giving rise to the tax benefit
  - Were the provisions frustrated by the tax benefit achieved?
  - Burden of proof lies with the tax authorities
- Canadian Federeal Court of Appeal
  - Tax payer prevailed
  - Lux was a person resident in a contracting state
  - Level of tax and the economic ties to Luxembourg were not important – if certain qualifications applied they would have been specified in the treaty.
- Impact on the PPT
  - Object and purpose (reflected in the words chosen by the contracting states)

Developments regarding GAARs

SKM 2019.413 SR: Liquidation of Danish holding company – following insertion of new EU holding company



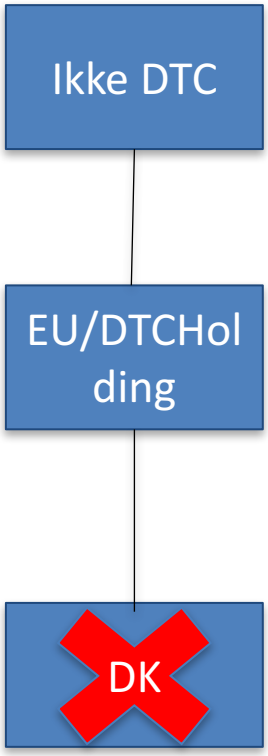
- Danish holding company liquidated following internal restructuring. Shares held by new EU/DTC holding.
- EU/DTC holding was the beneficial owner

GAAR test

- *Arrangement*
  - Removal of a company, where there was no tax treaty and insertion of Holding company is an EU/DTC state.
- *Tax benefit*
  - Previous holding company and ultimate owners resident in non tax treaty states.
  - Benefit

Developments regarding GAARs

SKM 2019.413 SR: Liquidation of Danish holding company – following insertion of new EU holding company



- *That defeats the purpose or object of the otherwise applicable tax provision*
  - *Main objective* to insert holding immediately prior to liquidation – aiming a benefiting from the tax treaty/EU PSD.
- *Non-genuine*
  - To simplify the structure due to strategic and business reasons
    - Must be documented
  - Cost savings
    - Which costs and how this is obtained? – set off against existing costs
  - Business reasons behind the new holding company were present – but not to explaing the timing immediately before the liquidation
  - C-126/10 Foggia : Business purpose must be proportional to the tax advantage obtained.
  - Loss of tax asset not a good argument for a empty company
- Result: Withholding tax in the liquidation proceeds as if distributed to ultimate owners.

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EU Developments

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Status on ATAD Implementation

Overview - Member States' ATAD Implementation

- The Commission's report only deals with interest limitation rules, CFC rules and the GAAR (application deadline 1 January 2019)
  - Not covering exit taxation and hybrid mismatches (appli-cation date 1 January 2020/2022)
- Key takeaways:
  - MS have made extensive use of the optionalities available
  - 4 MS have not yet fully complied with their obligations to adopt and notify transposition measures (Austria, Denmark, Spain and Ireland)
  - Other infringement procedures have been opened/closed
  - Currently hard to see ATAD as a truly unified response to BEPS – but better than no coordination at all?
  - More comprehensive report expected in early 2022

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Fair & Simple Taxation

Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy

- Part of the Tax Package adopted by the Commission on 15 July 2020 (also DAC 7 and ”Tax Good Governance”)
- Aims at making taxation fairer, greener and fit for the modern economy
- Only a first step – next steps to be presented before the end of the year in an ”Action Plan for Business Taxation in the 21st century”
- The action plan sets out two kinds of actions
  1) Measures aimed at reducing tax obstacles
  2) Intiatives helping MS to enforce existing rules

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Fair & Simple Taxation

Examples from the action plan

- Pilot project on cooperative compliance framework – aims to simplify reporting requirements (2021, Q1-Q2)
- Establishment of expert group on transfer pricing (2021, Q1)
- Implementation of Standing Committee for dispute resolution (2021, Q3)
- Digital solutions to levy taxes at source to facilitate tax payment and collection (2022)

Key takeaways

- Multiple initiatives to be expected from the Commission in the comings years
- The Commission stands ready to act if no global agreement is reached on Pillar I and II

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Status on the CCCTB

Proposal from 2016 - Common Corporate Tax Base (2CTB)

Proposal from 2016 - Common Consolidated Corporate Tax Base (3CTB)

- Currently the proposal is “dormant”
- A small part implemented through ATAD
- The European Commission is assessing whether other parts can be proposed/implemented bit by bit
- Revenue from CCCTB could potentially contribute to the Union’s “own resources”…

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“Own resources”

- Longstanding debate on ”own resources” to the EU
  - Today the EU mainly relies on direct contributions from MS
- EU’s vast borrowing to pay for pandemic recovery has re-ignited the discussions
- European Parliament is strongly in favor.
  - EP Report - Own Resources
- Ideas for raising ”own resources” have been floated, e.g. revenue from:
  - Financial transaction tax (FTT)
  - EU-wide digital services tax (DST)
  - EU Turnover Tax
  - The Emissions Trading System (ETS) and a new carbon adjustment mechanism (CBAM)
  - The penalty for non-recycled plastic
- (Some) MS more reluctant or against the idea
- New negotiations currently taking place

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EU Black list

- The EU list of non-cooperative jurisdictions for tax purposes consists of a Blacklist and a Greylist (observation-list)
  - Aims at helping EU Member States deal more robustly with countries that encourage abusive tax practices.
  - Encourage positive change in these countries through cooperation – not naming and shaming.
- The lists are based on a continuous and dynamic process of screening countries against international tax standards and engaging with countries which do not comply.
  - Criteria relate to tax transparency, fair taxation, the implementation of OECD BEPS measures and substance requirements for zero-tax countries.
- The following 12 countries were on the blacklist as of 12th March 2020:
  - American Samoa, Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, Seychelles, US Virgin Islands, Trinidad and Tobago, Vanuatu.

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EU Black list

- EU Sanctions
  - The EU Blacklist is directly linked to EU funding
    - Funds from these instruments cannot be channeled through entities in blacklisted countries.
  - Further there is a direct link to the EU blacklist in other relevant legislative proposals, including:
    - Transparency requirements for intermediaries (DAC6), a tax scheme routed through an EU blacklisted country will automatically be reportable to tax authorities.
    - The public Country-by-Country reporting proposal also includes stricter reporting requirements for multinationals with activities in blacklisted jurisdictions.
    - The Commission is examining legislation in other policy areas, to see where further consequences for blacklisted countries is to be introduced.

EU Black list

- Member State Sanctions
  - EU Member States are encouraged (only based on soft law) to apply at least one of the proposed defensive measures as listed below as of 1 January 2021.
  - The defensive measures include:
    - Non-deductibility of costs
    - Controlled Foreign Company (CFC)
    - Withholding tax measures
    - Limitation of participation exemption on profit distribution

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EU Black list

- Member States should ensure that they apply at least one of the following administrative measures in the tax area:
  - Reinforced monitoring of certain transactions.
  - Increased audit risks for taxpayers benefiting from the regimes at stake.
  - Increased audit risks for taxpayers using structures or arrangements involving these jurisdictions.

- NB: Domestic Blacklists
  - E.g. Netherlands, Spain, France, Germany, Luxembourg, Sweden

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State Aid and tax

Definition of State Aid

- Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by *favouring certain undertakings or the production* of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

The selectivity test

1. What is the ”normal regime” (the reference framework) ?
   - Often unclear what constitutes the reference
2. Does the measure discriminate between operators in a comparable situation, given the objective ?
3. Is the measure justified by the nature and general scheme of the system? (MS has the burden of proof)

The ECJ often disagrees with the General Court, which often disagrees with the Commission.

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State Aid and the Apple case

Background and facts

- Apple Operations International is a fully owned subsidiary of Apple Inc., and fully owns the subsidiary Apple Operations Europe (AOE), which in turn fully owns the subsidiary Apple Sales International (ASI).
- Apple Inc., on the one hand, and ASI and AOE, on the other, were bound by a cost-sharing agreement.
  - Under that agreement, the parties agreed to share the costs and the risks associated with the R&D concerning intangibles following development activities connected with the Apple Group's products and services.
  - The parties also agreed that Apple Inc. remained the official legal owner of the cost-shared intangibles, including the Apple Group's intellectual property ('IP') rights.
  - In addition, Apple Inc. granted ASI and AOE royalty-free licences enabling those companies, inter alia, to manufacture and sell the products concerned in the territory that had been assigned to them, that is to say, the world apart from North and South America.
  - Furthermore, the parties to the agreement were required to bear the risks resulting from that agreement, the main risk being the obligation to pay the development costs relating to the Apple Group's IP rights.

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State Aid and the Apple case

- ASI and AOE are both companies incorporated in Ireland, but are not tax resident in Ireland.
  - ASI and AOE set up Irish branches (PE).
- ASI and AOE obtained tax rulings (1991/2007) on the allocation of profits to the branches.
  - Most profits from an Irish perspective allocated to HQ – not the branches in Ireland– as IP was not allocated to the branches.

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State Aid and the Apple case



Source: European Union, "State aid: Ireland gave illegal preferential tax treatment to Apple", https://competition-policy.ec.europa.eu/publications/audiovisuals_en

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State Aid and the Apple case

Did the tax rulings constitute state aid?

- Commission in 2016 – Yes!
  - Wrong allocation of profit from IP sales.
  - Apple HQ had no physical presence or employees and such functions could not have been performed only by ASI and AOE's boards of directors (HQ), without any staff.
  - The profits should have been allocated to ASI and AOE's branches, which alone would have been in a position effectively to perform functions related to the Apple Group's IP.
  - Recovery of up to 13 b EUR from Apple (ASI and AOE).

- General Court in 2020 – No!
  - The Commission did not succeed in showing, in the present instance, that, by issuing the contested tax rulings, the Irish tax authorities had granted ASI and AOE a selective advantage.
    1. The Commission has not succeeded in showing that the Apple Group's IP licences should have been allocated to those Irish branches when determining the annual chargeable profits of ASI and AOE in Ireland.
    2. The defects in the methods for calculating the chargeable profits of ASI and AOE are not sufficient state aid.

  - Appealed to the ECJ.



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On the horizon and take-aways

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US presidential election

- The Biden campaign
  - 10 percent “Made in America Tax Credit” (revitalization or reshoring functions)
  - 10 percent surtax to US businesses whose foreign affiliates sell products into the US (offshoring penalty)
  - Stronger rules against inversion
  - Structural and rate changes – including an increase of CIT to 28 percent.

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Tax treatment of data

Hot topic for the coming years

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Take away's

- The unprecedented pace of the development continues.
- Imperative to think strategically about taxes, including the communication hereof.
- Potential effects of current tendencies
  - Increased ETR
  - Compliance burdens
  - Risk of double taxation
  - Legal uncertainty
  - Poor quality in legislation
  - Reputational effects
- Handling tax in the 21th century
  - Technical analysis as the starting point
  - GAAR assessment
  - Reporting obligations (MDR)
  - Alignment with tax policy
  - Assessment of civil society reactions

2020 CORIT

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