Global Tax Policy and Controversy Briefing
"I think companies should compete on the quality of products or the services they provide - and not on the performance of their tax planning."

An interview with Pascal Saint-Amans
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With the speed, volume and complexity of tax policy and legislative and regulatory change continuing to accelerate, accessing the leading global insights has never been more important. EY is pleased to make available a new Tax Policy and Controversy Briefing portal, providing earlier access to all articles in this publication and more, including interviews with minute-by-minute tweets of key news, daily tax alerts and more interviews with the leading stakeholders in the world of tax.

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Although the last few months have had less public discussion of BEPS, the OECD’s working parties have been using that time to negotiate and finalize the wording of the seven BEPS action items that were delivered on 16 September. The publication of these reports marks the beginning of what will surely be an extended period of assessment, discussion and potential implementation by countries around the world.
Not surprisingly, with the shift into the detail, the OECD has found it harder to obtain consensus as countries have started to firm up their positions. With the dates of the BEPS action plan inextricably linked to the political calendar and are therefore immobile, this has led to issues have been carried over for continued work where full agreement could not be reached. Indeed, only two of the reports were final, being the one on the Taxation of the Digital Economy and on the use of a multilateral instrument as a vehicle of delivery for many of the other deliverables.

Across the other deliverables, we saw an interim report with respect to Action 5 (Harmful Tax Practices), and reports with agreed draft recommendations on Action 2 (Hybrid Mismatch Arrangements), Action 6 (Treaty Abuse), Action 8 (Transfer Pricing for Intangibles), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). With the 2015 actions still in the wings, it will be a very busy year ahead and the detailed work on the BEPS project looks likely to spill well into 2016 and beyond, even if the reports are delivered to time.

In our feature interview, Alf Capito, Asia Pacific Tax Policy Leader for EY digs right into the heart of the debate in his discussion with Pascal Saint-Amans, Director for the OECD’s Centre for Tax Policy and Administration. The interview occurred during Pascal’s recent visit to Australia for the G20 Finance Minister and Central bank Governors’ Meeting and the message is forthright. “A number of these players are new players, and as new players they haven’t had a history of dealing with tax administrations.” he said of some companies operating in the digital economy. “They are risk takers, they don’t care, they take the risk, so they are more aggressive, a number of schemes which are actually very aggressive.” Pascal also spoke of a more inclusive future for the G20 efforts, reflecting the G20 communiqué that was issued just one day earlier: “The big emerging markets, which were emerging, which are still emerging, were not involved and they were thinking of developing their own sets of rules. Now they are part of the project.”

The G20 communiqué
Pascal’s comments closely reflect the content of the G20 communiqué. In that document, the G20 calls for far wider involvement of organizations including the International Monetary Fund, the World Bank and the United Nations in the global tax debate, as well as referring to how tax can and should support the members’ growth agendas. These are issues that we will come back to as the joint initiatives develop.

Other stakeholders increase their activity
Staying at the supranational level, the IMF’s late June report titled “Spillovers In International Corporate Taxation” added to the ongoing BEPS debate, describing features of the international tax architecture which raise issues for developing countries, identifying some possible policy responses, and suggesting some radical alternatives. You can read more on page 15.

Exchange of information
Mid-August, meanwhile, saw the OECD issue the voluminous Standard for Automatic Exchange of Financial Information in Tax Matters. Containing the text of the Model Competent Authority Agreement, the Common Reporting Standard and the Commentaries thereon, tax leaders in financial institutions will no doubt have made room for it in their late-Summer holiday suitcases.
Business as usual elsewhere

Beyond the supranational, many countries have been active on the policy front since our last edition; Spain and Sweden (among many others) have both issued significant tax policy reform packages, as has India in the area of tax administration. Major corporate and international tax changes in Japan and South Africa are also described by our authors, while in Australia an independent tax reform commission is called for in a recent EY report. In the UK, meanwhile, the government is clearly pushing to change the nature of the relationship between taxpayers and HMRC, announcing a consultation in relation to new criminal sanctions for offshore tax evasion.

Spain’s tax reform

Spain’s tax reform proposals (which were preceded by a controversial bill that expands a Board of Directors’ duties to include the approval of any transaction deemed significantly relevant for tax purposes) are discussed in our interview with Miguel Ferre, Spain’s Secretary of State for Finance, following our earlier interview of UK Minister, David Gauke.

Foreshadowing a fall in the main rate of corporate income tax to 25% (from 30%) by 2016, Mr. Ferre says that “The proposals we will retain (from the report on tax reform) are those which make it possible to enhance tax consolidation and to favor business competitiveness.” Speaking of the policy choice to not raise VAT rates, he adds: “At a time when the Spanish economy is beginning to show signs of recovery, a new increase in VAT will entail a negative impact on consumption and therefore on economic activity.”

Inversions

While tax reform in the United States remains somewhat of a sleeping giant, much talk has been heard on the subject of corporate inversions to lower-taxed jurisdictions. This includes a procession of senators speaking during a Senate Finance Committee hearing where such inversions were described as a “virus” and a “fever”, as noted on page 50.

Tax revenues rising

More widely, we highlight a series of reports from the OECD and European Commission that, taken together, confirm that global tax revenues are reaching and even surpassing pre-crisis highs. We also kick off the first in a series of discussions with leading revenue authorities on how they use technology both now and in the future to manage their own risks and facilitate service delivery.

More pressure

This broad mix of developments (and many more on top) are all layering more pressure on the tax function than ever before. This is confirmed by the results of EY’s 2014 Tax risk and controversy survey, summarized on page 12, which finds that reputation risk, legislative risk and operational risk are together making previous survey results pale in comparison.

Continuing to monitor the developments in tax policy and controversy, and predicting outcomes where possible therefore remains the order of the day. We hope this publication goes some distance to help you do that and, as always, if you would like to suggest topics for future consideration, please do let either of us know.

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Global updates

- **United States**: US Senator Levin introduces bill to tighten inversion rules under Section 7874.

- **Mexico**: Mexican SAT issues final rules on maquiladora revenue sources and VAT relief.

- **El Salvador**: El Salvador proposes tax reform.

- **Chile**: Chilean Congress approves tax reform, including CIT rate rise.

- **France**: France extends deadline for large companies to file Transfer Pricing Statement.

- **Ireland**: Ireland launches public consultation regarding corporate tax regime.

- **Spain**: Spain releases draft bill of Spanish tax system reform.


- **Tanzania**: Tanzania issues 2014-15 budget.

Czech Republic tax authority introduces mandatory intragroup transaction reporting.

Major corporate tax changes proposed in Sweden.

China’s Jiangsu provincial state tax authority releases guidance on international tax compliance administrative measures.

South Korea’s National Tax Tribunal holds indirect US shareholder is a beneficial owner.

Japanese Government announces plan to lower corporate tax rate below 30%.

Singapore issues guidance on income tax treatment of hybrid instruments.

Philippine lawmaker proposes tax reform bill seeking to reduce corporate income tax rate.

Hong Kong SAR concludes first advance pricing agreement.

Greece reforms mandatory contents of Transfer Pricing Documentation File.

Rwanda issues 2014-15 budget.

Italy introduces a tax credit for investments in new plants and equipment; increases notional interest deduction benefits.

Australia votes to repeal carbon tax.
Pascal Saint-Amans has been the director of the OECD’s Centre for Tax Policy and Administration, since the inception of the Base Erosion and Profit Shifting (BEPS) project. EY welcomed Mr. Saint-Amans to a breakfast event in Sydney, on 20 September, just four days after the OECD issued the first set of recommendations and the day after Mr. Saint-Amans attended the G20 Finance Ministers and Central Bank Governors’ meeting.

At our event, Alf Capito, Asia Pacific tax policy leader for EY asked Mr. Saint-Amans to share his insights on the journey travelled so far, the road map for the future and his thoughts on what it all means for business.
**Alf Capito**

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**Alf Capito:** Pascal, you’ve just come back from the G20 finance ministers meeting in Queensland. Can you tell us about the role of the OECD and the G20 specifically in regard to the tax agenda, as I’m not sure that all that many people understand the interplay between the two organizations?

**Pascal Saint-Amans:** Interestingly, the G20 was born at the leaders’ level. It’s been around for more than a decade and was escalated back in 2008 because of the global financial crisis. Part of their agenda at the first meeting in November 2008 was to include tax and the fight against bank secrecy. At that time, they had to save the banking industry and they said “we cannot put trillions of dollars on the table to save an industry which helps, in part, some taxpayers not pay their taxes.” They were thinking of Switzerland, Singapore and some other countries. As a result, the G20 leaders asked the OECD, as the technical body, to work on these aspects. So we’ve done that. We’ve created the Global Forum on Exchange of Information and now we’re developing the Common Reporting Standards so that all countries can move towards the automatic exchange of information.

More recently, at the Los Cabos summit in 2012, the G20 expressed concern about what we’ve called “base erosion and profit shifting” (BEPS). They said we’ve done good work to put an end to so-called tax havens and declared the era of bank secrecy as over. But they said we still have a problem with a lot of money stashed away in small places where nothing is happening except that you have trillions of dollars booked as profits. We don’t think the international tax system was built to deliver that result. So in June 2012 they mandated the OECD to work on this.

From October to November 2012, there was a lot of media in the UK about the taxation of some US multinationals that were accused of having a lot of activity in the UK, using it as a big market and not paying any taxes there. As a result, a number of the G20 finance ministers, such as George Osborne of the UK, Wolfgang Schäuble of Germany and Pierre Moscovici the then-French Finance Minister, said “this was an important topic. They asked the OECD to work on it, and urged us to work quickly on it”.

As a result, we were mandated to develop an analysis of this BEPS thing. In February 2013, we issued a report that the G20 welcomed in Moscow and asked for an action plan. We prepared an action plan that the G20’s finance ministers and leaders endorsed in Moscow and St Petersburg in 2013. And now we’re implementing this.

Why are we doing this? Is it because we don’t like multinationals and want to increase the effective tax rate of everybody? No, it’s not.

For the past 50 years, the OECD has been in charge of eliminating double taxation in order to facilitate cross-border investment. If you want to facilitate cross-border investment, you need common rules so that the countries tax profit once, and not twice. And that’s why we have the model tax convention, transfer pricing rules, mutual agreement procedures and a common understanding that serves as the basis for 3,000 bilateral treaties in the world.

The problem is it has worked so well in eliminating double taxation. Businesses are increasingly operating in a globalized environment. You have globalized markets so you don’t care too much about individual countries. This is good for business, but countries are sovereign from a tax perspective. They look at the coherence of their tax system internally and domestically and they don’t look at the spillovers on other countries. This creates double taxation that needs to be addressed, but also creates major opportunities for double non-taxation through businesses locating profit in the gaps between the sovereignties.

We have an international tax system that has been tested by this globalization since, I would say, the 1990s. It has not kept pace with the way companies are doing business. Initially we thought: “let’s do nothing. After all, we have rules, we have transfer pricing rules, we have treaties and we can do nothing.” And then we encountered evidence of countries that were unhappy with the system. They started taking unilateral measures. Here in Australia, for example, two or three years ago you started taking measures to strengthen CFC rules and to tighten the transfer pricing rules in the area of thin capitalization. But it’s not only about Australia. It’s about European countries and the global world. It’s interesting to refer to the G20 because 20 years ago it was the G7/G8; now it’s back to the G7. We’ve moved from this environment of big industrialized countries, advanced economies having a view and meeting as a club and discussing this, to the far wider G20.

We have eight non-OECD countries in the G20 - China, India, South Africa, Indonesia, Brazil, Argentina, Russia and Saudi Arabia - and these are big economies. One of the challenges for the OECD is developing rules and pretending that these rules are to be global, as we have a global economy, when actually we’re missing these eight countries – plus all the developing countries in the membership. So, one of the challenges was to bring all these countries on board when developing rules so that they are more relevant. One set of global rules is better than dual standards. Otherwise you would have rules for the BRICS (Brazil, Russia, India, China, South Africa) and rules for the OECD countries – because that’s double taxation for certain.
We thrive in an environment where countries are sovereign, they can take unilateral actions and are taking unilateral actions. But the BEPS Project is a way to limit the impact of these unilateral actions and to limit the number of unilateral actions. But for sure once the BEPS Project is completed I think you will have unilateral actions but which will be, if not coordinated, at least done in a cooperative manner across countries.

So, we’re trying:

1. To fix the system so that it’s sustainable and I think we have a converging interest with business there.
2. To fix it in a way that will eliminate double non-taxation and will preserve the elimination of double taxation. So, no double non-taxation, no double taxation. It’s a challenge at a time when countries are anxious to take unilateral measures as quickly as possible. We’re trying to hold them up, while waiting for a common set of rules to be agreed upon.
3. To do that with all the G20 and the OECD countries, which is 90% of the world economy. The Finance Ministers’ meeting yesterday in Cairns asked us to do even more to include developing countries, so they have a more equal footing in the process and in turn, we will have a global set of rules.

How the G20/BEPS agenda heads off unilateral law changes including hybrids

**Alf Capito**: Pascal, it seems to me that there was a lot pressure on countries to move unilaterally at one point. Is it fair to say that the OECD has put a brake on this to try to get some common way forward as opposed to unilateral changes resulting in a mess?

**Pascal Saint-Amans**: Well, it’s true that a number of countries are willing to take unilateral measures as quickly as possible. Let’s take the area of hybrid mismatches. A number of countries for years have said, “Hybrid mismatches, we don’t care, it’s a question of arbitrage, and arbitrage is for the companies to decide. We have our own system and whether it’s hybrid or not, we don’t really care.” Some countries have facilitated the emergence of hybrid mismatches, causing the magnitude of the problem to increase. But because of the crisis, a number of governments said we’ll close it down. We could have decided to do nothing, and let inconsistent decisions create double taxation.

We can do only what we can do. We are the OECD, an international organization based on consensus. We develop ‘soft legislation,’ meaning that the rules we’re developing are agreed by consensus, or are to be agreed by consensus. If there is no consensus, then there is no rule. And while the rules are morally binding, they are not legally binding. So, can we tell countries, can we instruct countries what they have to do or not to do? No, we cannot.

But we can influence the countries. We can tell them, “listen, if you act unilaterally, you will damage yourself and business in your country, but we recognize that you face issues. So, let’s work together and try to come up with model legislation.”

For instance, in the hybrid area we’ve just developed model domestic legislation with all 44 countries (34 members in the OECD, the eight non-OECD G20 countries plus Latvia and Colombia, which are becoming OECD countries) The countries bring their experience, all bringing their views, and all identify the risks of deciding on this rule, identifying spillovers that may be contrary to the policy intention.

Have we told the countries to stop doing anything? More or less, yes. But some countries have already taken action. I think the fact that the OECD, within the BEPS Project, is able to deliver new rules in a very short period of time has actually convinced a large number of countries not to take immediate action.

We live in an environment where countries are sovereign; they can, and are, taking unilateral actions. The BEPS project is a way to limit both the impact of these unilateral actions and the number of unilateral actions. But for sure, once the BEPS project is completed, I think you will have unilateral actions that will be – if not coordinated – at least done in a cooperative manner, across countries.

**Alf Capito**: Sticking with hybrids, what do you see going forward in the hybrid space?

**Pascal Saint-Amans**: The hybrid instrument and entities challenge is to be addressed in what we call Action 2, neutralizing hybrid mismatches. This action was to be delivered in September 2014. We have presented to the G20 finance ministers some model domestic legislation together with a model treaty provision for countries to neutralize the use of hybrid mismatches.

We’re just saying if you have an interest deduction here, actually it shouldn’t be dealt with as an exempt dividend there. It’s as simple as that.

We provide a common set of rules that would be either forced inclusion or no interest deduction depending on the case. The primary rule is about forced inclusion. If there was a deduction in the other country, it would be easier to administer because you have the information, while doing the opposite is far more complicated. You may not know in the source country what’s going to happen in the residence country, while in the residence country, you know more about what happened in the source country.

By the way, this is not a residence-source issue. A number of countries, as you know, would like to have more source taxation, while other countries are in favor of residence taxation. But this is not really about that, this is just to say that hybrid mismatches are over. So, it’s both the source and the residence countries that win, or stop losing, with forced inclusion.
So, we’ve developed that model. And there is full agreement, with all the countries agreeing that’s the right thing to do and that’s how to do it. There is a political commitment to implement this technical solution.

Now what happens? What’s next? As you know the BEPS project is for two years and we have an agreement which will be a soft law – an OECD recommendation. We’ll not formalize that until we have the whole package because there may be interactions between the different actions. There are some implementation issues that we also need to address. So on the hybrid mismatch, we have the agreement on the model legislation and the model treaty provision, but we need to provide guidance to business, industry and the tax administrations on how to implement. When we have the model tax convention, we will have commentary and extended commentary. We’ve started the commentary on the hybrid mismatches, but we need to expand it.

In addition, we also need to solve a couple of issues. One of the issues we are working on is how you deal with additional tier 1 regulatory capital based on Basel 3 regulations¹, how do you deal with that in the banking and financial industry?

To respond to your question, we are going to develop some further guidance that will be ready in the coming months. At the end of 2015, when all the Actions are completed, we’ll formalize this and then it’s expected that countries will change their domestic legislation according to what they have politically endorsed and technically agreed to. That may translate into brand new legislation in a number of countries. It may also translate into adapting the legislation that has been passed, over the past two years.

For example, in France we have anti-hybrid mismatch legislation and I understand they would be ready to adapt it so that it’s fully in line with the Project. Why? Because we think it’s going to be more effective, more efficient, and, for business, more relevant because you will face one set of agreed-upon rules among all the countries, instead of facing new hybrid mismatches that would result in double taxation.

¹. Basel 3 is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector. http://www.bis.org/bcbs/basel3.htm.
On the multilateral instrument

Alf Capito: Pascal, we touched on the multilateral instrument which might be an innovative way of putting things into treaties and saving time in the renegotiation of many treaties – 3,000 in fact. So, can you tell us a little bit about what you think might be the menu of things that might find its way into this multilateral instrument?

Pascal Saint-Amans: In the past I was the Chair of Working Party 1 of the Committee on Fiscal Affairs, which is the working party that updates the model tax convention, and I was a treaty negotiator. I loved traveling across the world to update France’s bilateral treaties. France has more than 110 treaties, so there were many countries to visit.

I’ve always been struck by the question “is it the most rational way of progressing”? A few years ago I remember we agreed to some provisions of the OECD’s treaties and one I strongly believe is very important is arbitration. Not all, but a large number of countries agreed that we should have arbitration provisions in the mutual agreement procedures article. We agreed at the OECD and then we went back to our countries and started negotiating 110 treaties. Everybody agreed on the language to be included in the treaties, but then they travelled the world to negotiate the bilateral treaties. And of course, you always find a good reason to depart from the model – here I will add a comma, or I do this. Is that absolutely necessary? The answer is no.

So business needs more certainty and countries need to be more efficient. When you update tax treaties – 3,000 bilateral tax treaties – it’s going to take 10-15 years and you will face here in Australia, and elsewhere, a situation in which some of the treaties have been updated, while others have not.

If we all agree and we also agree on language, have strong political support, be endorsed by the leaders of the G20, then why wouldn’t we sign a multilateral convention that would adapt all the bilateral tax treaties simultaneously?

We have delivered a report that examines the feasibility of a multilateral convention. The answer is yes, it’s feasible. It’s extremely complex, but it’s feasible. So, we shouldn’t hide behind complexity to say let’s not do it. And if we can do it, well let’s do it. We’ve been mandated to draft a mandate for gathering an international conference or group of countries, which would be very large, as many countries as possible, to negotiate this multilateral convention. It’s not that difficult because the technical work is being done through the different Actions. We’ll have the outputs and just have to put them together in a frame that is this multilateral convention.

Alf Capito: What’s the timing for this?

Pascal Saint-Amans: We’ll see whether we go forward because we need to look at the mandates for countries to be fully confident that’s the way they want to pursue it. I suppose that by early 2015 we’ll know whether we’re going forward or not. And if we go forward, which I strongly hope we do, we’ll probably start the negotiation – the framework – sometime in 2015. This will converge in terms of timing with the delivery of the other Actions. At the end of 2015, we should have a clear, positive view of where we are, quite advanced and it may take a few more months to finalize, but we’ll achieve this in a couple of years, maybe three years. Why? I think updating all the bilateral treaties would have taken at least 10 years.

On mutual dispute resolution processes

Alf Capito: You touched upon mandatory arbitration. As a result of this whole BEPS initiative obviously many tax authorities have decided that they want to examine the existing arrangements and that’s led to increased disputes. The current mutual assistance procedures in the treaties are really not very satisfactory. So what is the possibility and the likelihood of mandatory arbitration being part of this legislative instrument, to provide at least a better dispute resolution process?

Pascal Saint-Amans: I would like to make a comment on your question. You say the context of the BEPS project has led a number of tax administrations making adjustments or looking at them. I don’t think that’s accurate. It’s because tax administrations were doing so that we launched the BEPS project. So it’s not because we launched the project that you have increased disputes. We were facing increased disputes some time ago. It’s true that now you have a number of tax administrations using the BEPS brand to say, well, I’m doing a BEPS check.

Alf Capito: Perhaps as a result of the BEPS media, as opposed to the BEPS project?

Pascal Saint-Amans: Absolutely, and maybe sometimes I use the BEPS brand too much. BEPS is the problem and we’re trying to bring solutions to that problem. But that’s it.

I think we’ve had an issue with the lack of efficiency in mutual agreement procedures for decades, probably since the inception of the model tax convention.

We have countries endeavoring to eliminate double taxation. But they are not obliged to eliminate double taxation. First, they don’t feel the pressure. Second, while you have competent authorities that do their job, they do not...
have all the resources needed. They are not on the political radar and if things are not advancing well, there is no sanction of any form. They just endeavor to eliminate double taxation, and if they don’t do it, so be it.

I can give you an anecdote. In 2004, I was the French competent authority and I closed a case with Belgium eliminating double taxation. The case was initiated in 1973 – 31 years – the company was still alive – a miracle – and I guess it probably cost a fortune in terms of interest. But it shows that we could probably be slightly more efficient. And that’s true, I think, across the board in so many countries.

We’ve done a lot of work there. Some years ago we issued the MEMAP2, a practical manual on how to handle mutual agreement procedures. We included in the model tax convention the provision making mandatory arbitration a possibility. This was largely endorsed, but not fully endorsed.

And what has happened? Not much. We must recognize that we still have a problem. Personally, I think one of the reasons is that you have a number of tax administrations focused on fighting double non-taxation and not focused on eliminating double taxation when they see so many cases of double non-taxation. They see the cases, they try to make adjustments and they lose the cases because the planning is legal.

So, what are we doing? We’re changing the law. The law being the international tax rules, which will then translate into domestic legislation to neutralize this tax planning. By doing so, we actually deprive all the tax administrations of the argument that “well, there is so much double non-taxation, why would we put so much resource on elimination of double taxation on some cases.” I recognize that we live in an environment of increased uncertainty. That’s not good. So we need to gear up the way we handle this.

So, what are the solutions? We’ll see at the end of next year because that’s a deliverable for 2015. But I tend to think we have two avenues. One is to strengthen the legal obligation to eliminate double taxation. And ideally we should have mandatory arbitration. That said, a number of countries are extremely reluctant and are objecting to it. At the Finance Ministers’ meeting, some countries clearly said we have a problem with arbitration. And there are good reasons for that as well. Some developing countries with either corrupt tax administrations or uncertainty in the legal framework, having arbitration that is opaque, which is I give up my sovereignty to a bunch of people who will not report to anyone. Those in favour of arbitration recognise that. But we need to find legal avenues to put the emphasis on the needs – and I would say the obligation – to eliminate double taxation. That’s why we can probably update the model there.

But more importantly, arbitration can be a very down-to-earth solution. How can we unlock the roadblocks of the efficiency of the elimination of double taxation, how can we make the mutual agreement procedures work?

I think we have some elements of the solution here which is putting it on the political radar of politicians and the governments, so that the tax administrations feel the pressure. It may not be a complete ‘Big Bang’ change, but that may be the solution to have tax administrations really engaged and doing it. And I’m confident that we’ll come up with some simple principles that all the countries will implement.

The best solution would probably be to have some form of global forum. We have a global forum on transparency and exchange of information – and its working. Countries are changing their rules or changing the practice to exchange information because you have peer pressure. You level the playing field. Why not a global forum on mutual procedures? Why not publish the number of cases, the average time to eliminate double taxation, the outcome, and how many remaining cases of double taxation each country has?

If you publish that, and if you have the political pressure, leaders of the G20 will say, “where are you guys? We’ve committed to something - what have you done?” Maybe we’ll change the environment there and, if the tax administrations know that there will be efficient mutual agreement procedures for arbitration or through other ways, then the risk of uncertainty will probably. This is a deterrent effect on the tax administrations when they primarily do the adjustments. So, you know that’s a complex issue. It’s an extremely important issue. That’s why it’s in the Action Plan, but we’ll see what happens in 2015.

Alf Capito: There’s been a lot of talk about aggressive multinationals, but of course we’ve got plenty of cases of aggressive governments that this would help temper, if you like, with the arbitration process. The fact that they have to then submit themselves to this might make them pause.

Pascal Saint-Amans: It’s part of the Action Plan and there is political commitment to moving to that direction.

On country by country reporting

Alf Capito: Pascal, let me ask you about country-by-country (CbC) reporting.

Pascal Saint-Amans: CbC has been quite high in terms of media profile and position on the political agenda. That’s something I think CEOs care about. It’s something that the leaders of the G20 care about and they understand easily, because it’s a simple idea. It’s extremely complex, but it’s a simple idea. And it’s pretty hard to fight against that idea.
There is agreement at the G20 and all the G20 countries and OECD countries fully agree on the fact that we need to have this information protected and confidential, so, in the hands of tax administrations only.

This was promoted largely by NGOs initially - and this was translated in different sectors, in the European Union for the banking industry, worldwide with the EITI initiative for the mining industry which I think is something important here in Australia. But from a tax perspective, a number of countries were reluctant.

All that was unlocked in Lough Erne, which was the summit of the G8 last year in the UK, when the leaders said they wanted the OECD to develop the template. And interestingly, quickly afterwards, the G20 took on the idea and said, well, we want to work there too. It’s interesting to see that dynamic between the G7, G8 and the G20. So, we’ve developed a template for CbC reporting.

It says multinational companies should disclose to tax administrations - and to tax administrations only, it’s not a public report - some elements of information on a country-by-country basis. So, you have a template which will include columns and as many lines as countries where you operate. The columns are about the sales, profits, the accrued taxes, the paid taxes, the employees and the assets deployed in these different countries. You fill this in, you send it to your tax administration in your country of residence and then this will end up, through different mechanisms that I will go back to, in the hands of tax administrations where the company is present and so forth.

So this country-by-country reporting template is ready and is agreed. You will have seen in the explanatory statement that there is agreement to revise the content of the country-by-country reporting by 2020 based on the experiences we have. And this was the compromise because, you know that more countries would like to have less information and a number of countries would like to have more information. It was agreed that this is a risk-assessment tool for tax administrations. Some countries were a bit frustrated with the agreed-upon volume of information but there was an agreement.

It’s a good illustration, I think, to try to convince you that what we are doing actually is in the interests of the whole community, including the business community. It’s a good example of the compliance obligation on companies which might be perceived as additional compliance cost.

But let’s assume we did nothing. If we do nothing you will have a number of countries taking unilateral measures. It’s very high in the political debate and this is a bipartisan issue - right wing, left wing, in all the countries, members of parliament say why wouldn’t we know? So, a number of countries would have taken unilateral measures to say we want to introduce this reporting - China, India, Brazil, South Africa, France, Germany, the UK, maybe someday the US, and for sure Mexico.

Assume that that they don’t agree on a common template. They will all ask for different pieces of information. You may object on the basis that that’s unilateral legislation which is extraterritorial because if you have a subsidiary how come did you ask for the overall picture of the group? Well, I would respond that I have another example of a unilateral, extraterritorial legislation which is working pretty well – which is FATCA. So, it’s not because it’s unilateral or extraterritorial that it doesn’t work, and I have a number of countries saying well, the US does it, we’ll do it. Now, maybe you wouldn’t care about small countries, you’d say we’ll close down the operation in this small country. But I mean China is a 1.3 billion person market - will you say sorry, we don’t report there? No you wouldn’t.

Here, instead of these very different templates which could have been put in place by countries on their own you have a common template. 90% of the world economy has agreed on the common template. It’s agreed.

Now we need to come up with guidance on the implementation.

That’s a very good question. And that has been a source of dispute among many countries, or, to put it more bluntly, between the US, which is the country of residence of most of the digital economy companies, and the rest of the world.

We need to be clearer on who is going to need to report, because for the time being we say multinationals, but we probably need to put in thresholds so that SMEs would not be in scope. We need to handle the issue of some funds. Is it relevant to ask for some exempt funds to do this? So, we need to fine-tune the overall scope of the measure.

Second, we need to make clear and have an agreement on the process through which tax administrations will get the information. There are different options. One would be that companies would file in the countries where they operate. Another, which seems to be supported by a large group of countries, would be to say that we need not only to protect the confidentiality of the information - there’s full agreement there - but to protect it so we would need to use the tax treaties. And therefore this should be filed in the country of residence of the headquarters, which will then automatically exchange this information through tax treaties. Whatever the solution is, it will have to (1) protect the confidentiality of the information, (2) make sure that it’s efficient and quick, so the tax administrations don’t wait for ten years to get the CbC reporting.

I don’t know the precise timing, but I wouldn’t be surprised if we can come up with all a practical implementation package sometime in 2015 so that companies know exactly how to file it, where to file it, who needs to file it, and so tax administrations and governments know how to exchange this information in a timely manner so that the information flows could start quite quickly - 2016, 2017 - or let’s say 2017 to ask for 2016 information. Of course a number of countries will have to pass domestic legislation before this, but they are all on the starting blocks, they are waiting for the agreement to get there. So, that’s where we are on this important action.

A number of these players are new players, and as new players they haven’t had a history of dealing with tax administrations. They are risk takers, they don’t care, they take the risk, so they are more aggressive, a number of schemes which are actually very aggressive.

If I may finish with one remark, the agreement includes the fact that the CbC report is not public. There are people asking for the public release of this country-by-country reporting. There is agreement among all the G20 countries and OECD countries fully agree on the fact that we need to have this information protected and confidential, so, in the hands of tax administrations only. The challenge will be if it doesn’t happen quickly to all the tax administrations the pressure will be back onto make it public as quickly as possible.

On Action 1 - taxing the digital economy

Alf Capito: Pascal, a lot of this BEPS concern in the media started with the digital economy in the main. In the work that’s been done, we read that the whole economy is digitized, to a degree. What is the OECD doing around the digital economy? Is it now decided that there’s no point in being very specific about digital companies and it is, looking at other measures? Or is there still a chance that you might decide that it wants to bring in some new measures specifically around the digital space?

Pascal Saint-Amans: That’s a very good question. That has been a source of dispute among many countries, or, to put it more bluntly, between the US, which is the country of residence of most of the digital economy companies, and the rest of the world. This has turned sour with a number of countries saying, well we have some US giant tech companies not paying taxes anywhere – and not even paying much in the US on their foreign source income because all that is stashed in Bermuda through the hybrid entities and check the box regime. And there was nervousness, and the risk that a number of countries would have introduced some form of Internet taxes. That’s where we were one to two years ago. The virtue of this process is that we’ve got all the countries sitting around the same table and discuss to try to have a rational approach, a technical approach. Under political guidance, we want to address the area of the digital economy.

What can we do? The Action 1 Report is an agreed report, a diagnosis which is agreed by all the countries. The main message is that the digital economy is the economy itself. Traditional bric and mortar types of businesses are actually digitalizing. We cannot say we have pure players and another set of players who are not at all concerned with or involved in digital economy. That’s quite interesting, to say that the digital economy being the economy itself and it cannot be ring fenced. So, an Internet tax is probably not the right thing to do, because it would be distortive, and second it would lose relevance extremely quickly. And that’s not what countries want.

However, the second statement, which again is fully agreed, is to say that it’s true that a number of players actually exacerbate base erosion and profit shifting, because they rely heavily on intangibles which are easier to shift around. They have sometimes hardly any physical presence. And as a result it’s more difficult and more challenging to decide what the right tax regime should be. And I would add a number of these players are new players, and as new players they haven’t had a history of dealing with tax administrations. They are risk takers, they don’t care, they take the risk, so they are more aggressive, a number of schemes which are actually very aggressive.

And if I may add a last thing – and this one is not in the report – by pretending that they did not have PE in many countries where they operate, these companies have put in the mind of politicians and tax administrations that we needed to invent a new concept of a digital PE, where actually I tend to think that they do have permanent establishment. And it looks like through dispute resolution or through audits it’s recognized that they have PE. There are a number of cases in Europe where all the teams are in the country where they operate and they supposedly reporting all the information to Ireland where all the decisions would be made. It’s hard to be convinced of that and in a number of countries, it is recognized that there are some PEs, which is probably the best way to address this rather than inventing a digital PE.

So what are the solutions for Action 1?

Well, the first one is to recognize that many actions in the BEPS Action Plan will support the solution in this sector. The work on transfer pricing, intangibles, the work on PE, the work on CFC (controlled foreign corporation) rules. So, we have a set of rules which will support the solution.

There is agreement also that there are some specific actions to be taken quickly. One is on VAT. The delivery, or the supply of digital services, raises a number of VAT questions which are unsolved, and which may result in double taxation or double non-taxation. It’s very unclear. The OECD’s global forum on VAT, with more than 100 countries, will be addressing this, to come up with a set of rules which will increase the certainty as regards to the supply of digital services.

There is another dimension which is related to the PE. Is it still relevant in today’s environment where a company based in one country that delivers goods in another country – would have a warehouse, would do the delivery, would do some other preparatory and auxiliary work – would not have a PE, but everything is processed digitally through the Internet. That makes sense when you have a supplier of Champagne in France, selling on the UK market one century ago. But today, does that make sense? Probably not. So there is agreement that we need to tweak the definition of PE. That’s not a digital PE at all, but it’s revisiting the list of exemptions from the PE which is currently included in Article 5 of the model tax convention.
The big emerging markets, which were emerging, which are still emerging, were not involved and they were thinking of developing their own sets of rules. Now they are part of the project.

Finally, there is disagreement on some issues. The French and some others would like to say, well, that value is created with the collection of data and this should be reflected in some rights to tax. The US objects to that. They just agreed that we disagree, but we can keep talking about that to try to come up with a common understanding.

So, this report might not seem like a big bang change, but I think it’s a deep analysis of the questions, and comes up with sensible solutions that will be implemented in the course of the coming months.

On the risks of unilateral responses

Alf Capito: The whole goal of the OECD was to try and put a brake on unilateralism which creates a mess for the international tax framework. Do you think now that that’s been achieved, do you think there could still be some breakaway groups that decide “this is not fast for me or good enough for me and I’m going to go and do my own thing.”

Pascal Saint-Amans: We never know, I tend to think no. I might be biased, but what I see is that on the ground, we have tax administrations making adjustments and using the BEPS brand. And we are just telling the governments, be careful - we need to agree on rules. And most of the tax planning, once it’s legal. Businesses are doing the right thing, so to speak, except when it’s too aggressive. They are using the legal failure here and there. And that’s why we need to change this, to provide more certainty and to put an end to double non-taxation that is politically unacceptable. So something like “all this is fine, why should we change” is just wrong. This is over. I think that we must change, that’s clear.

The question is how will we achieve change? Will be through unilateral measures or through this agreed current approach? I favor the second, because it also saves my job, that’s our job to come up with sustainable rules which will be long lasting and that’s what we want to do.

Now, will countries quickly take unilateral measures? I think they have been convinced that we are able to deliver on time. It was not easy, it’s a big project, and it’s a serious revision of the international tax rules. And many commented one year ago, “you’ll never do it.” A number of companies just said “I won’t pay attention, nothing is going to happen.” But it’s time to wake up and realize that it is happening and the governments are convinced that they are able in this area, as reflected in yesterday’s communiqué by the Finance Ministers, that international co-operation in the tax field is relevant and good for the countries. If I see one extremely positive thing about the BEPS project is that years ago - or until last year - we were developing rules within a group of 34 countries. The big emerging markets, which were emerging, which are still emerging, were not involved and they were thinking of developing their own sets of rules. Now they are part of the project.

At the Finance Ministers’ meeting, the Chinese Finance Minister spoke quite significantly, for a long period of time, to say how much he likes this project and how much China likes being part of this project. That’s a big achievement.

Pascal Saint-Amans: What’s the articulation between tax policy and tax administration? You can have the best rules in the world, if they are not properly implemented, it doesn’t make a lot of sense.

At the OECD as well as a Committee of Fiscal Affairs (CFA), which is made up of tax policy makers, we also have the Forum on Tax Administration (FTA). That’s an OECD body which was created more than 10 years ago and which is the gathering of all the tax commissioners of all the OECD and G20 countries plus some others, Singapore, Hong Kong are part of it, for instance. These tax commissioners meet every 18 months, but they also have a number of networks, where their teams meet at the OECD, we have a permanent secretariat in my team dealing with that. It’s clear that we need now to gear up the cooperation between tax commissioners because there are a number of challenges that we face.

Audience questions

The role of tax authorities in lesser developed countries

Audience question: The tax authorities of the world are going to be critical to administer these rules, they’re going to have to exchange information about hybrids efficiently, CbC reporting and so on. We’ve seen in the (G20) communique a very strong initiative to bring the lesser developed countries up, increase their expertise as well. Is the OECD working directly with the tax authorities or are they in their own fora working on the active implementation and efficient implementation here.

Pascal Saint-Amans: What’s the
First, automatic exchange of information, with the common reporting standard, this raises the question of how to put in place the information systems which will make sure the information is securely exchanged between all these tax administrations?

It’s extremely important that the tax commissioners take ownership of CbC reporting, the cooperation on hybrid mismatches and on mutual agreement procedures. I’m meeting many of them. Yesterday I was with Australian Tax Commissioner Chris Jordan in Cairns. Mutual agreement procedures are not necessarily on the radar of the tax commissioner in every country, but this will change, and I’m back to the efficiency of mutual agreement procedure. When it’s on the radar, it changes the dynamic. So we intend to gear up the work of the Forum on Tax Administration. And when I say we, it’s a collective work, because you will find in the communiqué of the G20 that there is one sentence of the need for tax administrations to better work in this area.

So we have the forum, we have the commitment to the commissioners. It’s pretty scary, imagine a meeting where you have 45 tax commissioners - in the hotel hosting the meeting it had better be in good shape from its tax perspective! But you have these meetings, you have networks, you have a secretariat and now we can bring some highly political stuff, highly technical stuff to get the right implementation and the right communication with the treasury guys. There is good interaction between the FTA and the CFA, so that’s something important.

To the second aspect of your question, we have been invited to give a deeper and more engagement of developing countries. Developing countries have been involved.

The major innovation of this project is that, for the first time at the OECD, we have eight non-OECD G20 countries on an equal footing. Legally speaking, they can block consensus. This is big.. It’s been only one year and now many people take it for granted. I can tell you when I started my job as director, this was a long term objective. One year later, we got it and now all these countries are saying that at the end of 2015 they want to be here. The project might be over but they are part of the club now. And the answer is yes, they should be here.

But it’s only, so to speak, 90% of the world economy; we have another 10%. We have the developing countries which have their own perspective and their own challenges, things like lack of capacity for the tax administrations and the need to focus on domestic resource mobilization which is one of the top priorities of the UN, of the OECD and of the G20.

How can we move from an environment where they rely on aid to an environment where actually they are relying on the taxes they collect. Because that would improve democracy, that would improve the reporting to the people, because it’s spending people’s money. It’s absolutely key for the development of these countries, to reduce corruption, to start a virtuous process. I would like to quote an anecdote, in May or June I was in South Africa meeting Pravin Gordhan, who’s the former Finance Minister of South Africa. I was telling him you should be pretty happy, you know you are on an equal footing all the G20 countries - 90% of the world economy. He responded “Pascal, 90% isn’t good enough, all the African countries need to be there”.

So we need to work there and that’s what we are doing. So first, in the first year of project we have involved more than 80 developing countries through regional consultations in Africa, in South East Asia and Latin America. In Korea we held a meeting with all South East Asian countries; we held one in Colombia with 19 Latin American countries with the regional tax administration. The events were organized in partnership with ATAF, (the African Tax Administration Forum in Africa), CIAT which is the South American tax administration forum. Here in the Asia Pacific region, we don’t have such a body but SGATAR (Study Group on Asian Tax Administration Research) is emerging as a new body and we are working with them. So we’ve done regional consultation, we have held three or four global fora on tax treaties, on transfer pricing, on VAT. And now it’s time to go a step further. It’s time to bring them also to all the working parties. That means implementing the mandate that we received yesterday from the G20, which is to develop toolkits for developing countries, and to work on tax incentives, which is a disease, but particularly prevalent in developing countries where you have sweetheart deals concluded with the treasury which deprive the country from the resources they need. So we need to have leading practices there. It’s also about levelling the playing field maybe some do well with their policies, but suffer from the effects of unfair tax competition in others. We want to have global solutions, we want to remain relevant and we want to remain efficient. So we’ll find mechanisms where we have 200 countries speaking and not achieving anything. At the OECD we deliver. And we deliver practical stuff so that it’s useful. But we need to deliver also for developing countries.
Second, I understand from your question where the US will do nothing therefore nothing’s going to happen. But that’s wrong, because all these rules are about countries willing to protect their tax bases. It’s not a project which would require all countries to simultaneously adopt all the pieces of legislation needed.

On confidentiality or public disclosure of tax data of CBCR data

**Audience question:** Pascal, you commented that on country by country reporting there was some debate about whether that information should be in the public domain and here in Australia we’ve got our own transparency measures which mean that taxpayer information will be in the public domain this time next year. Does the OECD have a philosophy around the disclosure of taxpayers’ information in the public domain? Would you care to share with, whether it brings benefits or is more detrimental?

**Pascal Saint-Amans:** We not have a general policy on this, but we generally are very concerned about the confidentiality in the areas where we intervene. So there is no general guidance on what countries should do domestically, what countries should do domestically is their sovereignty. In some countries the information is public, in Norway for instance, all the information is public. In other countries it’s extremely protected. We strongly believe, though, that tax secrecy is even more important than bank secrecy, tax secrecy is a great value, though that doesn’t prevent some countries from releasing some forms of information depending on their own legal framework.

Now, to go back to CbC reporting, the agreement clearly states that was a condition of the agreement that this information will remain confidential. It’s to be used by the tax administrations where the companies operate. It’s not designed to be publicly released, otherwise there would be no agreement. So I think this is extremely clear and again that’s something that either a number of businesses were concerned about. This position is making a number of people unhappy, in particular the NGOs and the media.

On BEPS and the interaction with US legislation

**Alf Capito:** A lot of this deals with big multinationals, many of which are American companies. We know that it’s difficult to get legislation through US Congress; therefore I am often asked whether perhaps a lot of this won’t happen because the US won’t be able to deliver legislative change through Congress. Is it fair to say that that is an incorrect assumption?

**Pascal Saint-Amans:** That Congress is not extremely fast in delivering tax policy reform in the US is accurate information as we all know. I would make a comment though on your assumption that multinationals are largely an American issue. They are not. When you look at the global 500 Fortune index, I think you only have 140 US companies, out of the 500 biggest companies in the world.

The world is changing, so is it a US business type of project? The answer is no and that’s what I have told Congress at some hearings both in the Ways and Means Committee in the House and Senate Finance Committee as recently as July. So it’s not targeted to US companies, but of course they play an important role and, given the features of the American tax system with check-the-box, they raise some specific concerns.

Second, the implication from your question is that where the US will do nothing, nothing’s going to happen. But that’s wrong, because all these rules are about countries willing to protect their tax bases. It’s not a project which would require all countries to simultaneously adopt all the pieces of legislation needed. Because we don’t need that. A country willing to protect its tax base will be able to do so, in a way which is in cooperation with all the other countries, which doesn’t create spillover. If a country doesn’t want to protect its tax base, so be it.

I understand from the US political debate that we want to protect the taxpayers and it’s bipartisan.

Republicans as well as Democrats want to put an end to what they call base erosion. It’s one of the chapters of David Camp’s proposal which is still on the table even though David Camp is stepping down from the Ways and Means Committee and David Camp is a Republican. So there is agreement that US reform will include a chapter to put an end to base erosion. When it will happen, I don’t know, maybe after the presidential election at the end of 2016. But again, whether the US moves or not doesn’t prevent all the other countries moving and that’s what they are doing. And it’s a concern I think for the US business community that their own country is not able to move with a very complex tax policy debate on corporate income tax.

Timing of action by companies and by countries

**Audience question:** What you think proactive companies should be doing now? As you’ve outlined, the strategic direction is clear, the implementation is really next year. So what would you expect leading companies to be doing? And when do you think that countries should be changing their tax laws? We notice that the Netherlands is saying they want to wait to next year to see the full package before they do their domestic tax changes. So what do you think about the corporate action and the government action?

**Pascal Saint-Amans:** On the government side, we are telling the governments we have an agreement on a number of measures. This agreement has not been legally formalized because there will be interactions with the 2015 actions. We understand governments want to take action but probably better to wait for the overall agreement, but they know the sense of direction, they know where we are.
That’s the same for the companies. It’s time to look at this and to pay attention. It may take one year or two years before the law really comes into force. Do you wait for all the regulations to be passed to move forward on your investment strategy? I guess not. Well here you have the package, you know what the new rules are about, you know what’s the sense of direction, you know which countries are interested. 90% of the world economy agrees with this.

So it’s your choice, you can wait for the whole package to be adopted and you will gain even more certainty, because at the end of 2015 we’ll have a package agreed at the OECD and then you need domestic legislation changes which may take another year, so you can say you ‘have another two or three years where I can do whatever I want and I don’t care’. Or you can say ‘OK, there is a new environment, global rules that will be implemented shortly, shall I anticipate’? I think the answer is in the question.

But again, whether the US moves or not doesn’t prevent all the other countries to move and that’s what they are doing. And that’s a concern I think for the US business community that their own country is not able to move with a very complex tax policy debate on corporate income tax.
An interview with Miguel Ferre, Spain’s Secretary of State for Finance.

Members of the Spanish Government join EY at an event in London.

Left to right:
- Mr. Federico Linares - Tax and Legal Managing Partner, Ernst & Young Abogados, S.L.
- Mr. Jose Manuel Gutierrez - Financial Counsellor, Spanish Embassy
- Mr. Miguel Ferre - Spanish Secretary of State for Finance
- Mr. Federico Trillo-Figueroa - Spanish Ambassador in London
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Miguel Ferre is Spain’s Secretary of State for Finance. He has a deep tax background and has driven the recent release of a comprehensive tax reform plan for Spain.

He has 17 years professional experience as a Government Finance Inspector, holding various positions in the Ministry of Finance. He has been Deputy Director General for International Tax Matters at the Ministry of Finance, was also responsible for work on tax harmonization in the European Union and participated as a member of the Spanish delegation at the Councils of Ministers ECOFIN. In addition, he was responsible for upholding Spanish interests on the OECD’s Committee of Fiscal Affairs in relation to international taxation. Previous to his government roles, Mr Ferre worked for PricewaterhouseCoopers.

He spoke with Jose Bustos at a recent EY event held in London.

**Jose Bustos:** The Spanish Government has recently presented its tax reform proposal. Prior to that, a Committee of Experts designated by the Spanish Government presented its report on potential tax reform options for Spain. How are your proposals aligned with that report?

**Miguel Ferre:** Firstly, it must be said that the report made by the commission of independent experts is not binding on the Government of Spain. Likewise, it must be taken into account that at the international level the request for reports with similar characteristics is common practice. These reports include independent analysis of potential measures for the governments to analyze their pros and cons and offer a base on which to build the tax reform to be finally adopted. Good examples of that are the Mirrless report,1 or the older Carter report.2

Of course, we have to make sure these proposals are considered in line with the current Government policy and the Spanish economic situation. As regards direct taxation, a good deal of the Committee’s proposals have been adopted in relation to individual taxation. Concerning corporation taxes, the proposals kept are those which make it possible to enhance tax consolidation and to favor business competitiveness. Finally, in regard to VAT, the proposal to increase rates has not been considered appropriate at the current time, as the last increase in September 2012 is still quite recent.

**Jose Bustos:** What are the main messages for business in the Tax Reform Proposal?

**Miguel Ferre:** The main targets of this tax reform are the attraction of economic activity towards Spain and the improvement of our tax system’s competitiveness as compared to those countries around us. The general reduction of corporate tax rate systems and the presence of incentive measures promoting economic activity – which further reduce effective tax rates – such as the capitalization or equalization reserves, are clear examples of a policy obviously biased towards promoting economic activity in Spain and to ameliorate business financing. At the same time, we hope the reforms will create more legal certainty in the tax system, which is critical for any foreign investor, as well as simplifying elements of our main taxes. Overall, our intention is to achieve the framework necessary for investors to have the confidence to invest in a country such as Spain.

2. In the United States
The plans for this tax reform are a gradual, two-stage implementation. A substantial part of it — constituting the bulk of the tax reform — will come into effect in 2015.

Jose Bustos: When do you see tax reform playing out? Are there particular elements that you would like to prioritize over and above others?

Miguel Ferre: The plans for this tax reform are a gradual, two-stage implementation. A substantial part of it — constituting the bulk of the tax reform — will come into effect in 2015, and the rest will be included with the additional CIT reduction in 2016. However, the announcement of this clear proposal should be seen as an encouraging element for any investment decision to be now taken and which, logically, will consider the future of different tax regimes in Europe.

We should not forget the important measures reducing the tax burden in Spain. In 2012, for example, the Spanish Real Estate Investment Trusts or REITs (SOCIMIs) regime was modified, positively contributing to the recovery of the Spanish immovable property sector. In addition, R&D incentives have been upgraded with the primary object of enhancing these activities in Spain. It’s also important to mention here the possibility of monetizing this tax incentive, as well as the upgrading of the applicable allowance percentages in specific cases. This, together with the reduction of the tax rates, amounts to a substantial improvement.

Jose Bustos: In the area of incentives, you made your patent box regime more attractive in October 2012. How important do you think this regime will be in the future? Is it safe to assume that this policy will be retained in the future?

Miguel Ferre: The improvement of the patent box regime had a very structural approach. Our former regime became obsolete as compared to that of other countries and required updating so as to make it competitive. In spite of the new policy of reducing the overall number of tax incentives, this one remains and therefore its elimination is not foreseen. We have no intention to remove a recently established regime; on the contrary we are committed to promote its presence.

Jose Bustos: Do you think many countries will gather around the future Spanish Corporate Income Tax rate?

Miguel Ferre: The reduction of the tax rate is a reference element for any foreign investor. However, in all countries comparable to ours, except the United Kingdom, the tax rates are higher than the Spanish ones and no general reduction seems to be envisaged in countries such as Germany, France or Italy, as far as I know.

Jose Bustos: You mentioned that you would not be adopting the VAT recommendations made by the expert committee. According to the EU’s recent Taxation trends in the European Union publication, Spain ranks 27th in the EU in terms of indirect taxes collection as a percentage of GDP, although the standard VAT rate was increased twice in recent years: from 16% to 18% in 2010 and from 18% to 21% in September 2012. The EU states the main reason for low collection is sluggish domestic consumption and imports. How do you balance the possibility of shifting to higher consumption taxes with the fact that domestic consumption is sluggish. Are these two forces not in fact competing with one another?

Miguel Ferre: It is true that according to that publication, the proportion of indirect taxation in Spain as a percentage of GDP remains very low as compared to the EU average. That said, although in September 2012 the last increase of standard VAT rate came into effect, its outcomes are hardly reflected in 2012 data. It will not be until 2013 data when the real effect of the increase could be accurately confirmed.

We see on the other hand, on 13 July 2013 the European Commission released the results of the report “Study to quantify and analyze the VAT Gap in the EU-27 Member States (Final Report, July 2013).”

This report takes as its starting point the impact of Tax Administration’s efficiency and effectiveness on the size of the VAT Gap, considered as the difference between theoretical and actual VAT collected, caused by tax fraud and tax evasion, bankruptcy, financial insolvency, miscalculations etc. It refers to another recent study undertaken by the Commission, analyzing data from 2007 to 2010, extended up to 2011, and which placed Spain behind all other States in terms of collection as a percentage of GDP.

However, it should be taken into account that — apart from certain defects in methodology already reported by the Spanish Authorities to the Commission — this study does not account for the revenue data after the last revision of tax rates applied under Royal Decree 20/2012 of 13 July. In its explanatory statement, this Royal Decree states in particular its intention to align VAT rates to those of the other Member States, as well as to redistribute the tax base by broadening the segment taxed at the standard rate as compared to that taxed at reduced rates similar to other Member States. Therefore, by updating data to include the results for tax years 2012 and 2013, Spain would be given a much more positive position.

On the other hand, it is true that any increase in VAT rates generally results in shrinking consumption, obviously depending on the elasticity of the different products taxed; but the economic circumstances in Spain are different to those of 2012. Economic activity is just beginning to show slight signs of recovery and thus a rise in overall economic consumption, a tendency which we feel will continue during the next few months. The larger amount of disposable income that taxpayers will have as a consequence of the tax reform currently in process will boost this tendency, hence increasing indirect taxes collection.

In conclusion, the Government package of measures, effective as from 1 January 2015, which cover both direct and indirect taxation, intends to revitalize economic growth and consumption by moderating direct taxation and generally keeping indirect taxation as it is. We hope that these measures will constitute an important stimulus for consumption and therefore an important boost in tax collection.

Jose Bustos: I’d like to move on to another topic, that of Base Erosion and Profit Sharing or Base Erosion and Profit Sharing or BEPS; some commentators argue that BEPS is not a 2014 thing, it is actually a 2007 or 2008 thing. Do you agree with that statement?

Miguel Ferre: Absolutely not. On the contrary, BEPS is a very recent project which has developed at an extraordinary speed from its conception. It is true that the problem which gave birth to this project – the erosion of tax bases and the shifting of profits towards jurisdictions with more favorable tax systems by abusing of differences among internal tax legislations – is a longstanding issue. And it is true that this problem became particularly acute with the crisis in 2008, due to the increased need for tax revenues experienced by countries.

However, from the time when in 2012 the OECD and the G20 Member States felt the unavoidable need to jointly cooperate in facing this problem, BEPS was born and evolved swiftly: it was officially brought forth in July 2013 with the presentation of the Action Plan which diagnosed the main problems to be tackled. Now in June 2014, just one year after, the first set of recommendations has been already approved for implementation and it covers half the targets of the Action Plan. Its final implementation is expected for the end of 2015. That means that this project, which has shown the global cooperation capacity of countries to face a problem of the scope and scale of BEPS, is being developed in just two and a half years.

Spain has also acted swiftly: the recently-issued tax reform package includes the implementation of one of the measures recommended by the OECD as a consequence of the BEPS project, namely to prevent the deduction of expenses resulting from hybrid financial instruments on which the beneficial owner of the gains, occurred abroad, is untaxed.

Jose Bustos: How will you align your tax reform efforts with the unfolding BEPS agenda? As an example, your government recently approved a draft bill4 that includes among the non-transferable duties of the board of directors the determination and management of the company’s tax risk policy, the approval of investments or transactions with a high tax risk, the approval of the incorporation or acquisition of special purpose vehicles or entities located in a tax haven and the determination of the company’s tax strategy.

This would seem to be influenced by the OECD’s BEPS project and is similar to other countries’ measures in that regard. Do you expect future tax reforms along the lines of the BEPS project in Spain and other countries? Don’t these proposals specifically seem like quite an unfriendly bundle of new obligations and requirements for countries trying to design business friendly tax policies?

Miguel Ferre: Currently a bill is under discussion where not only the policy concerning control and management of tax risks is included as a non-transferable duty of the board of directors, but also the determination of the company’s tax strategies.

We think it is fair to send a message to all of Spanish society that paying taxes is an important element of citizenship. In this context we consider that the company, and in particular the board of directors, should be fully responsible and fully aware of what methods are being taken by their people to be tax efficient.

On 16 September 2014, the Organisation for Economic Co-operation and Development (OECD) released a series of deliverables (the 2014 Deliverables) that address seven of the focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The documents released consist of a brief explanatory statement, final reports with respect to Action 1 (Digital Economy) and Action 15 (Multilateral Instrument), an interim report with respect to Action 5 (Harmful Tax Practices), and reports with agreed draft recommendations on Action 2 (Hybrid Mismatch Arrangements), Action 6 (Treaty Abuse), Action 8 (Transfer Pricing for Intangibles), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). In this article, we provide an overview of the OECD press conference and webcast, both held on the day of the deliverables’ release, plus an overview of each of the seven focus areas for which deliverables were published. For each of the seven areas of focus, we also provide a link to more detailed coverage on our EY.com website.

The webcast featured Pascal Saint-Amans, who leads the OECD’s tax work. Also participating were senior members of the OECD Secretariat that led the technical work on the 2014 Deliverables: Raffaele Russo, who has responsibility for the work on the digital economy and the multilateral instrument as well as overall responsibility for the BEPS project; Marlies de Ruiter, who has responsibility for the tax treaty, transfer pricing and financial transactions work; and Achim Pross, who has responsibility for the international co-operation and tax administration work.

A collaborative effort between governments

During the webcast, Saint-Amans described the recommendations presented in this first set of deliverables as being a result of a collaborative effort between governments from OECD and G-20 member countries, with input from more than 80 developing countries and from the business community and other stakeholders. He noted that that the recommendations set forth in the deliverables released are not yet final and may be subject to some revision given the interrelationship between the focus areas covered in the 2014 Deliverables and the focus areas covered by the other BEPS Actions which have target delivery dates of September and December of 2015. The reports released were described by Saint-Amans as reflecting agreement by the participating countries on the present status and future steps to be taken with respect to the covered Actions, while the draft recommendations released were described by Saint-Amans as “soft legislation” that contain the countries’ consensus and commitment with respect to rules to be developed to address the matters dealt with by those Actions.

The 2014 Deliverables were presented at the upcoming G20 Finance Ministers’ meeting, held in Cairns, Australia on 20-21 September and will be further considered at the G20 Leaders’ meeting in November 2014. Below is an overview of each of the 2014 Deliverables.
The report on Action 1 (the Digital Economy Report) builds on the objectives reflected in the discussion draft released by the OECD on 24 March 2014 (the Digital Economy Discussion Draft), which focused on the key features of the “new” business models in the digital economy, how those features may exacerbate BEPS risk in a global economy, and what broader direct and indirect tax challenges are raised by the digital economy. Moreover, the Digital Economy Discussion Draft provided an overview of potential options for addressing the tax challenges of the digital economy, along with a framework for evaluating these options. The alternatives discussed in the Digital Economy Discussion Draft included: (i) modifying permanent establishment (PE) rules (i.e., preparatory and auxiliary exemptions, PE nexus based on significant digital presence, and virtual PE), (ii) introducing withholding tax regime for digital transactions, and (iii) modifying existing value added tax (VAT) regimes.

The Digital Economy Report largely follows the discussion in the Digital Economy Discussion Draft. It continues to acknowledge that it would be impossible to ring-fence the digital economy (a key point repeated during the OECD webcast) and also underscores that the landscape is still moving rapidly, therefore making it a challenge to anticipate all potential issues. It also continues to stress the importance of the fair, equitable and efficiency principles introduced by the Ottawa Taxation Framework Conditions. The Digital Economy Report includes a new chapter that discusses the fundamental principles of taxation and, in doing so, reconsiders some of proposed approaches for addressing the tax challenges of the digital economy. Specifically, the Digital Economy Report: (i) reiterates that PE exemptions for preparatory and auxiliary activities should not be available for core activities; (ii) discusses how to deal with tax planning by businesses engaged in VAT-exempt activities; (iii) addresses the importance of data and its impact on transfer pricing; and (iv) identifies the need to adapt CFC rules. The Digital Economy Report indicates there remain certain areas of disagreement among stakeholders (e.g., import of data in driving value for tax purposes), but that there is consensus that action is needed to clarify PE issues in the Digital Economy (presumably, to be addressed more in Action 7) as well as the need to address consumption taxes on business-to-consumer transactions.

Importantly, the OECD indicated that as the recommendations on the other Actions Items are finalized, the OECD will evaluate how the outcomes affect the broader tax challenges raised by the digital economy and will complete an evaluation of the options to address them. This work will be concluded by December 2015 and a supplementary report reflecting the outcomes of the work will be finalized at that time.

Read more on the report on Action 1 at: www.ey.com/BEPSAction1

Replay EY webcasts discussing the latest BEPS developments

EY held a series of webcasts discussing the September 2014 BEPS recommendations, and replays are now available to view at your convenience. To access the webcasts, please visit www.ey.com/webcasts
Action 2 – Neutralizing the effects of hybrid mismatch arrangements

The document on Action 2 (the Hybrid Mismatch Report) includes two sets of recommendations to address hybrid mismatch arrangements. Part I contains recommendations on domestic law rules to address arrangements that result in double non-taxation or long-term tax deferral, Part II contains recommended changes to the OECD Model Tax Convention to deal with the use of dual resident entities and transparent entities to obtain treaty benefits and to address the interaction between the domestic law recommendations and the provisions of the OECD Model Tax Convention.

The recommendations for domestic law reflect the approach originally described in the discussion draft released on 19 March 2014 (the Hybrid Mismatch Discussion Draft), with some important refinements. First, the OECD recommends the enactment of linking rules that seek to relate the tax treatment of a specific hybrid entity or arrangement in one jurisdiction to the tax treatment of such entity or arrangement in the other jurisdiction. Second, the report recommends a “rule order” under which primary and defensive rules would operate to address double non-taxation outcomes and avoid double taxation. Third, reflecting extensive comments received from stakeholders, the report limits the scope of the recommended rules by using the “bottom up approach.” More specifically, the recommended rules would apply to hybrid arrangements involving related parties and members of the same controlled group and to certain “structured” arrangements. Moreover, for this purpose, the threshold for related party status is increased to 25%, from 10% as proposed in the Hybrid Mismatch Discussion Draft.

The recommendations with respect to the OECD Model Tax Convention include (i) a change to Article 4 of the Model Tax Convention to deal with dual resident entities; (ii) a new provision in Article 1 and changes to the Commentary to address fiscally transparent entities; and (iii) various proposed changes to address treaty issues that may arise from the recommended domestic law changes.

The Hybrid Mismatch Report indicates that the OECD is continuing its work on Action 2 to develop guidance on the implementation of the recommended rules. In addition, the report notes that there are some specific areas where further refinements in the recommended domestic law rules may be needed, including the treatment of certain capital market transactions such as on-market stock-lending and repos and the treatment of imported hybrid mismatches. Moreover, concerns regarding the application of the rules to intra-group hybrid regulatory capital will be explored further. Similarly, additional work will be done on how income inclusions under CFC regime should be treated for purposes of the report. It is anticipated that this additional work will be finalized in September of 2015 and that the output will likely be in the form of commentary and transitional rules.

Read more on the report on Action 2 at: www.ey.com/BEPSAction2

Action 5 – Countering harmful tax practices

Action 5 of the OECD BEPS project committed the OECD’s Forum on Harmful Tax Practices (FHTP) to revamp the work previously done by the OECD on harmful tax practices of countries. In this regard, the FHTP is to deliver three outputs:

1. A review of member country preferential regimes
2. A strategy to expand participation to non-OECD member countries
3. Consideration of revisions or additions to the existing framework for analyzing whether regimes are harmful

The interim report on Action 5 (the Harmful Tax Practices Report) discusses the progress on the first output. The work of the FHTP focused on designing a substantial activity test for any preferential regime and on improving transparency between tax administrations related to the existence and mechanics of preferential regimes, such as by mandating compulsory spontaneous exchange of information on rulings. The second and third outputs are expected by September and December 2015, respectively.

In the review of preferential regimes, the FHTP concentrated first on intellectual property (IP) regimes. It suggested that a “nexus approach” would be most appropriate when determining whether the substantial activity test is met. Under this approach the application of an IP regime would be dependent on the level of R&D activities carried out by the taxpayer. Discussions of the approach are continuing. In the next stage the FHTP will evaluate all existing IP regimes of OECD and associated countries to determine whether or not they require “substantial activity.” In addition, the approach that will ultimately be agreed on will need to be extended to tax regimes not related to

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1. The FHTP was created in 1998 when the OECD started its work in the field of harmful tax competition with the publication of the report “Harmful Tax Competition: An Emerging Global Issue.”
IP. With respect to the goal of improving transparency, the FHTP developed a framework for compulsory spontaneous exchange of information by tax administrations on taxpayer-specific tax rulings and Advance Pricing Agreements (APAs). The framework would require rulings (or summaries of such rulings) on preferential regimes that meet certain criteria to be exchanged spontaneously with the competent authorities of the tax jurisdictions involved. The framework also deals with questions such as time-limits, legal basis, confidentiality and the type of information to be exchanged. An ongoing monitoring and review mechanism, including annual review by the FHTP, will be put in place to ensure countries’ compliance. The FHTP expects to issue a progress report on the adherence to the framework in 2015.

1. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.
2. Clarify that treaties are not intended to be used to generate double non-taxation.
3. Provide tax policy considerations for contracting states to consider before entering into a tax treaty with another country.

To prevent the granting of treaty benefits in inappropriate circumstances, particularly through treaty shopping arrangements, the report recommends the inclusion of anti-abuse rules in the OECD Model Tax Convention. The report includes a “limitation on benefits” (LOB) provision, similar to those found in US tax treaties, and a general anti-abuse rule (GAAR), similar to the “main purpose” test found in UK tax treaties, based on the principal purposes of transactions or arrangements (a principal purpose test or “PPT” rule). In contrast to the Treaty Abuse Discussion Draft, the Treaty Abuse Report acknowledges that the adoption of both the LOB and PPT rules, together, might not be appropriate for all countries. Therefore, the report suggests that at a minimum, countries should: (i) affirm through an express statement in their tax treaties that they intend to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and (ii) adopt either (A) the LOB and the PPT rules, (B) the PPT rule, or (C) the LOB rule supplemented by a mechanism (such as a restricted PPT rule applicable to conduit financing arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would address conduit financing arrangements not already addressed in tax treaties.

The LOB provision includes many of the same tests as those included in the LOB provisions of existing US tax treaties. Notably, the LOB provision in the Treaty Abuse Report includes a derivative benefits test. The Treaty Abuse Discussion Draft had discussed derivative benefits tests but had raised concerns about the implications of such a test. The Treaty Abuse Report also adds a proposed change to the OECD Model Tax Convention addressing the availability of treaty benefits to collective investment vehicles (CIVs) and other funds. It further states that there is more work to be done in this area. In addition, the report indicates that further work will be needed with respect to the precise contents of the anti-abuse rules, in particular the LOB rule. Finally, the report indicates that the proposed OECD Model Tax Convention provisions and related Commentary should be considered as drafts that are subject to improvement prior to the release of the final version in September 2015.

Read more on the report on Action 5 at: www.ey.com/BEPSAction5

Action 6 - Preventing the granting of treaty benefits in inappropriate circumstances

The draft recommendations under Action 6 (the Treaty Abuse Report) reflect the recommendations made as part of the discussion draft published on 14 March 2014 (the Treaty Abuse Discussion Draft). The Treaty Abuse Report includes proposals to:

1. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.
2. Clarify that treaties are not intended to be used to generate double non-taxation.
3. Provide tax policy considerations for contracting states to consider before entering into a tax treaty with another country.

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Read more on the report on Action 6 at: www.ey.com/BEPSAction6
Action 8 – Transfer pricing aspects of intangibles

The draft recommendations under Action 8 (the Transfer Pricing Aspects of Intangibles Report) contain revised standards for transfer pricing of intangibles and additional standards with respect to comparability and transfer pricing methods.

The first part of the Transfer Pricing Aspects of Intangibles Report contains amendments to Chapter I (The Arm’s Length Principle) of the OECD Transfer Pricing Guidelines relating to the transfer pricing treatment of location savings and other local market features, assembled workforce, and the existence of multinational enterprise (MNE) group synergies. The second part of the report contains an entirely revised Chapter VI (Special considerations for intangibles) of the OECD Transfer Pricing Guidelines. It contains guidance on: (i) the definition of intangibles, (ii) identifying and characterizing specific controlled transactions involving the use or transfer of intangibles, and (iii) determining arm’s length conditions in cases involving intangibles. The Transfer Pricing Aspects of Intangibles Report also contains interim guidance on ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles, the application of profit split methods, and arm’s length pricing when valuation is highly uncertain at the time of the transaction. The interim guidance will be finalized in connection with the 2015 BEPS work on risk, recharacterization, and hard to value intangibles.

Key features of the Transfer Pricing Aspects of Intangibles Report, and key differences compared to previous work in connection with Action 8, include:

- The definition of an intangible, which is similar to that contained in the discussion draft of 30 July 2013 but which includes a new definition of “marketing intangibles.”
- New guidance providing that it is not necessary to define when goodwill or going concern value may or may not constitute an intangible. If features of a business allow a company to charge higher prices, such contribution should be compensable without regard to the labeling.
- Interim guidance on ownership, the thrust of which is that legal ownership as such and the funding of the development of an intangible without performing important functions would not create an entitlement to the full intangible related return. The allocation of returns should be in line with value creation.
- New guidance on how profits or losses relating to unanticipated events should be shared between MNE group members contributing to the development, enhancement, maintenance and protection of the intangible.
- The use of valuation techniques as part of the five OECD transfer pricing methods or as a useful tool.
- New and revised examples to illustrate the revised guidance.

In the next several months, additional work will be undertaken in connection with risk, recharacterization, and hard to value intangibles, which will lead to partial revisions of Chapters I, II, VI, VIII and IX of the OECD Transfer Pricing Guidelines. In this process, so-called “special measures” which deviate from the arm’s length principle may be considered. Some examples of potential special measures have been included in the report.

Read more on the report on Action 8 at: www.ey.com/BEPSAction8

Action 13 – Guidance on transfer pricing documentation and country-by-country reporting

The draft recommendations under Action 13 (the Transfer Pricing Documentation and CbC Report) contain revised standards for transfer pricing documentation and a template for country-by-country reporting, to be included in the OECD Transfer Pricing Guidelines in the place of the existing Chapter V. The Transfer Pricing Documentation and CbC Report is aimed at ensuring better transparency for tax administrations by providing them with adequate information to conduct transfer pricing risk assessments and at improving the consistency of requirements for taxpayers. The transfer pricing documentation standards and the country-by-country reporting standards will be revisited by the OECD members no later than the end of 2020 “with a view to continuously improving the operation of those standards.”
The country-by-country reporting template requires MNEs to report the amount of revenue (related party and unrelated party), profits, income tax paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets annually for each tax jurisdiction in which they do business. In addition, MNEs are also required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity conducts.

The guidance on transfer pricing documentation requires MNEs to include a high-level overview of their global business operations and transfer pricing policies in a “master file” that would be made available to all relevant country tax administrations. Specific information would be required for intangibles and intercompany financial activities. Moreover, the transfer pricing guidance will require that detailed information on all relevant material intercompany transactions be included in a “local file” in each country.

The Transfer Pricing Documentation and CbC Report contains some significant changes compared to the discussion draft released on 30 January 2014. For example, the country-by-country reporting template will require information to be reported on a jurisdiction by jurisdiction basis rather than on an entity by entity basis. Moreover, certain detailed information on payments and receipts for intercompany royalties, interest and services will not be included on the country-by-country report, but instead will be reported in the transfer pricing documentation local file. Furthermore, the country-by-country report will not be made a part of the transfer pricing documentation master file.

Additional work will be undertaken by the OECD over the next months with respect to implementation and filing of the master file and the country-by-country report. The Transfer Pricing Documentation and CbC Report states that “due regard will be given to considerations related to protection of the confidentiality of the information required by the reporting standards, the need for making the information available on a timely basis to all relevant countries, and other relevant factors.” Guidance in this respect is expected to be delivered in early 2015.

**Action 15 – Developing a multilateral instrument to modify bilateral tax treaties**

The report on Action 15 (the Multilateral Instrument Report) examines the feasibility and desirability of a multilateral instrument as a way to implement treaty measures developed under the other Actions. The report considers that such an instrument is desirable because it would achieve swift implementation of these measures by avoiding the need to individually negotiate existing bilateral tax treaties and it would allow for a consistent outcome. The Multilateral Instrument Report acknowledges that there can be obstacles to a multilateral instrument from a technical (public international law and international tax law) and political perspective. Drawing from numerous examples of multilateral treaties in areas other than tax, it concludes that these obstacles can be overcome so that the instrument appears to also be feasible.

The Multilateral Instrument Report suggests that the scope of such multilateral instrument should at this stage only include treaty based outputs of the BEPS project. It further identifies a number of provisions that are “multilateral in nature” and could thus be included as such in a multilateral instrument (e.g., a multilateral mutual agreement procedure and provisions on dual-residence, hybrid mismatch arrangements, and treaty abuse). Other provisions (e.g., changes to the permanent establishment definition) would need to take bilateral specificities into account and should thus offer more flexibility for contracting parties. Stressing the urgency of creating a multilateral instrument, the Multilateral Instrument Report proposes to convene an International Conference in 2015 under the aegis of the OECD and the G20. The International Conference would be open to all interested countries and would develop the content of the multilateral instrument. The proposed mandate of the International Conference should be limited in time to two years and in scope by focusing only on the treaty related BEPS outputs once finalized.

**Concluding thoughts**

The release of the 2014 Deliverables represents a significant development in the OECD BEPS project. The reports and recommendations reflect agreements reached by the OECD and G20 member countries. The documents also describe further OECD work that will continue into 2015 in all of these focus areas. At the same time, the OECD has reiterated its commitment to issue output with respect to the remaining BEPS Actions by the end of 2015.

While the OECD continues its work on the BEPS Action Plan, countries around the world are already acting to address concerns about BEPS through legislative and regulatory changes and changes in administrative practices. Companies will want to keep informed about developments in the OECD BEPS project and related developments in the domestic tax laws and practices in the countries where they operate or invest.
Bridging the divide

An extract from EY’s 2014 Tax risk and controversy survey

EY’s latest survey of 962 tax and finance executives in 27 jurisdictions on tax risk and controversy, completed in January 2014, indicates that the tensions described in previous reports pale in comparison to the tax risks that companies say they are currently experiencing and anticipate in years to come.

The majority – 81% of all companies – surveyed agreed or strongly agreed that tax risk and controversy will become more important for their companies in the next two years. The results of this new survey offer a glimpse of the hazards that must be overcome in order to safely navigate the next steps of the journey.

It is clear from the findings that many companies may wish to consider enhancing their preparations and their tools in order to bridge the divide between current and future risk management frameworks.

Overall, companies say their leading source of risk remains transfer pricing. This is consistent with findings from EY’s 2013 Global Transfer Pricing Survey of transfer pricing professionals, which found that 66% of companies identified risk management as their top transfer pricing priority, a 32% increase over 2007 and 2010. Companies in our 2014 Tax Risk and Controversy Survey identified indirect taxes and permanent establishment risk as their second- and third-highest sources of tax risk, respectively.

These activities – in particular, transfer pricing – are under unprecedented scrutiny from an ever-growing list of groups, including the news media, national policy makers, activist groups and supranational organizations. Assertions of tax avoidance by any one of those groups often trigger reactions by the others. This cycle has helped keep the issue of tax in the headlines and at the forefront of policy conversations.

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A BEPS effect in tax enforcement?

- Intense media interest in particular has driven new and significant concerns about tax-related reputation risk. Stories and investigations alleging tax avoidance have become even more prevalent in newspapers and TV programs around the world since we last conducted this survey in 2011. As a result, it is not surprising that 89% of the largest companies surveyed say they are now somewhat or significantly concerned about the media coverage of taxes some companies are paying or their seemingly low effective tax rates. This is up from 60% in 2011. Conversely, just 9% say they are unconcerned now, compared to 40% in 2011.

- More tangibly, the intense media focus has galvanized policy makers into action. Lawmakers have reacted to news stories by convening parliamentary hearings, proposing legislation and supporting efforts by the Organisation for Economic Cooperation and Development (OECD) to recommend 15 specific areas for coordinated action to protect countries' tax bases.

- Our survey respondents say they are feeling the effects. For example, 74% of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.

- Some countries have already taken steps to implement concepts related to base erosion and profit shifting (BEPS) in the form of new legislation, establishing “working groups” to review existing frameworks and formulate new ones, and in some cases suspending advance pricing agreements (APAs) or applying future BEPS concepts to previously executed transactions.

- Even if directionally consistent with the BEPS project, these early actions may actually threaten the coherence of the overall project, creating more uncertainty, greater risk and an erosion of trust between tax authorities and taxpayers.

- At the same time, governments continue to pursue day-to-day legislative change and tax reform at the national level. Additional layers of complexity are added as governments strive to balance tax competition with raising enough revenue to fund ongoing spending commitments.

Reputation risks are on the rise

- Four major sources of tax risk identified
  - Reputation risk: 89% are somewhat or significantly concerned about the media coverage of the taxes some companies are paying or their seemingly low effective tax rates. Our survey shows just how rapidly reputation risk has become a key concern. Companies need to act deliberately and assertively to manage this complex and sensitive issue rather than being put in a situation where they must react to reputational challenges from a defensive posture.
  - BEPS and legislative risk: 74% felt that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach. Concern about the outcomes of the BEPS project pervaded our survey responses. To that end, much attention has focused on the OECD BEPS Action Plan. But unilateral actions by individual governments may be an even bigger source of risk, with the potential to create “global tax chaos” that both the OECD and businesses want to avoid.
  - Enforcement risk: 69% felt that tax audits had become more aggressive and frequent in the last two years. Our survey indicated more aggressive, focused tax enforcement and a sense that mutually constructive relationships between taxpayers and authorities may be becoming strained.
  - Operational risk: 75% cited insufficient resources to cover tax function activities as their leading source of operational risk. Our survey indicated that as pressures continue to build, many companies may lack the appropriate resources to effectively manage the first three issues. This growing operational risk spans people, processes and technology.

Leading sources of operational tax risk

- To learn more about the survey results, read our 2014 tax risk and controversy survey highlights at www.ey.com/taxriskseries

2014 Tax Risk and Controversy Survey benchmarking

- On this site, you can benchmark yourself against a selection of the survey questions as answered by your peers. Benchmarking against geographic location and company revenue is also available, and you will be able to print a copy of your benchmark report at the conclusion.
On 21 July 2014, the OECD published the first edition of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (The Standard). The Standard includes the text of the Model Competent Authority Agreement, the Common Reporting Standard and the Commentaries thereon as read on 15 July 2014 after the approval of The Standard by the Council of the OECD. The document, which is 311 pages in length, is available at:


The Standard was developed at the request of the G20 in order to create a global standard for the automatic exchange of financial account information. It builds upon the draft model Standard released on 13 February 2014.1 The Standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions that are required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

The Standard is formed of three sections:

- Part I provides an introduction to The Standard
- Part II contains the text of the Model Competent Authority Agreement (Model CAA) and the Common Reporting and Due Diligence Standard (CRS)
- Part III contains the Commentaries on the Model CAA and the CRS as well as a number of Annexes

Financial institutions will need to implement The Standard from 1 January 2016, with the first exchanges of information beginning by the end of September 2017. The Standard draws extensively on earlier work of the OECD in the area of automatic exchange of information. It incorporates progress made within the European Union, as well as global anti-money laundering standards, with the intergovernmental implementation of the Foreign Account Tax Compliance Act (FATCA) having acted as a catalyst for the move toward automatic exchange of information in a multilateral context.

As financial institutions will need to implement The Standard from 1 January 2016, the publication of the Commentaries in Part III is to be welcomed as they provide more detail on the requirements that will be demanded of financial institutions.

As of 19 March 2014, 44 “early adopter” jurisdictions had announced their intention to adopt The Standard2 with the first exchange of information beginning by the end of September 2017. Attention must therefore now be focused on examining the next steps of domestic tax authorities who will be responsible both for translating The Standard into domestic law and for considering its implementation among financial institutions. Until more details are published at the domestic level, a degree of uncertainty on implementation issues will remain.

Given that the Standard has been built upon the foundations laid by FATCA, financial Institutions should review the full OECD documentation in detail and assess whether current and planned FATCA processes and systems may be leveraged in order to ease the additional compliance burden. The additional volume of due diligence required and multi-lateral country requirements mean that significant work is likely to be required, however.

More information on the Standard is available in a detailed EY Global tax alert available at:


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The International Monetary Fund (IMF) report *Spillovers in International Corporate Taxation* looks at how national tax decisions can have international impacts, examining how tax systems influence the global economy in general and developing economies in particular.

The report highlights those features of the international tax architecture which raise issues for developing countries, identifies some possible policy responses and suggests some radical alternatives. Offered as a complement to the OECD’s BEPS work program, the report also refocuses on the question of “fragile” concepts of “residence” and “source” which underpin current international tax arrangements.

The world of tax policy is becoming crowded; with more players seek to influence how the world’s tax systems operate. While previously taxation was seen as a core part of “fiscal sovereignty,” in a globalizing economy, international organizations are increasingly influencing how the world’s tax systems operate.

The BEPS project of the G20 and, OECD’s and the United Nation’s a wider perspective than that of just the developed world have played a strong role recently. But in late June, we saw published another foray into the field of international taxation, this time from the IMF, or more precisely from the staff members of the IMF’s Technical Assistance team.

So how does this new report differ and what does it add to the debate?

The IMF approach

The report looks to complement the work being undertaken in the G20 and the OECD, but also seeks to differentiate its contribution by reminding readers of the experience that the IMF has in providing technical assistance.

The report is unconstrained by the highly political origins of the BEPS project and the IMF has gone further to look at some of the fundamental concepts and processes underpinning the current international tax architecture.

The IMF’s focus is on “spillovers” the impact that one country’s tax policies have on another country. The report distinguishes between “base spillovers,” where one country’s actions directly affect another’s corporate income tax base (for example, by reducing taxable income through debt financing) and “strategic spillovers” where one country’s actions induce changes in other countries’ tax policies (i.e., tax competition, such as reductions in corporate income tax rates).

The big picture

This focus on spillovers allows the IMF to engage with two crucial “big picture” questions:

1. Does the current tax architecture help or hinder economic growth? Does the current model of competition and the current framework for managing relationships between tax systems increase or decrease overall welfare?
2. Who are the winners and losers under the current system? In particular, what is the effect of the current arrangements on the prospects of developing countries?

The elephant in the room

At the heart of the IMF document is the recognition that there are fundamental concerns about the viability of the current international architecture for allocating taxing rights between the source country (where investment and production takes place) and the residence country (where a company is based). To some extent, this is touched on in the discussion on the digital economy action item in the BEPS project, which itself appears unlikely to conclude on fundamental changes. Freed from the constraints of consensus, the Staff of the IMF have sought to bring alive the challenge, noting that 42% of the value of US goods traded in 2012 was in intra-firm transactions, which are harder intellectually to allocate between source or residence.

The paper notes that the allocation of rights is especially important for low-income countries. As source countries, flows for them are commonly very asymmetric. It argues that deeper notions about the fair allocation of tax revenue and powers across countries are at issue and the current initiatives do not address some of these concerns. Failing to address this, it warns, may increasingly give rise to unilateral national measures that risk further undermining the coherence of the international system.

The impact of spillovers

The report sets out the various ways in which one country’s international tax decisions can affect other countries. These include impacts on FDI flows (where low effective tax rates attract inward flows); on the corporate tax base (either through shifts in real investment or profit shifting); and on tax-setting incentives (where the response to tax changes elsewhere may be to change tax rules at home).

As to the scale of these effects, the report suggests that base spillover effects – due to shifts in real activities and profit shifting – are both large and significant, although these are described as “suggestive conclusions” rather than hard findings. For strategic spillovers, the report points to the decline in corporation tax rates over the last 30 years and the recent proliferation of intellectual property “boxes.”

On welfare implications, the complexities of identifying the effects are even greater and the report suggests these issues should be further explored in the IMF’s own consultations with tax authorities and through more work in the G20 process.

Suggestions on approach

Turning to the impact of spillovers on developing countries, the report identifies a range of ways in which the current international system impacts on developing countries and points to approaches that could be adopted in response.

The impacts include: the use of tax treaty networks to reduce tax payments (where the IMF says developing countries would be well-advised to sign treaties only with considerable caution); the potential for avoidance of tax on capital gains on natural resources and some other assets in their jurisdiction by the realization of these gains (i.e., the transfer of ownership) in low tax jurisdictions; a lack effective provisions to guard against the use of borrowing to shift profits to lower tax jurisdictions and a need for capacity...
building, simplified rules and guidance in the area of transfer pricing. Finally the report identifies that these issues may themselves detract a country’s focus from the development of its own domestic tax policies.

The approaches that the IMF report says could be adopted in response include:

- Encouraging developing countries (which will largely be capital importing countries) to be cautious about entering into any bilateral tax treaty and to evaluate whether it realizes sufficient gains from increased FDI to offset any revenue loss. It notes that limitation on benefit provisions can provide important protection.
- On the issue of taxing indirect transfers of interest (i.e., transfer of ownership to a low tax jurisdiction), the paper notes that this is of particular importance to developing countries. While it acknowledges arguments which suggest that taxing such transfers are not necessary (on the basis that the accumulated and expected earnings have been or will be taxed), the paper concludes that, as countries do seek to tax such transfers, they need to strengthen their laws, by, for example, by ensuring that “immovable property” is adequately defined and extending taxing rights into multi-tiered structures.
- In a relatively short section on interest deductibility, the paper notes that this is also an area of particular concern and that restrictions can be “relatively straightforward” and have considerable potential for addressing avoidance through debt shifting.
- Regarding the arm’s length principle, the paper defends this in principle, before arguing that it is difficult to operate in practice. Here the recommendation is for a comprehensive agenda covering anti-avoidance rules, more detailed guidance, improved public data availability and capacity building.

**More radical suggestions**

The report closes with a run-through of the possible alternatives to the existing international architecture, focusing on:

- Minimum domestic taxation as a means of bolstering the tax base of developing countries by charging tax on measures “less subject to manipulation than taxable income.” While noting such schemes can lead to complexity and distortions, the report highlights that they nevertheless offer a possible response for developing countries.
- The trend of a move away from worldwide and toward more territorial systems of taxation, arguing that territoriality can amplify profit shifting and intensify tax competition, causing particular concerns for developing countries. It argues that spillovers are likely to be less frequent under a worldwide tax system (without deferral). In what may be a hint of its focus in the future, the IMF paper notes that tough controlled foreign company rules can be a close substitute.
- In what might be a blow to the European Commission, the paper is relatively lackluster on the options of formulary apportionment. It argues that such a system (as forms the European Commission’s proposal for a common consolidated corporate tax base) is seen as an alternative that might be attractive to developing countries, but is beset by difficulties around weightings and definitions and general operation. Again, focusing on the practical aspects of international taxation, the paper comments that in any case such a system is unlikely to be adopted internationally.
- There is a more positive approach taken to Formulary Profit Split, which might offer a hybrid approach combining the best aspects of formula apportionment and arm’s length principles.
- The IMF paper also comments briefly on the radical suggestion of a destination-based corporate tax, which is somewhat akin to VAT. It argues that this has the very strong appeal of having only minimal cross-country spillovers, but says that there are a number of unresolved issues (including the treatment of services and consistency with the WTO prohibition on direct tax equivalents of export subsidies).

**Impact?**

So what is the significance of all this? On one level, this report revisits some familiar BEPS issues, but applies an analytical perspective to explore the issues rather than a political lens to classify and categorize them. Indeed, this report may be seen by some as a critique of the lack of radicalism in the BEPS Action Plan and may offer a rallying point for those who wanted it to go further. For developing countries and their advocates, of course, the report offers a welcome refocusing of the tax competition debate.

In terms of the big picture questions that the report seeks to address, it certainly delivers a clear set of messages on the issues for developing countries and provides an analytical base to support its arguments. On overall economic welfare impact, the conclusions are less clear cut, but the report does enough to lodge this as an issue that needs to be returned to, and suggests doing so in the IMF’s consultations with tax authorities.

In a field where we have seen a fair amount of institutional competition between the OECD and the EU to set both the standard and the pace of change in international taxation, the IMF has flexed its analytical muscles. It has drawn on its deep well of experience through its technical assistance program and has suggested that the debate so far is only addressing part of the question.

What impact will this report have? It’s hard to say quite yet and the underlying analytical basis for the IMF’s conclusions will no doubt receive much scrutiny. But it is clear that anyone with an interest or a stake in the BEPS process, or in the tax and development discussion, could do worse than to spend awhile getting behind the headlines of this report.
On 1 August 2014, the Organisation for Economic Co-operation and Development (OECD) released the first part of a report on Base Erosion and Profit Shifting (BEPS) in developing countries. Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries (the Report) was discussed during the G20 Development Working Group (DWG) meeting in May 2014. The Report focuses on developing countries and their key challenges in addressing BEPS, their priority items in the OECD Action Plan on BEPS, released on 19 July 2013, and their other BEPS-related tax issues.

A second part of the Report will be made available to the G20 DWG in September 2014 and will describe how the DWG can assist developing countries to address the challenges posed by BEPS.

The Report states that the G20 had directed the OECD to develop a report identifying the main BEPS challenges in developing countries and determine how these challenges relate to the OECD/G20 BEPS Action. It was compiled based on consultations with developing countries and the experience of international organizations in working with developing countries.

The OECD consultations identified that BEPS reduces resources available to developing countries, especially countries that disproportionately rely on tax revenue from multinational corporations (MNCs). It also states that BEPS undermines the effectiveness and credibility of developing countries’ tax systems. The Report notes that the BEPS challenges faced by developing countries may be different in both scale and nature than those faced by developed countries. Therefore, BEPS measures for developing countries may need to be tailored to their particular circumstance.

The Report asserts that while the tax planning strategies MNCs deploy in developing countries may be less sophisticated, legislation in those countries may be inadequate to address BEPS. It also states that it is difficult for tax authorities to gather relevant taxpayer information due to inadequate reporting rules, poor compliance and enforcement, and ineffective processing systems for capturing information. Tax authorities are often resource constrained, leading to inadequate staffing and the inability to retain skilled staff. Many developing countries lack effective procedures for settling tax disputes with large taxpayers related to complex cross-border transactions. Governments also may not have the political support necessary to make legislative changes and deploy resources to counter BEPS. Finally, the Report asserts that, while beyond the scope of the BEPS Action Plan, investment-targeted tax incentives granted to MNCs are eroding tax bases, often with little demonstrable benefit to the granting countries.

The OECD also found that developing countries have identified high-priority BEPS Actions, including excessive and unwarranted payments for intercompany financing, services (such as information technology, legal, management or technical advice services), or intangible property (IP); the contractual shifting of risk and IP in supply chain restructuring to low-tax jurisdictions; the inability to obtain the information needed to assess BEPS risk and hence to take effective action to counter such activity; and treaty shopping. The Report notes there is strong support by several developing countries for some form of a country-by-country reporting template.
Other issues identified
The OECD’s consultations also identified other BEPS-related issues that are important to developing countries. These issues include the lack of comparable data needed to apply the arm’s length principle; the loss of tax revenue from capital gains due to indirect transfers; and the erosion of the tax base from the granting of tax incentives.

The Report notes that many international organizations have provided assistance to developing countries on international tax policy and administration matters. The Report suggests that the areas where developing countries request assistance are evidence of the areas of concerns for these countries. The areas where the International Monetary Fund has provided requested assistance in the last few years include transfer pricing, tax treaty issues, cross-border capital gains, and issues regarding holding companies, related party debt and thin capitalization.

In interim conclusions, the Report finds that BEPS has the potential to have significant impact on domestic resources in developing countries. As BEPS may affect developing countries differently, they have highlighted that some of the Action items are more relevant to them than others and have identified other issues beyond the Action Plan that concern them.

In closing, the Report indicates that the second part of this report, which will be released in September 2014, will explain how the G20 DWG can assist developing countries to meet the challenges of the most relevant BEPS issues they face. That report will:
- Confirm the Actions that are most relevant to developing countries and the outcomes of those Actions that are expected to benefit them.
- Discuss other BEPS-related issues that have a direct impact on developing countries’ tax bases, including wasteful tax incentives, the lack of comparability data, and tax avoidance through the indirect transfer of assets.
- Discuss capacity building initiatives to accompany regulatory measures. This will include a discussion of actions needed to ensure that developing countries can fully benefit from the BEPS Action Plan and how specific Actions may need to be adapted or supplemented to ensure they are effective for developing countries.

Implications
This Report is the first document related to the BEPS project that specifically addresses the concerns of developing countries. The OECD has stated that, in order to arrive at international consensus, the views of developing countries must be considered in the BEPS project. The second part of this report will provide insight on how developing countries may adapt recommendations from the BEPS project. Companies that operate in developing countries should continue to monitor the developments in the OECD and in relevant countries, evaluate how the recommendations may affect them, and consider participating in the dialogue regarding the OECD BEPS project and the underlying international tax policy issues.
BEPS-related developments

France
France releases new transfer pricing form with initial deadline of 20 November 2014

Ireland
Irish Department of Finance launches a public consultation process to evaluate the competitiveness of Ireland’s corporate tax regime.

United States
United States House of Representatives Ways and Means Committee Chairman Dave Camp and Senate Finance Committee Ranking Member Orrin Hatch released a joint statement regarding the OECD BEPS project. They expressed concern that the project is “now being used as a way for other countries to simply increase taxes on American taxpayers.”

El Salvador
El Salvador’s Treasury Ministry sends four tax reform bills to Congress for discussion. The tax reform introduces a number of important amendments to the current tax laws and regulations and also creates new taxes. The amendments include modifications to the tax code to make specific reference to the OECD transfer pricing methods.

Portugal
Portuguese Secretary of State for Fiscal Affairs announces that a committee will be established to monitor corporate income tax reform.

Brazil
Brazil promotes changes in its black and gray listed jurisdictions, reassessing Switzerland and Hungary.
Spain

Spain releases draft bills introducing significant modifications to existing tax legislation and, among many other measures, proposing certain amendments in focus areas related to the OECD’s BEPS project.

Spanish Government approved a draft bill which modifies the Spanish Company Law with the stated aim of improving corporate governance practices of listed companies.

Sweden

Swedish Committee on Corporate Taxation presents a report to the Swedish Government proposing major corporate tax changes. In regard to the deduction of interest expenses, the report sets forth a “main proposal” and an “alternative proposal.”

Sweden’s National Tax Board issues three advance tax rulings on the application of the interest limitation rules, which entered into force on 1 January 2013.

Dutch State

Dutch State Secretary of Finance sends a letter to parliament: Supportive, but premature to implement the measures published by the OECD.

China

China issues draft administrative guidance on general anti-avoidance rules for public comments.

India

Provisions of the new Indian Companies Act 2013 dealing with registration of foreign companies that have a place of business in India are made effective.

Tanzania

The Tanzania Revenue Authority has released transfer pricing guidelines.

South Africa

South Africa releases proposed international tax changes for comment.

Italy

Italian tax authorities issue Circular Letter no. 12, providing significant clarifications regarding the national interest deduction regime.

Australia

Australia votes to repeal carbon tax
Life at the intersection of tax and technology: how technology is entering a new era - and the impact it is having on tax administration

A discussion with members of the Australian Taxation Office

“Technology evolves rapidly and then, just when global and local tax systems start to address the resulting new business models, technology evolves again.” These are some words that Channing Flynn, EY’s Tax leader for the technology sector, said to me a few months ago. Their simplicity describes the very magnitude and impact of the technological transformation that is under way today.
Business is ever more global, highly mobile and virtual. Transactions are not merely conducted across borders but in borderless clouds; ever-growing volumes of transactional and personal data are being generated.

From a tax administration perspective, these activities present both challenges and opportunities – e-invoicing has become a reality in many countries; electronic filing is maturing in others; new and rapidly improving data analytics platforms are enabling e-audits; and data-driven risk assessment processes are blooming among the more mature revenue authorities, which, like many topics before it, will surely benefit from increased levels of collaboration and the sharing of leading practices.

But of course, no tax administrator will have the pleasure of a restful night’s sleep at present, as they address the challenges of how to manage the exponential growth of available taxpayer data as the number of double tax conventions and tax information exchange agreements continues to drive higher and multilateral, automatic information exchange comes into play.

So what impact is technology having on tax administrations? In this first of a series of roundtable discussions with leading revenue authorities, I was very grateful to the Australian Taxation Office for agreeing to speak with me on what can be a sensitive issue – how do they use technology today, how do they plan to use technology - and specifically, data analytics – in the future, and what impact are new technologies having on their overall strategy and service delivery models?

Joining me in a roundtable discussion were Robert Ravanello - Deputy Commissioner Service Delivery, David Allen - Assistant Commissioner Internal Engagement and Transparency and Matthew Hay - Assistant Commissioner, Strategic Program.
The other thing that we’ve been doing is looking more closely at the value of information exchanges – and as a consequence, understanding the overall value of the treaty network.

Rob Thomas: David, to help us set the context, are you able to share any information about what kind of volume and types of data the Australian Taxation Office (ATO) typically exchanges with any other countries?

David Allen: We’ve been doing a lot of work in the last couple of years on two dimensions of information exchange. The first has been our focus on the requests we’re sending to other countries. We’ve had a program of working with our compliance business lines to ensure that they understand what our treaty arrangements are with other countries and the processes for doing the information exchange. We have managed to increase the overall number of exchanges, which has been very important for us closing our gap of understanding with what is happening with cross-border transactions.

We have also been looking more closely at the value of information exchanges and, as a consequence, understanding the overall value of the treaty network. For the last financial year we calculated that just under half a billion dollars was directly linked to exchanges with other jurisdictions. The other part of this is that we are working closer with our key jurisdictions. We are building up personal relationships and trying to facilitate requests to Australia as well. (Editor’s note: see table for further information.)

Rob Thomas: As we move from a bilateral, on-request information exchange model to one that is focused more on multilateral and automatic exchange, what kind of impact is that having on the ATO and how are you preparing to receive what could potentially be exponentially larger volumes of data?

David Allen: A lot of our focus has been around the implementation of the Common Reporting Standards (CRS). This week we have got a series of meetings with industry on CRS so we can understand the smartest way to implement. To date, we haven’t fully put our mind to how we are going to use opportunities.

It is fair to say that we have had a traditional focus on domestic third party data - to do things such as verify and pre-populate tax returns. We have also used this data to drive much of our data analytics and our risk assessment methodology. Having a reliable and extensive set of data from offshore allows us to extend our thinking on taxpayer assurance, risk assessment tools and reducing the need for taxpayers to fill in tax returns. So although there has been some blue sky thinking, we are just at the starting line. The challenge is, rather than each tax administration inventing its own analytics tools and algorithms for CRS data, how do we develop a multilateral approach instead?

Australia’s information exchange network

Australia has exchange of information relationships with 106 jurisdictions through 45 DTCs, 37 TIEAs. Australia is a signatory to the Convention on Mutual Administrative Assistance in Tax Matters.

On 19 June 2014, the Australian Treasury released a discussion paper, Common Reporting Standard for the automatic exchange of tax information, for comment. The paper follows various actions by the OECD under their BEPS action plan item 5. The discussion paper seeks stakeholder views on timing and financial institutions’ potential implementation and compliance costs, as well as suggestions on how to minimize the implementation and compliance costs.

### Australia’s Country Specific and Spontaneous exchanges in relation to the Project DO IT voluntary disclosure regime

<table>
<thead>
<tr>
<th>Country</th>
<th>Incoming exchange requests</th>
<th>Outgoing exchange requests</th>
</tr>
</thead>
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<tr>
<td>Cayman Islands</td>
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<td>China</td>
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<tr>
<td>United States</td>
<td>17</td>
<td>27</td>
</tr>
</tbody>
</table>

Sources: OECD Exchange of Tax Information Portal, Australian Taxation Office
The Australian Taxation Office (ATO) announced in March 2014 an initiative, Project DO IT: Disclose Offshore Income Today. It provides eligible taxpayers the opportunity to voluntarily disclose unreported foreign income and assets before these are identified by ATO activity. The ATO offers significant penalty and other concessions to encourage disclosure, including of structures established by earlier generations. To date (end of July 2014), the project has resulted in 250 disclosures.

Project DO IT is a major opportunity to reduce the risk of penalties, other sanctions and reputation damage which have occurred for some Australian and overseas businesses, families and individuals whose unreported foreign income has been identified by tax authorities. The fast approaching deadline means that taxpayers need to consider whether action is necessary.

Read EY’s full analysis at:

Rob Thomas: It’s interesting to see the trend of increasing multilateralism firstly in both information exchange, joint and simultaneous audits. There’s a push for multilateralism in cooperative compliance, and now the possibility of multilateral risk assessment and data analytics.

David Allen: I think that’s right; we’ve not yet come to an answer, but it gives us the opportunity to think afresh about the way we approach risk management. We need to think not where we are today but where we will be in five years, 10 years and 20 years; the world is globalized now, and will be exponentially more so in 20 years.

Rob Thomas: Moving on to the use of data analytics in assessing risk; how do you approach using analytic techniques in the risk-based selection of tax interventions and risk assessments? As the technology changes, and the amount of data that is available to you changes, how are you using data analysis?

David Allen: It’s a very complicated question because we use data analytics in different ways across the organization, depending on the taxpayer segment, the industry and other factors. So it’s a bit of a multi-pronged answer, but I think it is fair to say that we’ve invested heavily in the organization, firstly in tailoring our tax return to capture information that we think is relevant to doing a risk analysis.

We’ve also developed additional schedules to the tax return, to particular market segments where we might have particular concerns or where there’s more complexity. The most obvious one is our International Dealings Schedule which has been completely reworked in the last couple of years and which very much tried to pick up an understanding about what we perceive as risk. We use our data analytics from that information to really try and apply our risk management approach. In doing that we then try to differentiate risks, identifying those areas where we have most concern to which we generally will apply a review or an audit. Risk differentiation also allows us to develop other strategies to support the system including through customer communications, improving participation and nudge-type strategies.
In terms of the future, the Commissioner has set as a priority analytics to drive increased level of assurance, increased focus on risk assessment and, more importantly, our move into real time use. One of our biggest risks at present is dealing with issues that happened one, two, three years ago or more. Aged issues present challenges in identifying one, two, three years ago or more. Aged issues present challenges in identifying the parties, following up, getting the right information and collecting the debt.

We are seeing this shift in the large business market where we are realigning our focus and resources from post-lodgement audits to real time activity. As a consequence, we are developing our focus and resources from post-lodgement audits to real time activity. We are seeing this shift in the large business market where we are realigning our focus and resources from post-lodgement audits to real time activity. As a consequence, we are developing different skill sets, a different way of looking at information and dealing with the taxpayer in real time - and resolving issues in real time as well.

Robert Ravanello: I think you’ve picked up the importance of both structured and unstructured data. As we get more sophisticated, unstructured data will become a more important part of our future.

There’s a “sophistication spectrum” for data analytics;

- “Reporting” - what happened
- “Understanding” - why it happened
- “Identifying” - given a known risk, identifying who this might apply to
- “Predicting” - using analytics to find new and emerging risks

As we improve our capability, we will use analytics to identify and prevent issues before they happen. That’s where we would really like to be.

Rob Thomas: Could you give me an overview of where the strategy for service delivery is heading and maybe how does technology in particular enable that - particularly for large corporate taxpayers?

Robert Ravanello: From a service delivery perspective, our key strategy is to reduce the cost of compliance and move to more contemporary service approaches. The days of paper interactions and the associated long response times are, I think, a thing of the past. People are now looking for real time interactions and greater certainty. It goes to what David said earlier about having that real time analytics to give you certainty.

It’s Government policy in Australia that digital be the default method of interaction. By December 2017, digital options for interactions must be available where there are 50,000 or more interactions per year, so we’re definitely in that group. We have a program of work to identify interactions across all channels - paper, phone, face to face, digital - to prioritize future investments.

It’s not just digitizing what we’ve currently got; we’re looking to re-engineer processes. Sometimes that’s possible within the existing legal framework and sometimes we will be approaching Government to suggest changes to the law so that we can re-engineer processes.

We’ve also started mapping standard charts of accounts to our income tax returns, looking at what return information can be generated from a standard chart of accounts, and where it can’t be generated, what sub-ledgers or what additional breakdown would be required to create information in returns.

By leveraging a business’s natural system, their software systems, we can reduce their cost of compliance and increase certainty.

Matthew Hay: I would also echo that for the corporate and business community, we are very much looking to leverage software. As well as doing the work around how we can leverage the chart of accounts in someone’s accounting system more effectively to satisfy tax reporting obligations, we are also progressing an initiative called “Single Touch Payroll,” which is quite similar to, I think, a UK initiative known as “Real Time Information” - again, looking at using the digital environment to enable business to satisfy employer obligations with the tax office at the time of their payroll events, be they weekly, fortnightly or monthly. So from a services perspective, from small, right through to large businesses, a key focus is how we can leverage their natural business systems and natural business process environments to make some of their tax reporting and tax payment obligations a bi-product of what they are already doing in running their business.

Robert Ravanello: There’s another point in relation to “Single Touch Payroll.” The social welfare system in Australia is dependent on knowing the income details of citizens. Real time income reporting will remove the need for citizens to notify changes in salary and wage income, resulting in more accurate payments, reducing under- and overpayments.

Rob Thomas: A great point to end on - the ATO is playing its part in joined-up Government, making the Australian economy more efficient!
Tax risks are rapidly increasing year-on-year. Reputation risk, the OECD’s Action Plan on BEPS, complex new national legislation and more robust tax enforcement worldwide are all putting greater pressure on tax function resources, processes and technology.

These are the main findings in our report *Bridging the divide*, drawn from responses from 962 tax and finance executives in 27 jurisdictions who took part in our 2014 Tax risk and controversy survey.

A panel of professionals explored the challenges revealed in the survey and gained insight into some of our key findings:

- A 21% increase in more frequent and aggressive tax audits for large multinational companies
- Far greater focus by tax authorities on cross-border transactions
- Signs that some countries see the OECD’s BEPS project as a reason to change their enforcement approach ahead of any OECD recommendations passing into national law
- Concern among the largest global companies regarding media coverage on the taxes they are paying
- Expectations of an increase in tax risks over the next two years, with greater impact on tax function resources and operations

Is your company prepared to meet the new challenges? To find out, replay the webcast at:

A key driver behind the OECD/G20 BEPS project was to change the international tax architecture in unison and thereby reduce risks to international trade. Unilateral action risks creating double taxation, something that the OECD has long sought to avoid.

However, since the Action Plan was published we have seen a range of BEPS-inspired policy changes across the globe and across the broad categories of cross-cutting, coherence, substance and transparency. To some extent, this is to be expected, as the BEPS discussions have helped to ensure a shared understanding of tax risks.

**Action on cross-cutting issues**

We might be forgiven for thinking that Action 1 – on the digital economy – is among the least well suited to unilateral action, given how quickly the sector changes. But at the same time, digital is one of the sharpest political pressure points around BEPS, with key players featuring prominently in the public debate. To date, we have seen various changes, from adopting a broader interpretation of the permanent establishment (PE) rules in countries such as Spain and India, to the consideration of a tax on the purchase of online advertising space in France. This latter idea has not been pursued but the Government has called for the OECD to redefine PE at a treaty level.

**Action on “Coherence” issues**

Going solo on Actions 2 and 4 (hybrid mismatches and interest deductibility) always looked more likely as a number of countries already operate rules in this area. The risk, of course, is that moving first will expose movers to competition from non-movers, with diversions in investment flows. Nevertheless, we have seen unilateral action through tax reform in Mexico which included rules targeting certain interest, royalty and technical services payments to related parties where payments are not taxed. Elsewhere, the Board of Taxation in Australia released a consultation paper inviting comment on whether there can be improvements made to address any inconsistencies between debt and equity rules in other jurisdictions. Proposals in Japan include denying participation exemption of foreign source dividends that are deductible in the source country. And in a show of mini-multilateralism, the EU has amended the Parent and Subsidiary Directive to address hybrids.

Action 3 – strengthening controlled foreign companies (CFC) rules – is another case where the risk of unilateral action exists and we have seen new or strengthened CFC rules coming in across a slew of countries including Australia, Chile, China, Greece, Israel and New Zealand. Russia has proposed CFC rules applying to entities in which the Russian taxpayer (individual or legal entity) has an influence or a direct or indirect holding of more than 10%, that are resident in specific “blacklisted” countries.
Action on “Substance” issues

Action 6 covers treaty abuse and we have seen an increased focus here in jurisdictions as diverse as China, Israel and Vietnam (all have issued anti-treaty shopping guidance with strict beneficial ownership criteria). Meanwhile, India has seen an increased focus by tax authorities on claims for treaty benefits. The Mexican Tax Reform also includes a provision that could restrict access to treaties or impose additional administrative requirements.

On the definition of permanent establishments (PE) - Action 7 - there have been national moves in Belgium and the Slovak Republic where the permanent establishment definition has been broadened, including by introducing the concept of a service PE.

There has been a good deal of activity on transfer pricing (Actions 8, 9 and 10), with changes in Poland, Mexico, France, Australia and the Netherlands. While these may not stem directly as a result of the BEPS project, they are generally consistent with its goals. Moreover, the BEPS influence is clear in the generally heightened scrutiny being applied to intangibles, business restructurings and/or high-risk transactions.

Actions of “Transparency” issues

This area of disclosure of avoidance schemes (Action 12) has been one of the quieter areas for unilateral moves, with the French Finance Bill 2014 provisions to introduce an obligation to disclose aggressive tax planning arrangements giving rise to difficulties with the Constitutional Court. Even so, both the Czech Republic (requiring taxpayers to disclose their aggressive tax planning arrangements and setting up a Specialized Tax Authority for large taxpayers to encourage transparency and disclosure) and Canada (with an Offshore Tax Informant Program) have been active in this area.

In contrast, country-by-country (CbC) reporting is an area where there is strong support for multilateral action. While the European Commission has moved forward with the reporting of CbC for banks under CRDIV, countries are waiting for September’s release and the subsequent recommendations on implementation.

Conclusions

What this leaves us with is a very mixed picture where different jurisdictions are moving forward at different speeds and to different destinations. The result may be a whole that is much less than the sum of its parts.

So why is this happening? To a certain extent it was inevitable that, once BEPS had raised the profile of base erosion issues, pressure would build for early action. Faced with this, national governments may well be tempted to go for political wins today, rather than waiting for BEPS actions to gain approval.

But does it really matter?

It does, and potentially quite a lot. If the real value of BEPS lies in its capacity to deliver a coherent, comprehensive framework that will offer certainty to both policy makers and businesses as they navigate their way around the global economy, then a fragmentary approach clearly heads in the opposite direction. This then has two further negative implications. First, it creates an uncertain and unstable climate for business. Second, it could weaken the longer-term prospects for securing multilateral fixes as jurisdictions settle for self-protection rather than wait for collective security. And of course, as was underlined in the recent IMF report on spillovers, national decisions on tax policy can have international consequences.
The Senate Finance Committee hearing on international tax issues on 22 July 2014 was dominated by discussion of corporate “inversions,” as Chairman Ron Wyden’s (D-OR) call to “immediately cool down the inversion fever” was met with a set of parameters by Ranking Republican Orrin Hatch (R-UT). Other senators suggested limiting the deductibility of interest expense for inverted companies given the potential for earnings stripping.

Committee leaders, who had maintained that inversions should be addressed only in tax reform, opened the door to more immediate action in the week running up to the hearing. “Absent tax reform being enacted immediately, what happens if the inversion virus leads to 20 more inversions over the summer?” Chairman Wyden asked during the hearing, adding that there is some speculation that the inversion trend could spread to a wider range of industries.

Sen. Hatch reiterated that he feels there may be steps Congress could take to at least partially address this issue in the interim, but said such legislation should not be retroactive or punitive; should be revenue neutral; should move the United States “towards, or at least not away from,” a territorial tax system; should not enhance the bias toward foreign acquisitions; should not impede overall progress toward comprehensive tax reform; and “should not be inconsistent with our House colleagues’ approach.”

Sen. Chuck Schumer (D-NY) said it is “absolutely critical” to develop and process legislation that goes beyond legislation proposed thus far and restricts the deductibility of interest expense for inverters. Sen. Schumer said he supports the provision in legislation (S. 2360) introduced by Sen. Carl Levin (D-MI) in May to require that more than half of the stock of the merged company be owned by stockholders who were not stockholders of the US corporation in order for the merged company to be treated as foreign for US tax purposes. He has concerns with the bill’s “managed and controlled” provision, however.

Sen. Schumer pushed back against calls to address the issue in reform, saying, “if we wait for tax reform, we're going to have lots more inversions and ... it’s going to take far too long if we ever get to tax reform at all.”

Sen. Sherrod Brown (D-OH) also expressed concern about earnings stripping with respect to intercompany debt and asked what can be done now to create a “temporary tripwire” that will allow legitimate mergers but prevent arbitrage-driven inversions. Witness Robert Stack, Deputy Assistant Treasury Secretary for International Tax Affairs, pointed to the President’s budget proposals on interest expense, intangibles income, and hybrid arrangements as reflecting the urgent need to protect the US tax base.

Republican Sen. Chuck Grassley (R-IA) pressed Stack on a delivery date for Treasury’s report on inverted corporations mandated under the American Jobs Creation Act, and suggested the report be completed before any new anti-inversion legislation is enacted. Stack could not provide a timetable for the report but nonetheless said it is not necessary to wait given the pace at which new transactions are occurring.

Sen. Grassley said that unlike most transactions in the early 2000s involving low-tax countries, current transactions involve major trading partners with competitive systems and rates – substantive transactions that come with risk and benefits for the companies and involve factors other than taxes. One area that should be studied further is the role tax rules that allow inverted companies to strip earnings out of the United States play in the decision for companies to invert, he said.

Sen. Rob Portman (R-OH) said he fears targeted legislation could “make it even harder to be an American company,” exacerbating the problem, and the United States could end up with a hollowed-out corporate tax base. Rather than a short-term measure, Portman advocated solving the underlying problem through tax reform, but said there must be a push from the Administration. Sen. John Thune (R-SD) also expressed skepticism about short-term anti-inversion legislation and instead advocated reforming the tax code.
Witness testimony
Six witnesses were called to present testimony:

- Mr. Robert B. Stack, Deputy Assistant Secretary for International Tax Affairs, U.S. Department of the Treasury, Washington, DC
- Mr. Pascal Saint-Amans, Director, Centre for Tax Policy and Administration, Organisation for Economic Co-operation and Development (OECD)
- Dr. Mihir A. Desai, Mizuho Financial Group Professor of Finance & Professor of Law, Harvard University
- Dr. Peter R. Merrill, Director, National Economics and Statistics Group, PricewaterhouseCoopers
- Dr. Leslie Robinson, Associate Professor of Business Administration, Tuck School of Business, Dartmouth College
- Mr. Allan Sloan, Senior Editor at Large, Fortune

Robert Stack used his testimony to “emphasize the serious need for the United States to once again directly address the potential loss of federal tax revenues from corporate inversion transactions,” and cited the potential for base erosion through inversions. “Once companies invert, there is a permanent loss to the U.S. income tax base since it is safe to assume these companies are not coming back to the United States,” he said. Stack also provided an update of the US involvement in the OECD BEPS project.

Pascal Saint-Amans, Director, Centre for Tax Policy and Administration, OECD, described the reasoning behind, and provided a more general overview of, the BEPS project.

Mihir Desai, Mizuho Financial Group and Professor of Finance & Professor of Law, Harvard University, said the increase in inversions is merely the most visible manifestation of factors including a high US corporate statutory rate and worldwide system at odds with most of the rest of the world, and various elements of globalization. He said while protecting US interests is thought to be achieved by limiting foreign activities of domestic firms, evidence suggests that as firms expand globally, they also expand domestically.

Peter Merrill, Director, National Economics and Statistics Group, PricewaterhouseCoopers, said US rules requiring repatriation of foreign earnings make it more attractive for U.S. multinationals to invest abroad than at home and, combined with the high tax rate, has contributed to the number of cross-border merger and acquisition transactions resulting in the combined company being headquartered outside of the United States.

Leslie Robinson, Associate Professor of Business Administration, Tuck School of Business, Dartmouth College, said research suggests multinational companies based in countries with worldwide tax systems have lower effective tax rates than those in countries with territorial systems. To that end, the current system of international taxation can be reformed, as opposed to switching to a different system.

Allan Sloan, Senior Editor at Large, Fortune, said Congress does not have time to deliberate about an approach to limiting inversions, because, without swift action, “by the time you get around to dealing with them as part of corporate tax reform, the corporate tax base will have been so diminished that it will be extremely difficult for you to come up with any sort of revenue-neutral program.”

Tax reform
There was some discussion of tax reform aside from the inversion issue. Sen. Debbie Stabenow (D-MI) suggested there are other factors beyond just the tax rate in determining US competitiveness, and noted that reducing the rate could require eliminating current provisions like the R&D credit and accelerated depreciation. Stack observed that a lot of the discussion ignores the fact that there will always be countries with tax rates lower than ours.

He also noted that the effective rates of US companies vary widely across industries. “So in addition to lowering the rates, we think it’s very important to broaden the base for these taxes so that we can create some equality, eliminate the winners and losers, so that everybody has the advantage of this lower effective rate as we go forward,” Stack said.

Sen. Hatch inquired about the UK and Japan taking steps to make their tax systems more attractive in recent years. Merrill said the UK had experienced a phenomenon not unlike what we are seeing in the United States, with companies moving their headquarters to other nations. In the wake of changes to the system, some have actually moved back to the UK, he said.

A video of the hearing can be viewed on the Senate Finance Committee’s website, where witness testimony may also be accessed:

http://www.ow.ly/CqsSi
The Honorable Dave Camp  
Chairman  
Committee on Ways and Means  
U.S. House of Representatives  
Washington, DC 20515  

Dear Chairman Camp:

A corporate inversion is a transaction in which a U.S.-based multinational group restructures so that the U.S. parent of the group is replaced by a foreign corporation, typically located in a low-tax country. Such transactions allow firms to reduce their level of worldwide taxation, but in the aggregate, they function to hollow out the U.S. corporate income tax base.

The President has called for undertaking business tax reform as a way to improve the investment climate in the United States and to support the creation and retention of high-quality American jobs. Short of undertaking a comprehensive reform of the business tax system, there are concrete steps that Congress can take now that would address this urgent issue.

In recent months, there have been reports of a number of corporate inversion transactions designed to change the tax domicile of a U.S.-based multinational firm with minimal change in its business operations. These transactions involve the purchase of a foreign corporation (generally in a country with a much lower corporate tax rate and generous rules for shifting income between countries), the transfer of tax domicile to the foreign firm's country of incorporation, and the shifting of tax liability for the combined firm to the new foreign tax domicile.

Recently announced transactions cover a wide range of industries including pharmaceuticals, retail, consumer, and manufacturing. The firms involved in these transactions still expect to benefit from their business location in the United States, with our protection of intellectual property rights, our support of research and development, our investment climate, and our infrastructure, all funded by various levels of government. But these firms are attempting to avoid paying taxes here, notwithstanding the benefits they gain from being located in the United States.

The best way to address this situation is through business tax reform that lowers the corporate tax rate, broadens the tax base, closes loopholes, and simplifies the tax system. But, even as we work to do that, we should prevent companies from effectively renouncing their citizenship to get out of paying taxes. That is why President Obama included in his Fiscal Year 2015 Budget a proposal to ensure that companies could not change their corporate tax domicile without a change in control of the company itself. Senators Ron Wyden and Carl Levin and Congressmen Sander Levin and Chris Van Hollen have supported this idea in Congress and have put companies on notice that any transaction that takes place after early May 2014 will not have the desired effect of lowering future U.S. tax liabilities. Congress should enact legislation immediately - and make it retroactive to May 2014 - to shut down this abuse of our tax system.

What we need as a nation is a new sense of economic patriotism, where we all rise or fall together. We know that the American economy grows best when the middle class participates fully and when the economy grows from the middle out. We should not be providing support for corporations that seek to shift their profits overseas to avoid paying their fair share of taxes. I hope that you will support these legislative initiatives to reverse the trend towards corporate inversions.

Sincerely,

Jacob J. Lew

Identical letter sent to:  
The Honorable Sander Levin  
The Honorable Ron Wyden  
The Honorable Orrin Hatch

July 15, 2014

A letter from the US Secretary of the Treasury
Progress toward adoption of several major tax proposals, all of which have been on the Council’s table for several years, remains slow under the Greek presidency. But the picture is very different in the areas of state aid investigations and anti-tax avoidance measures.

11 June saw the European Commission announce that it had commenced three in-depth investigations to examine whether “tax rulings” issued by national tax authorities in Ireland, The Netherlands and Luxembourg with regard to the corporate income tax to be paid by certain companies conflicts with the EU rules on state aid by providing selective advantages to a company or group of companies.

Since September 2013, the Commission has been investigating under EU state aid rules certain tax practices in several Member States, following media reports alleging that some companies have received significant tax reductions by way of “tax rulings” issued by national tax authorities. Tax rulings as such are not problematic: they are comfort letters by tax authorities giving a specific company clarity on how its corporate tax will be calculated or on the use of special tax provisions. However, tax rulings may involve state aid within the meaning of EU rules if they are used to provide selective advantages to a specific company or group of companies.

The Commission in particular is scrutinizing tax rulings which are used to confirm transfer pricing arrangements. If tax authorities, when accepting the calculation of the taxable basis proposed by a company, insist on a remuneration of a subsidiary or a branch on market terms, reflecting normal conditions of competition, this would exclude the presence of state aid. However, if the calculation is not based on remuneration on market terms, it could imply a more favorable treatment of the company as compared to the treatment other taxpayers would normally receive under the Member States’ tax rules. This may constitute state aid.

The opening of an in-depth investigation gives interested parties, as well as the three Member States concerned, an opportunity to submit comments.

**Tax harmonization**

Under the Greek Presidency, discussions in the first half of 2014 continued in the Council working group on a number of legislative proposals designed to introduce new harmonized taxes (the Common Consolidated Corporate Tax Base and the Financial Transaction Tax) or to amend existing harmonized taxes (Energy Taxation, the Standard VAT Declaration and the proposal concerning VAT on Vouchers). However, no really significant progress has been made on any of these proposals, although the Council has noted that, in the case of the VAT on vouchers proposal, agreement would be desirable before the introduction of new B2C place of supply rules on 1 January 2015, given the significant use of vouchers for e-service and telecommunication transactions.
Anti-avoidance measures
The picture is somewhat different, however, in the case of those proposals which are designed to reduce possibilities of avoidance, evasion or fraud. As previously indicated in our last EU update, after six years of negotiations, the amendments to the Savings Tax Directive were finally adopted on 24 March. These are intended to plug a number of loopholes in the scope of the Directive, thus preventing certain forms of evasion, and will be a cornerstone of the EU’s legislative structure for implementing the new global standard on automatic exchange of information.

The next stage in the process, which is now well under way, is the negotiation with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, of amendments to the EU’s agreements with those countries to ensure that they continue to apply measures equivalent to those in the EU, particularly in respect of automatic exchange of information. The Commission, which is leading the negotiations, has been asked to report on progress to the Council before the end of the year.

In a similar vein, the Council also adopted on 8 July an amendment to the Parent/Subsidiary Directive that will prevent the double non-taxation of dividends distributed within corporate groups deriving from hybrid loan arrangements. Under the amendment, which Member States must implement by 31 December 2015, the Member State where the parent company is established will refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary. The amendment is part of a broader proposal that the Council agreed to split in order to allow early adoption of the new rule on hybrid loans, while enabling work to continue on the introduction of a common anti-abuse provision. Member States are divided on this latter aspect. More information on the adoption of the amendment can be found in an EY Global Tax Alert dated 20 June.1

Administrative co-operation
Council has not yet reached agreement on two other initiatives designed to enhance administrative cooperation. The first is the proposal to amend Directive 2011/16/EU on administrative cooperation in the field of taxation (the DAC) in order to upgrade and broaden automatic exchange of information in the area of direct taxation, especially for financial income. The intention is to align EU law with the emerging new OECD standard (the Common Reporting Standard). The second is the Commission’s request to be granted a mandate to open negotiations for an agreement between the EU and Norway and Russia, respectively, on administrative cooperation, combating fraud and recovery of claims in the field of VAT.

Tax policy coordination
The Code of Conduct Group
Discussions are continuing on an ongoing basis in the Code of Conduct Group on the rollback and standstill of harmful tax regimes, but no new significant agreement has been reached, particularly in respect of the issue of regimes such as the UK patent box. The Group is also examining ways of tackling undesirable effects of mismatches involving intra-EU hybrid entities.

Base erosion and profit shifting (BEPS)
A new area of EU tax policy coordination has emerged in connection with the OECD’s/G20’s BEPS initiative. The Council has stressed the need for the EU to coordinate its position in order for the EU as a whole to cooperate closely with the OECD and the G20 to develop internationally agreed standards for the prevention of BEPS. Among the areas which are being examined is the interaction between aspects of the EU’s legislative framework (including the EU Treaty Freedoms) and the various BEPS initiatives.

The European Semester
Taxation is one of the key policies monitored through the “European Semester” process - a yearly cycle of economic policy coordination and monitoring of Member States’ progress toward the targets set in “Europe 2020,” the European Union’s 10 year growth and jobs strategy.

Each year, the Semester starts with the publication of the Annual Growth Survey, which sets the priorities to boost growth and job creation for the year to come. The Annual Growth Survey highlights areas of taxation where the Commission considers there is scope for improvement and guides Member States in implementing growth-friendly tax reforms. The 2014 Survey has suggested the following priorities in the field of taxation:

* Broadening tax bases and removing “ill-targeted” exemptions, rather than increasing tax rates. In particular, this priority is aimed at encouraging Member States to move toward a simpler and more efficient VAT system.
* Shifting the tax burden away from labor - in particular for the low-skilled and young workers - toward tax bases linked to consumption, property and pollution.
* Improving tax compliance by combatting fraud and evasion, by coordinating action to tackle tax planning and tax havens, by ensuring greater efficiency of tax administration and by simplifying compliance procedures.
* Reviewing tax schemes which lead to debt bias.

The Semester culminates in late Spring with the adoption of tailored advice to Member States - known as “country specific recommendations.” These are not legally binding but are subject to peer review and monitoring in regular ministerial-level council meetings where individual Member States are called upon to explain why they may not have acted on a specific recommendation. Twenty-two Member States received tax-related recommendations in 2014.

In this edition, we examine how technology and globalization are having an impact on indirect taxes and on how tax and trade administrations and businesses are dealing with the challenges of the digital age.

Mismatches in the application of VAT to international trade can cause issues of double taxation and unintended non-taxation. We report on the OECD Global Forum on VAT and the adoption of the International VAT/GST Guidelines.

We consider how new VAT rules for the digital sector are being introduced around the world, focusing on the EU and South Africa and the proposals for the digital economy being put forward by the OECD. Pedro Meneguetti, Assistant Secretary for Finance for the Minas Gerais State Finance Office in Brazil, speaks to us about how the state’s tax administration uses data analysis tools to carry out more effective tax audits.

Technology and globalization are rapidly changing how we live and how we do business, making cross-border trade far easier and far more prevalent in all sectors.

And we report on how the South African tax authority (SARS) is using data analytics and sophisticated systems-based audits.

How can businesses respond to these trends? The executive summary of our recent report Managing indirect tax data summarizes our findings on how businesses can respond to the challenge of “big data” to reduce risks and gain valuable insights and control.

We also look at the particular indirect tax management issues that arise in the Asia-Pacific region. Our article sets out some of the indirect tax challenges that companies face while operating in this part of the world, which includes very developed VAT/GST systems (such as in Australia, New Zealand and Singapore) and new and developing systems (such as in China and Malaysia).

We also consider ways that companies can proactively manage indirect taxes to go from dealing with day-to-day operational and compliance issues to incorporating indirect tax planning into corporate strategy.

In our country update section, we outline several developments that may increase taxpayers’ compliance obligations, including the differing opinions about the VAT rules on finance leases in Bulgaria, the impact of missing trader fraud in Russia and the need for bona fide companies to verify their suppliers’ credentials, the possibility that extra dutiable costs may apply to imports into Canada, and the new trade certification rules in Mexico.

Finally, we updated our snapshot map of recent developments around the world. See our articles to find out more, or contact us for in-depth insight on the issues affecting your organization.

Download a copy at www.ey.com/tax
Tax revenue growth continues its upward trajectory around the world

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Two reports from the OECD and one from the European Union indicate that many countries are now equaling or even surpassing their former revenue highs of 2006 and 2007. Among the 34 OECD countries, tax revenue as a percentage of GDP was 34.6% in 2012 (the last full year for which data are available), just 0.4% shy of the 35% achieved in both 2006 and 2007. The takeaway for business is clear: while economic growth may be fuelling tax revenues, tax policies are a key instrument through which governments attempt to influence behavior. As noted in our study of tax policies for 2014,1 while many countries continue to lower statutory CIT rates, a greater number of countries are actually increasing the overall CIT burden by expanding the tax base. Understanding how, where and when the base may be expanded should be a core component of business’ tax policy monitoring efforts.

1. www.ey.com/2014taxpolicyoutlook
Highlights from the three reports

OECD 2013 Revenue Statistics report
First to hit the airwaves, in late December 2013, was the OECD’s annual revenue statistics publication\(^2\) which in turn flows through into the OECD’s well-respected statistics database which is available on the internet.\(^3\)

As noted, perhaps the key indicator in the report was that the average tax burden in OECD countries increased by 0.5 percentage points, to 34.6% in 2012. This followed rises of 0.2 and 0.3 percentage points in 2010 and 2011, reversing the decline from 35% to 33.6% between 2007 and 2009. This is still below the most recent peak year of 2007 when the OECD-wide tax revenue to GDP ratios averaged 35%.

The ratio of tax revenue to GDP rose in 21 of the 30 countries for which 2012 data are available, and fell in only 9 countries. The number of countries with increasing and decreasing ratios was similar to that seen in 2011, indicating a continuing trend toward higher revenues.

Between 2011 and 2012, the largest tax ratio increases were in Hungary (1.8 percentage points) and in Greece (1.6 points). Other countries with substantial rises in their tax to GDP ratio between 2011 and 2012 were Italy and New Zealand (1.4 points), plus Belgium, France and Iceland (1.2 points). While the report points out that economic growth fuels growth in tax revenues where the tax regime is progressive, it is interesting to note that the results from many of these countries would seem to mirror the austerity measures which remain in place in a number of jurisdictions. Again, this highlights the importance of understanding where a country is on the policy spectrum and what drivers are influencing the formation of policy.

Among those countries experiencing falls in tax revenues as a percentage of GDP, the largest was in Israel, with a decline from 32.6% to 31.6%. Portugal and the United Kingdom showed falls of 0.5 percentage points - again, perhaps highlighting both the economic fortunes of those two countries during the global financial crisis and their tax policy stance since.

It will be interesting to see whether Israel’s 2014 CIT rate rise from 25% to 26.5% (itself the largest percentage rise among the countries tracked in EY’s 2014 Tax policy outlook) has an impact on future data.

One particular phrase in the report confirms the importance of monitoring the tax policy environment as part of ongoing tax function activities: “Discretionary tax changes have also played a role, as many countries raised tax rates and/or broadened tax bases. Discretionary tax changes played a greater role in a handful of European countries where GDP levels actually declined in 2012.” So in effect, the impact of these discretionary measures was amplified.

\(^2\) http://www.oecd.org/ctp/tax-policy/revenue-statistics.htm
\(^3\) http://stats.oecd.org/Index.aspx?DataSetCode=REV
The increase in the United States, from 24.0% of GDP in 2011 to 24.3% in 2012, was lower than that seen in the OECD area as a whole, while compared with 2007 (pre-recession) tax-to-GDP ratios, the ratio in 2012 was still down by more than 3 percentage points in four countries – Iceland, Israel, Spain and Sweden. The biggest fall has been in Israel – from 36.4% in 2007 to 31.6% in 2012.

The tax burden in Turkey increased from 24.1% to 27.7% between 2007 and 2012. Four other countries (Belgium, France, Luxembourg and Mexico) reported increases of more than 1.5 percentage points over the same period. Denmark has the highest tax-to-GDP ratio among OECD countries (48% in 2012), followed by Belgium and France (43.5%). Mexico (19.6% in 2012) and Chile (20.8%) have the lowest tax-to-GDP ratios among OECD countries. They are followed by the United States which has the third-lowest ratio in the OECD region at 24.3% and Korea at 26.8%.

Finally, the report indicates that revenues from personal and corporate income taxes are now recovering, following the sharp falls seen during the 2008-09 crisis period. Data for 2011 - the latest year for which a breakdown of revenues by category of tax is available for all OECD countries - shows that the 33.5% share of these taxes in total revenues remains below their 35.9% share in 2007. The share of social security contributions has increased from 1.6 percentage points to an average of 26.2% of total revenues.

OECD revenue statistics in Asian countries 2014

A second report from the OECD4 applies OECD analysis methodologies to two non-OECD countries, Malaysia and Indonesia, in order to provide a comparison of their tax structures with two OECD member countries in the Asia-Pacific region (Japan and South Korea).

The report notes that tax revenues as a proportion of national incomes in Indonesia and Malaysia are substantially lower than in Korea and Japan. In 2011 (the latest available year for all countries covered in the Report), the ratios in Indonesia and Malaysia ranged from 12%-16% compared with 26%-28% in the two countries that are OECD members. The OECD average was higher still, at 34.1%.

The tax ratios in this group of four Asian countries have all risen since the year 2000 but they are still lower than the average for OECD countries as a whole. Since 2000, there have been increases of 4 percentage points in Indonesia (9% to 13%) and Korea (23% to 27%) and of 2 to 3 percentage points in Japan (27% to 29%) and Malaysia (14% to 17%). This compared with the OECD average estimated at 34.6% in 2012.

For business, the information on tax structures in this report is of particular interest. Taxes on incomes and profits represent 44% of tax revenues in Indonesia and 71% in Malaysia. This compares with 30% in both Japan and Korea and a 34% average for OECD countries. The relatively high proportion of revenues coming from income and profits in Indonesia and Malaysia is partially offset by the smaller collection of revenues from social security contributions. Within the income and profits segment, revenues from corporations account for 77% of total income taxes in Malaysia and 70% in Indonesia.

European Commission report: taxation trends in the European Union

Rather than just approaching pre-crisis revenue levels, the June 2014 report Taxation trends in the European Union5 highlights the fact that the tax-to-GDP ratio for the European Union6 not only exceeded pre-crisis levels in 2012, but is also set to continue growing in 2013. In 2012, tax revenues as a percentage of GDP increased in 22 EU Member States as well as Norway, remained stable in Cyprus and decreased in six Member States – Portugal (–0.9% of GDP), Slovakia and the United Kingdom (both –0.3% of GDP), Lithuania and Sweden (–0.2% of GDP) and Romania (–0.1% of GDP) – as well as Iceland (–0.5% of GDP).

One of the main reasons for this is set out in the first heading of the very first chapter of the report: “The EU remains a high tax area.”

The report sets out that in 2012 (again, the latest year for which full data are available), the overall tax ratio in the 28 Member States amounted to 39.4% in the GDP-weighted average. This is three percentage points higher than the OECD average, and nearly 15 percentage points of GDP over the level recorded for the US and around 10 percentage points above the level recorded by Japan.

In fact, as the report itself notes, the tax ratio in the EU is high not only compared to those two countries but also compared to other advanced economies; among the major non-European OECD members for which recent detailed tax data is available, Canada (30.4% of GDP in 2011) and New Zealand (31.5% of GDP in 2011) have tax ratios exceeding 30% of GDP, while tax-to-GDP ratios for Australia and South Korea (2011 data) were well below 30% (26.5% and 25.9%, respectively).
The importance of consumption taxes is noted in the report data: consumption taxes increased from 10.7% of GDP in 2009 to 11.1% of GDP in 2010 and remained relatively stable to stand at 11.2% of GDP in 2012. This was mainly due to increases in VAT rates in many Member States, resulting in higher VAT revenues, as well as resumed domestic demand in most Member States.

For business, the report notes that taxes on capital in 2012 represented 8.2% of GDP across the 28 Member States, up from 7.9% in 2011 and continuing the upward trend demonstrated since 2010.

The two main components of capital taxes — taxes on the income of corporations and taxes on stocks of capital/wealth have shown a similar upward trend over the same two-year period. The report notes that, since the mid-1990s, corporate income tax revenues have shown a rather variable trend in spite of the steady fall in corporate tax rates. After falling sharply in 2008-09 (in response to the fall in demand), they have since recovered, though not to their 2007 peak. Corporate income tax revenue for across the European Union represented 2.6% of GDP in 2012, compared with the 2007 peak of 3.4%. Unfortunately, the EU report does not report on the composition of each Member State’s tax revenue, making comparisons with OECD data impossible.

Interestingly, the report notes that although Member States raise roughly equal shares of revenues from direct taxes, indirect taxes and social contributions, the more recent joiners to the European Union, with the notable exception of Malta (41.3%), typically display a lower share of direct taxes in the total. The lowest shares of direct taxes are recorded in Croatia (17.1% of the total), Lithuania (18.0%), Bulgaria (18.8%), Hungary (19.2%) and Slovakia (19.7%). All of these countries have, of course, adopted flat rate tax regimes.

**Conclusion**

It may be reasonably concluded that continuing economic growth in many parts of the world will drive tax revenue collection forward, as will the ongoing programs that many revenue authorities are putting in place to enhance collection activities. But the actual composition of tax revenues also continues to change in each and every country as governments tweak their tax policies in response to long-term trends, domestic needs and, of course, activities like the G20/OECD’s BEPS project.

Much like the data discussed in these three reports, it will be fascinating to understand the OECD’s own economic analysis of the impact of the BEPS recommendations (under BEPS Action 11 - Development of data on BEPS and actions addressing it) when it appears in 2015, and then to see whether the projected impacts flow through to countries’ own revenue collections in due course. It is a little odd that the economic analysis of the impact of base erosion and profit shifting is coming some months after the first set of recommendations are made on how to tackle it. But that is probably another article altogether ...

For tax leaders in the private sector, the messages in these reports may not be explicit but they are still important — virtually everyone is continuing to adjust their tax policies. Adopting a robust, accurate way to monitor and assess the changes in your key jurisdictions is an important preparation for the journey ahead.
Tax revenues in 2011*

Source: OECD revenue statistics database: data extracted on 17 Jul 2014

*2011 is the last year for which full and complete OECD data is available spanning both data points
The case for an Australian Tax Reform Commission

Australia’s tax system needs work and reform. However, based on recent years’ approaches to reform and the intensely political environment surrounding tax reform, changes are unlikely to come easily. This parallels the experience of various other countries. On 17 June, EY in Australia launched its report “Tax reform: A better way - The case for an Australian Tax Reform Commission.” The EY report focuses on how to improve the processes and institutions responsible for Australia’s tax system to achieve sustainable tax reform. EY recommends an independent Australian Tax Reform Commission, with clear responsibilities and institutional power, to develop and review tax reforms for the governments of the day.

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The EY report is available at

An EY webcast discussing the report is available at:
https://event.on24.com/eventRegistration/EventLobbyServlet?target=registration.jsp&eventid=810727&sessionid=1&key=CC57850B0407884CF0DBADAC76364C05&sourcepage=register
Australia's tax system is a key influencer of Australia’s success as a nation and a society. Many recent reports and presentations, including by Australia’s Treasury, highlight that Australia’s tax system fails to raise sufficient revenue, fails to support the international competitiveness of Australian businesses, fails to address the growing needs of the states and is beholden to the short-term needs of the electoral cycle.

Without reform of the tax system, the Government faces persistent and ultimately unsustainable budget deficits. A driving factor behind these deficits is the aging population, which will make greater claims on the retirement and health care budgets but contribute less to government tax revenue. The Government announced measures in the 2014-15 Budget to rein in these deficits. However, these appear unlikely to be fully implemented.

Australia’s tax system leans heavily on personal income tax, company tax, and a goods and services tax that excludes many fast-growing categories of expenditure. This tax base gap means the tax burden is borne heavily by some sectors but not by others and also leads to volatile revenue streams. This tax base gap is significant given projected budget deficits for many years in the absence of reform.

With the ongoing globalization of the world economy, Australia’s tax system is failing to support the international competitiveness of Australian business. Tax is an important part of the cost structure (and so competitiveness) of businesses. And tax is also a key factor that international businesses (whether Australian-based or foreign) take into account when choosing where to operate and invest.

On the tax rate side, Australia’s personal income tax rates rise higher sooner than many countries in which a global workforce can choose to live. Australia’s company tax rate was well below the OECD average in 2001 but is now well above it, at 30%, versus the 2014 OECD average of 25.2%.

Instead of the desired broad-base : low-rate system, Australia has a narrow-base : high-rate system.

Australia’s tax system has a major challenge for both the state and Federal Governments: the “vertical fiscal imbalance.”

States have significant spending commitments but limited direct revenue streams. They rely on grants from the Commonwealth Government.

This makes for unclear responsibilities for both services and duties. State government incentives are not aligned with the Commonwealth, affecting the delivery, the political will and the capacity to implement tax reforms.

Again, improved tax policy settings could improve the productive and allocative efficiency of the Australian economy. Productivity performance determines the economic well-being of Australians in the long run, and recent productivity performance has been lagging.

So Australia’s tax system needs structural reform. There are constant calls for tax reform from across the community. But Australia lacks a strategic tax reform infrastructure, the “pathway” to achieve reform. The EY paper identifies the gap and recommends action.

Australia’s tax system can arguably be described as “unresponsive.” It has failed to react sufficiently quickly to recent developments in the domestic and international context and the law itself is a tangle. Thousands of pages of applicable rules interact and complicate, muddying the job of the tax system’s administrators and inhibiting their ability to simplify. The problems are compounded by recent over-reliance on tax announcements and inadequate delivery of these. The result is uncertainty for businesses and individuals, affecting confidence and perceptions.

So the tax system needs urgent repair and maintenance just to ensure that it remains fit for purpose.

The Government plans a strategic tax reform initiative, which will lead to a white paper to take to the election in 2016. Working backwards that will see a green paper in 2015 and potentially issues papers seeking public input, to emerge in 2014.

EY hopes that our ideas contribute to the reform process and the ongoing wider debate about Australia’s tax system.

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Fig 1: Commonwealth and states’ revenue and spending imbalances

The current tax reform landscape

The tax reform landscape is crowded with participants: business, the community, advocacy groups, different levels of government and their agencies and political parties.

Political support must exist if tax reform is to be sustainable. But it is often in the interests of opposition or minority parties to oppose government tax reforms regardless of their merits.

Australia has many institutions, bodies and committees with a stake in tax reform. These bodies themselves have recognised the need for change.

Tax reform outcomes would be improved if better processes and clearer responsibilities were established, to elicit from interest groups and government entities their views as early and as often as possible.

The EY report distills many lessons from Australia’s history of tax reform, covering the various types of tax reform, including policy-based reforms focused on revenue raising, reforms focused on achieving behavioral change and the repair and maintenance of existing rules.

These lessons include:

- A long gestation period for tax reform is useful. A significant period of deep public interest and lengthy debate assists successful reform. Reforms introduced “out of thin air” without advance policy consultation tend not to endure. A gestation period is useful to outline the potential reforms, to enable discussion and to build public acceptance of reform. So there is benefit from regular long-term strategic reviews of the tax system where all options are considered, without immediate political pressure to jump to any reform.

  The Resources Super Profits Tax (RSPT) and its successor Minerals Resources Rent Tax were linked to a sharp rise in the price of commodities and a perceived need to “share the benefits” arising from claimed inadequate tax collections from the sector. But the perceived tax gap was not well explained or accepted and the RSPT was undeveloped and introduced without proper consultation, resulting in political and policy turmoil.

  Those experiences showed that, even if an initially attractive policy is developed, further consultation is needed for the reform to be a success. This confirms the need for robust consultation in respect of specific reform packages.

- Bundling reforms into packages helps, provided the identification of the winners and losers is credible. A body independent of the operational arm of government can help give credibility to this process without removing ultimate government decision making authority. The tax system needs constant repair and maintenance. The backlog of unlegislated reforms at the 2013 change of government showed the need for a clear process and responsibility for repairs to existing tax law. It highlighted the political, management and governance problems in Australia’s tax reform processes. The list is also a warning not to overreact or overreach: various announcements to deal with apparent anomalies and/or loopholes were overblown, or unworkable, with remedies out of proportion with the problem.

  EY recommends that the Government establish an Australian Tax Reform Commission (the Commission). The Commission could be responsible and accountable to the Government for:

- Regular scheduled whole of tax system strategic reviews
- Consultation on specific tax reform packages and advice to government
- Yearly tax reform maintenance reviews
- Post-implementation reviews of legislation and regulations

Tax reform: A better way

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- Regular scheduled whole of tax system strategic reviews
- Consultation on specific tax reform packages and advice to government
- Yearly tax reform maintenance reviews
- Post-implementation reviews of legislation and regulations
EY recommends that the Federal Government encourage the states to support and participate in the establishment and activities of the Commission.

EY is wary of perceptions of “creating yet more bureaucracy.” But recent experience shows the much greater economic cost of inadequate tax reform processes and governance.

**Recommendation 1**

That the Government establish an Australian Tax Reform Commission (the Commission) as the Australian Government’s independent research and advisory body on tax reform matters.

Its role would be to help citizens and governments make better decisions about tax reform. The activities of the Commission should help identify opportunities for consensus and the risks to tax reform. The Commission would seek public submissions from stakeholders, interact with stakeholders at public forums and perhaps accept secondments from stakeholder institutions.

The Commission’s responsibilities should include those currently performed by the Board of Taxation, which has performed well but has no formal status or institutional power. The responsibilities could also include some activities currently performed by the Revenue Group of the Australian Treasury Department.

The Commission would not impinge on the Government’s ultimate decision making authority.

The Commission should be formed as a statutory authority under its own Act, following the models of the Australian Law Reform Commission and the Productivity Commission. It would be an independent entity under the Treasury Portfolio.

Its statutory independence would not only permit frank and fearless advice but encourage public confidence in the quality and impartiality of that advice.
Conclusion

Australia needs fearless, bold tax leadership and needs it now.

An independent, a-political Tax Commission, we believe, is the answer for much-needed tax reform.
“Basically I’m just making potato salad. I haven’t decided what kind yet.”

Tax has been in the news a lot recently, with coverage of the “fair share of tax” debate over how much corporations pay dominating the front pages of the world’s newspapers. But even the most offbeat of news stories can have a tax angle, as one man who raised more than $55,000 to make potato salad soon discovered.

In July, Zack Danger Brown of Columbus, Ohio, made international headlines for his fundraising effort using Kickstarter, which describes itself as “the world’s largest [crowd]funding platform for creative projects.” (We are not sure if “Danger” is actually his real middle name). Pledges poured in from more than 5,000 people around the world who were promised recipe books, potato salad hats, even a potato salad-themed haiku depending on the amount of money they donated.

But while the story was gaining steam (Brown was interviewed on the US national television show Good Morning America, among others) the tax accountants started calculating – and bickering.

The Tax Foundation, a nonprofit, Washington, D.C.-based organization, soon announced that Brown’s potato salad phenomenon would ultimately cost him US$21,000 in US income taxes. As evidence, it quoted Kickstarter’s own policy, which states:

“In the U.S., funds raised on Kickstarter are considered income... A creator can offset the income from their Kickstarter project with deductible expenses that are related to the project and accounted for in the same tax year. For example, if a creator receives $1,000 in funding and spends $1,000 on their project in the same tax year, then their expenses could fully offset their Kickstarter funding for federal income tax purposes.”

The Tax Foundation concluded, “While the pledges continue to stream in, it’s important to remember there will be a tax bill on any profit Brown retains,” the group reported. Its analysis generated headlines in The Washington Post and Business Insider, among others.

The Tax Foundation claim touched off a bit of debate. “My Advice To Kickstarter Potato Salad Guy: Don’t Write That Tax Check Just Yet,” Forbes columnist and tax lawyer Kelly Phillips Erb wrote in her own blog post. “Here’s the scoop: income isn’t income because Kickstarter suggests that it is,” Erb wrote.

“I would submit that a lot of the folks who are donating aren’t doing so because of the signed jar of mayonnaise,” Erb continued. “They’re doing it because of Brown. Whether they’re paying for goods or services – or just sending in money for a fun cause that has some bells and whistles attached – will make a huge difference come tax time. I suspect that some of these pledges could be considered income but I think there’s a good argument that it’s not all income.”

So intangibles rear their head yet again! And to think most arguments over potato salad revolve around whether to use mayonnaise or salad dressing as the base.

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The percentage of Canadian-initiated cases remained high, at 88% of cases completed in 2013-14, down slightly from the historical high level of 92% of completed cases in 2012-13. Comparatively, the percentage was 88% in 2010-11, 80% in 2009-10 and 83% in 2008-09. These high levels continue to reflect an increase in Canadian transfer pricing audits coming through the pipeline, following an increase in the CRA’s international audit resources in the mid-2000s.

Going forward, given the inherent time lag between transfer pricing audits and the completion of the MAP resolution process, the percentage of foreign-initiated cases is expected to increase as other countries – most notably the US – focus more attention on international audits and assign more resources to them. In 2009, the US Internal Revenue Service confirmed its commitment to boosting its international enforcement efforts, and announced it planned to significantly increase the number of agents assigned to the audit of international issues. As US cases work their way through the system, we expect that these additional US resources will begin to impact the MAP program in Canada and become more evident in future program report statistics.

Canada's MAP report reflects continued improvement

On 9 June 2014, the Canada Revenue Agency (CRA) released its Mutual Agreement Procedure (MAP) Program Report for the fiscal year ending 31 March 2014, covering the period from 1 April 2013 to 31 March 2014. The report provides an overview of the operations of the MAP program, including statistical analysis of cases completed and in progress, covering cases dealing with resolution of double taxation or taxation not in accordance with a bilateral tax treaty.

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Percentage of Canadian-initiated cases remains high

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Continuing improvement in timelines
The time required to complete these Canadian-initiated cases has decreased significantly, again to an average of 22.63 months. This is down from 26.13 months in the prior fiscal year.

This decrease reflects continued improvement in the early-phase evaluation of the Canadian position, which took an average of 3.47 months in fiscal 2013-14, compared to an average of 5.36 months in 2012-13 and 10.43 months in 2011-12. This continued improvement brings the program very close to meeting its target of 12 months to complete the initial phases (acceptance, preparation and evaluation of the Canadian position) and within the overall target of completing negotiation of a case within 24 months for Canadian-initiated cases.

The time to complete foreign-initiated cases increased to 30.9 months from 21.93 months in 2012-13, primarily due to a longer negotiation phase. This variance is likely not significant given the small number of foreign-initiated cases completed in both years, varying negotiation procedures and communication patterns with different competent authorities, and the potential statistical influence of one or two longstanding cases being completed in the year.

Overall, the closing inventory of negotiable cases stood at 257 cases at the end of the fiscal year, up somewhat from 235 cases at the end of 2012-13. With regard to transfer pricing cases, which represent the majority of the MAP cases, the ending inventory increased from 209 in 2012-13 to 232 at the end of the current fiscal year. While the ending inventory of double tax cases was up, almost 19% more files were taken in than in the prior year (127 versus 107) and approximately 7% more cases were completed (105 versus 98).

Few cases not receiving relief from double taxation
Of the 105 cases negotiated with other jurisdictions, two (2%) did not obtain complete relief from double taxation, down from 8% in 2012-13. This rate reflects a traditional level for the program, where rates below 10% have historically prevailed.

In one case, the taxpayer concurred with a CRA Appeals Branch decision, and the other competent authority was not able to grant correlative relief in the circumstances. In the other case, it is reported that the taxpayer did not respond to the competent authority settlement offer. Encouragingly, neither case appears to fall into the category of the respective competent authorities simply being unable to come to an agreement. Nonetheless, these cases particularly exemplify the need for taxpayers to pay close attention to the process and technical requirements of the Income Tax Act and applicable tax treaties as they move through the dispute resolution process, in order to fully protect their rights and maintain the highest probabilities of obtaining double tax relief.

Still silent on arbitration
As in prior years, the report notes the existence of the arbitration feature under the Canada-US treaty. We understand that there have been several cases that have been through the arbitration process so far. While it would have been informative to provide at least general information about the Canadian Competent Authority’s experience in arbitration to date, without breaching the confidentiality provisions of the arbitration process, the report remains silent on that front.

Continuing high volume of non-negotiable MAP cases
The report indicates that the Canadian Competent Authority resolved 2,818 non-negotiable MAP cases, compared to 1,977 in 2012-13 and 813 in 2011-12. Non-negotiable cases are those that do not require the Canadian Competent Authority to negotiate with another jurisdiction, and usually pertain to excess withholding tax, pension issues, capital gains deferral agreements and other items.

The report does not provide an explanation for the continued increase in the volume of these cases, but we understand that it is likely due simply to improved recognition by taxpayers and representatives of the ability to claim a refund of withholding tax in certain situations. The refund analysis for these files is performed by a field office, and the Canadian Competent Authority’s role is generally limited to review of the finding and ensuring the request meets the relevant treaty’s time limits.

TNMM remains the most prevalent methodology to settle transfer pricing cases
Transfer pricing cases represented 84% of the 105 completed negotiable cases. Among completed transfer pricing MAP cases, the transactional net margin method (TNMM) was applied in 47% (35 out of 75 cases where a transfer pricing method was used to resolve the case).

Among these TNMM cases, operating margin was the most commonly used profit-level indicator, in 42% of the 75 cases, followed by total cost plus (4%), Berry ratio (3%) and return on assets (2%). Along with similar results in the APA program, they show the continued attractiveness of the TNMM as a basis to determine transfer prices.

Other methods used to settle cases include cost plus (27%), comparable uncontrolled price or transaction (15%), resale price (4%) and profit split (4%) in descending order of frequency.

These percentages are largely in line with those in previous years.

Summary
While the program continues to experience an environment of government restraint and tight resources, the results in the 2013-14 MAP report indicate continued progress in improving the operations and efficiency of the MAP program. As the primary dispute resolution mechanism for taxpayers to resolve their international disputes, these continued improvements are important and welcomed.

France’s tax evolution: slow pace of change continues - but not for tax enforcement

The peaceful climate of the summer vacation season will likely not reach the French Government, beset with budgetary constraints and a tense social environment. In May, the European Commission revealed its forecasts for the French deficit and growth - a deficit of 3.9% of GDP and a growth rate that may be 1.5% lower than the Eurozone average. These figures, unfortunately, were lower than the Government’s own forecasts. The newly appointed Finance Minister, Michel Sapin, explained this discrepancy as being an underestimate of the effects of the responsibility and solidarity pact, undertaken to face challenges related to the budgetary situation, the functioning of the labor market and external competitiveness. To achieve those objectives, a large number of measures were put in place to simplify the tax system, reduce the tax burden suffered by companies and by lowest income households, while simultaneously fighting against fraud and aggressive tax planning.

New anti-hybrid regulation and its draft regulations

To address concerns around aggressive tax planning, the French legislature has acted ahead of similar OECD work by implementing new “anti-hybrid” financing provisions which were first included in the 2014 Finance Bill. The French Tax Administration (FTA) released draft regulations on these new provisions on 15 April 2014, which were subject to a public consultation process which lasted just two weeks - and in fact, were actually binding on the FTA since the day of their publication.
These provisions introduced in the 2014 Finance Bill under article 212, I (b) of the French Tax Code (FTC) also introduce a new interest limitation rule. The rule provides that interest paid by a French enterprise subject to corporate income tax (CIT) to a related French enterprise or a nonresident related enterprise is no longer tax deductible for French CIT purposes if the interest paid is not subject to tax at the level of the beneficiary company at a rate of at least 25% of the French CIT that would have been due under the standard French rules.

France’s CIT rate: the story continues

When the FTA released the draft regulations, the mostly intensely discussed issue was around exactly what the French CIT rate would actually be for purposes of the provisions.

Parliamentary debates clearly indicated that the CIT rate for the purposes of the “anti-hybrid” financing provisions should be 25% of the standard French CIT rate of 33.33%, i.e. 8.33%. This explains the unpleasant surprise experienced when it was learned that, for the French Tax Administrations (FTA), that notion of the French CIT rate refers to the standard French CIT rate (i.e., 33.33%) increased by applicable additional CIT contributions/surcharges (i.e., a 3.3% social security surcharge and the 10.7% exceptional contribution (surtax)) that is currently in place. This effectively leads to a maximum effective tax rate of approximately 38% (or 34.43% in the case that the exceptional contribution to CIT would not be due). Therefore, the CIT reference rate for the purpose of the minimum taxation test could be equal to either 8.33%, 8.61% in the case where the social security surcharge only applies or 9.5% where the social security surcharge and the exceptional contribution to CIT would apply. It should be noted that the application of the surcharges and additional contributions depends on the turnover of the company. It can therefore be assumed that the effective CIT rate applicable to the company at stake is the one that will be used for reference.

Alongside this difference of views, many professionals voiced concerns around the lack of precision regarding the treatment of interest that must be reintegrated. The issue here is whether they have to be reclassified as deemed dividend and as a matter of fact be subject to a possible withholding tax and to the 3% tax surcharge on distributions.

As well as new subjects for technical discussion, the “anti-hybrid” provisions show the determination of the French authorities to prosecute abuses regarding double exemption situations. Particular attention is given to issues raised by situations at an international level (OECD and European Union) where this issue is also being studied in detail. In this context, France has been leading the way, but its new provisions will need to be tested to confirm their compatibility with future recommendations made by these institutions. This international commitment highlights the need to preserve the tax base at a critical time for public finances.

An additional transfer pricing documentation obligation

On 8 December 2013, the French Government adopted a new, additional transfer pricing documentation requirement, codified under Article 223 quinquies B of the French Tax Code, obliging certain taxpayers to file a “reduced” – but mandatory – transfer pricing documentation within six months of the official deadline for filing their tax return. More recently, the deadline was postponed to 20 November for companies whose financial year ends on 31 December.

The new law applies to all tax returns filed after 8 December 2013 and thus in practice applies to multinational companies eligible to Article L13AA of the French Procedure Tax Code (with notably the €400 million thresholds of total net sales before taxes, or total gross assets or companies hold directly or indirectly by a company above these thresholds) and that have a financial year ending 30 September 2013 or thereafter.

There continues to be great uncertainty surrounding this new obligation, as no official tax return form nor any formal guidance have been issued by the French Tax Authorities. This uncertainty was allayed to a certain degree in June 2014 when the FTA released an unofficial and draft version¹ of the new tax return form to professional organizations with the stated objective of seeking comments from industry.

In addition to a general description of the group, taxpayers will have to provide specific information regarding the French entity, specifically a presentation of the transfer pricing methods used for determining arm’s length transfer prices and a summary of changes that occurred in the last fiscal year.

Even if these obligations do not require detailed functional or economic analyses (as information may already be available in the companies’ “general” transfer pricing documentation), the draft version of the tax return form casts major doubts over issues as crucial as the language it should be written in. Indeed, it specifically states that the information should be submitted in French, whereas the “general” transfer pricing documentation may be submitted in English and doing so does not expose the taxpayer to penalties. Therefore, in addition to the administrative costs this new obligation creates, there may be some additional compliance costs incurred.

The introduction of this “reduced” contemporaneous transfer pricing documentation requirement should be regarded as a new risk assessment tool being rolled out by the FTA. In addition, as tax returns can be filed three years (or more) before they are subject to audit, taxpayers are advised to consider the link that will be made by the FTA between this new Transfer Pricing Statement, which is submitted with or shortly after the tax return, and the Transfer Pricing Report, which is handed over in case of tax audit only.

Reduction of the tax burden, simplification of the tax code: the draft of Amended Finance Bill and the Amended Social Security Financing Bill for 2014

French Parliamentarians have not been idle as the summer season approached; an active debate has been taking place in regard to the Draft Amended Finance Bill for 2014. This bill should be seen as part of the “Responsibility and solidarity pact” strategy, with the repeatedly expressed objective to lower the tax burden for companies and lowest income households.

Adopted as first reading 1 July 2014 by members of the National Assembly and recently rejected by the Senate (the National Assembly will have to review the draft but has final word in case of disagreement with the Senate), the bill contains a number of important measures.

The first significant package of measures is relative to an increase of fines incurred in several cases, all related to the standardization of accounting practices. The first fine relates to failures to submit the appropriate format of computerized accounting data. In such a case, the fine incurred would jump from €1,500, as currently applicable, to €5,000 or up to 10% of the tax reassessment, when applicable. The second relates to failures to submit cost accounting or consolidated financial statements within a tax audit of the accounting records. In that case, the fine incurred, with more than a tenfold increase, would be equal to €20,000, compared to just €1,500 currently.

A second significant package includes proposals to reduce several contributions, mainly within the draft of Amended Social Security Financing Bill for 2014. Firstly, implementing one of the announcements of the “Solidarity pact,” the draft bill provides for a reduction of the social solidarity contribution that would be applicable for the contribution paid in 2016, based on the turnover derived in calendar year 2015. Companies with a turnover exceeding €760,000 are currently subject to this contribution of 0.16% assessed on their turnover. The proposed reduction would take the form of a €3,250,000 basis rebate applied on turnover that would lead to a reduction of the social contribution by €5,200 for companies with a turnover exceeding this threshold.

In essence, the measures provided by the draft law on social security contributions due by employees on salaries should exempt companies from paying most contributions on salaries equal to the minimum wage, starting 2015.

As the set of measures laid down by the “Solidarity pact” cannot be implemented all at once, the explanations under the draft Amended Finance Bill confirm that, as announced by the Government in April, the standard CIT rate will be reduced from its current rate of 33.33% to 28% in 2020, with an intermediate step in 2017.

Despite all these proposed changes, it is already possible to forecast a new evolutionary path for the French tax landscape as soon as the end of this year. Indeed, with the latest economic expectations anticipating that the budget deficit and growth rate targeted by the French Government will not be reached, it is very likely that year-end adjustments will be put in place in the Finance Bills of December. “Watch this space,” as the old adage says.
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India’s Tax Administration Reform Commission issues first report on tax reform, recommending broad and deep changes

With the objective of recommending fundamental reforms exclusively in the area of tax administration and enhancing its effectiveness and efficiency in line with the global leading practices, in late 2013 the Government of India established a Tax Administration Reform Commission (TARC) comprised of senior Government officials and private sector tax professionals under the chairmanship of Dr. Parthasarathi Shome. The first report (Report) from the TARC was made available to the public in June 2014. The Report is comprehensive and expresses an overwhelming need for reform in India’s tax administration; it also contains various recommendations to achieve the desired tax reforms. These recommendations are the result of extensive discussions with a wide range of groups and stakeholders.

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Efforts undertaken in the past to improve tax administration in India have typically been limited in scope and targeted at immediate requirements. The focus has more often been on revenue collection, and the need to fundamentally reform the tax administration was ignored. In fact, there has been no comprehensive, in-depth reform in India’s tax administration in many years. The TARC was, therefore, established to examine and review the application of tax policies and tax laws in the context of global leading practices and to recommend measures that would enhance the effectiveness and efficiency of India’s tax administration.

The TARC has issued a detailed Report that discusses the current status of tax administration in India, highlights the global leading practices and offers recommendations that are suited to the Indian context to make the administrative machinery more responsive and efficient.

The Report spans almost 600 pages and extensively discusses the need for customer focus, concerns on structure and governance of the tax department, people function, dispute management and resolution, internal business processes and use of information and communications technology (ICT).

Customer focus

The Report recognizes that one of the core functions of any tax administration is not only to help taxpayers comply with their obligations but also to make them feel like “valued customers” who are being treated professionally with respect and fairness. However, this is not the current state in India. For example, taxpayers currently have to approach a number of different departments for registration of different activities or functions, all of which result in the issuance of various identification numbers. There is no dedicated taxpayer service structure and taxpayer services are delivered in a diffused manner.

To improve the experience of taxpayers and to align the taxpayer services with prevailing leading practices, the TARC recommends the following:

- Creation of a dedicated organization, resources and personnel to deliver taxpayer services with customer focus. Such services would be delivered jointly under one umbrella, i.e., apex boards of direct taxes (Central Board of Direct Taxes or CBDT) and indirect taxes (Central Board of Excise & Customs or CBEC) for large taxpayers. For other taxpayers, i.e., medium and small, the operations of the apex boards (Boards) can continue separately.
- More specialized and intensive training for the officers and staff of the tax administration in order to improve customer orientation.
- A minimum of 10% of the tax administration’s budget should be allocated toward ICT-based taxpayer services. Sufficient funds must also be allocated to conduct customer research and surveys.
- With respect to taxpayers’ grievances, the decision of the ombudsman should be binding on tax officers. It is recommended that non-Government professionals should also be inducted into such post.
- The other TARC recommendations for enhanced customer focus are: providing pre-filled tax returns to all individuals, who would have the option to accept or modify the return; seeking regular stakeholder consultations on tax issues; enabling taxpayers to track online the status of their application of refund/grievance under a central system generating a unique identification number; and continuous benchmarking of tax administration in relation to taxpayer services.

Structure and governance of tax administration

While the two current tax boards (CBDT and CBEC) and the respective departments under them have broadly similar structures and processes for their governance, they work independently of each other. There is no synergy between them, either in data sharing or in carrying out key functions where such synergy would result not only in value to the departments and taxpayers but also in elimination of duplication of work and infrastructure.

The TARC, therefore, recommends that:

- The two Boards work to achieve better tax governance and, in the next five years, move toward a unified management structure with a common Board for both direct and indirect taxes called the Central Board of Direct and Indirect Taxes (CBDIT).
- Functions such as human resource management and vigilance, finance, ICT, infrastructure and logistics and compliance verification can also be covered under the unified management structure.
- The integration can begin for the large business segment by setting up a large business service (LBS) unit which can be integrated and operated jointly by both Boards. The two Boards would be responsible only for policy dimensions of tax administration, while the directorates under them would be responsible for operations in the field formations.
- A functional orientation to promote specialization.
- A common approach for developing a robust and comprehensive enterprise risk management framework is recommended to be adopted by the two Boards.
• There should be one Knowledge, Analysis and Intelligence (KAI) center for both Boards and its role should be recognized and used for policy and operational effectiveness.

• The tax administration should have functional and financial autonomy and independence from Governmental structures, given its special needs. To achieve this, various independent councils or units, such as the Governing Council, Independent Evaluation Office, Tax Council, Common Tax Policy and Analysis unit and KAI center should be set up. The post of revenue secretary is recommended to be abolished with the respective functions allocated to the two Boards so as to empower them to carry out their assigned responsibilities efficiently.

• All regulation and tax policy measures such as exemptions, are mandated to be reviewed periodically to see whether they remain relevant to contemporary socio-economic conditions. This requires robust processes which need to be institutionalized. As a first step, a thorough review of the existing rules, regulations and notifications is recommended. Going forward it should be a standard practice to build a sunset clause into each rule, regulation and notification.

**People function**

The TARC report recognizes a wider need to facilitate better understanding among tax officers of complex business transactions. In this regard, the following recommendations are made:

• It is imperative to train tax officers and staff and to encourage them to specialize in specific tax areas. Further, specialization in other areas, such as dispute resolution, taxpayer services, human resource, finance, tax analysis and ICT management, is also recommended to render services to high-quality tax intermediaries and taxpayers.

• A carefully designed recruitment and promotion plan and comprehensive performance appraisal process is recommended for an efficient tax administration workforce. There should be a provision for lateral entry of experts in key roles and specialized areas, including on a contract basis for five years.

• All key operations of tax officers are suggested to be shifted to the digital platform to ensure uniform and reliable measurement of their performance.

**Dispute management**

The TARC recognizes that the credibility of tax administration depends to a very great extent upon the credibility of its dispute resolution mechanisms in terms of how quick, consistent, transparent and fair the dispute resolution mechanism is in the eyes of taxpayers. The quality of tax administration is also influenced by its ability to ensure that avoidable disputes do not occur or are not prolonged. This requires clarity in laws, rules and procedures and adoption of a transparent and collaborative approach toward taxpayers.

In the context of India’s current dispute management mechanism, the Report acknowledges the following:

• Members of the two Boards (Central Board of Direct Taxes and Central Board of Excise and Customs) are expected to design policy, but have little policy experience.

• Members’ risk aversion leads to low productivity or low motivation to provide guidance or clarity. Boards’ decisions or pronouncements in the form of legislative changes, binding circulars, clarificatory guidance notes or press releases are few and far between, and even then are under external force.

• Risk aversion permeates down and leads to infructuous tax demands. For example, when an officer is convinced about a demand s/he has made but the Controller and Accountant General’s (CAG) auditor has disagreed with it, the Boards have issued standing instructions that a “protective demand” must be issued by the officer.

• Some taxpayers express helplessness against rude or arbitrary behavior of officers with little assigned accountability in practice.

• There is a complete absence of economic, statistical, behavioral or operations research-based analysis of policy or of taxpayers prior to making major or minor legislative or subordinate legislation-based (rule-based) decisions.

• A blind revenue target causes unjust pressure on good taxpayers. Also, revenue targets have an adverse impact on tax officer equilibrium.

• Wrong use of tax avoidance instruments for revenue generation: ordinarily, transfer pricing examination between associated enterprises should be used as a tool to minimize tax avoidance. In India, transfer pricing measures are used for revenue generation, which comprises a completely incorrect approach. This is revealed through the allocation of revenue targets to transfer pricing officers (TPOs) from transfer pricing adjustments. This is unheard of internationally.

• Lack of accountability in raising tax demands without accompanying responsibility for recovery has led to India experiencing by far the highest number of disputes between the tax administration and taxpayers, with the lowest proportion of recovery of tax, while arrears in dispute resolution are pending for the longest time periods.
Practically, it has been observed that the Dispute Resolution Panel (DRP) rarely affirms a position different from the one proposed by the AO. Further, the absence of independent experts within the DRP, tight timelines for the filing of objections by a taxpayer and the fact that the DRP is available to only limited categories of taxpayers - cases of international taxation and those of transfer pricing - are some of the issues which curtail the efficacy of the DRP as an alternative dispute resolution forum.

Quoting the (in)famous Vodafone judgement\(^1\) by the Supreme Court which held that Indian tax authorities did not have territorial jurisdiction to tax offshore transactions and therefore that the taxpayer was not liable to withhold the taxes, the Report observes that an overnight change in the interpretation of a provision, which earlier held ground for to rake up settled positions. This approach to retrospective amendments has resulted in protracted disputes, apart from having deeply harmful effects on investment sentiment and the macro economy.

In view of the above, TARC recommends:

- Clarity in law and procedures, timely intervention by the Boards to clarify contentious matters, avoidance of tax demands which are not based upon merit, pre-dispute consultation, and proper control over quality of show cause notices, demands or questionnaires issued to the taxpayers and an approach to resolve conflicts before conclusion of audits.
- Retrospective amendments should be avoided as a principle.
- The fundamental approach should be collaborative and solution oriented.
- A functionally independent structure should be set up for dispute management with adequate infrastructural support.
- To minimize the potential for disputes, clear and lucid interpretative statements on contentious issues should be issued regularly which would be binding on the department.
- The current practice of raising demands irrespective of merits should be discontinued. Pre-dispute consultation should be followed as a practice before issuing a tax demand notice.
- Disputes should be resolved within the time limit specified in enactments and consequences should be provided in case those time lines are not adhered to.
- Ordinarily no appeal should be filed by a tax officer against an order of a commissioner (Appeals), except where the orders are ex-facie perverse. All corporate cases and cases of a complex nature should be decided by a three-member commissioner (Appeals) panel. Other cases should be dealt with by an individual commissioner (Appeals). If the case is not decided within the prescribed time frame, the taxpayer’s appeal would be deemed to have been allowed.
- The DRP in income tax should be comprised of full-time panelists. Their mandate should be expanded to include corporate cases of domestic companies. A similar mechanism should be introduced for dispute resolution in indirect taxes, where a group of three commissioners would decide complex cases involving extended period of limitation, related party transactions and taxability of services. Processes for alternate dispute resolution, arbitration and conciliation should be statutorily introduced in both direct and indirect taxes legislations.
- Settlement Commission should act as part of taxpayer services and be made available to the taxpayer to settle disputes at any stage.
- Appeals to High Courts and the Supreme Court should only be on a substantial question of law. On disposal of a case by High Court, if the judgment is accepted by the department and on disposal of a case by Supreme Court, an instruction should be issued to all authorities to withdraw appeal in any pending case involving the same issue.
- Both the Boards must immediately launch a special drive for review and liquidation of cases currently clogging the system by setting up dedicated task forces for the purposes. This task force would be required to review and liquidate all cases pending in departmental channels for more than a year. This one-time exercise should be completed within a period of one year.

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Other internal processes considered

**Scrutiny in direct taxes and audit in indirect taxes**

In all tax cases, hearings by personal presence should be avoided; data can be sought through e-system wherein the taxpayer can upload the data. A personal hearing should be sought only in complex cases. There should be specialization in scrutiny and audit work, capability of people involved being developed through training and re-training. The two Boards should develop a standard audit protocol, with clear emphasis that the assessing officers must follow the principles of natural justice and respect the taxpayer’s right to privacy and dignity.

Audit Commissionerates in the CBEC should undertake an integrated audit, covering central excise and service tax, as well as on-site customs post-clearance audit in the case of accredited clients as the records and books to be verified are common to all the taxes administered by CBEC.

The TARC also recommends assigning the audit function to a specific Audit Commissionerate in major cities for carrying out an integrated audit of customs, central excise and service tax, joint audits by field formations of CBDT and CBEC to shorten the examination processes and reduce costs, and putting in place broad-based selection filters for a risk assessment matrix.

**Refunds**

Refunds should be granted within a strict time frame under a separate budgetary head to ensure transparency and adequate allocation. Refunds should be automatically accompanied with applicable interest. The rate of interest on refunds has to be the same as that charged by the tax department.

Refunds pursuant to a favorable appeal should be paid in time or allowed to be set off against tax liability of subsequent years. Tests to determine unjust enrichment in indirect taxes should be limited to cases involving direct passing on of amounts claimed as refunds. An easier and simplified refund filing and processing mechanism (preferably online) for service exporters has to be introduced.

**Foreign tax credit (FTC)**

CBDT should publish clear FTC guidelines, which should also cover the timing differences between different tax jurisdictions.

**Tax collections**

There should be a separate unit for tax collection. Risk assessment models should be set up to compute risk scores for each new tax debt, reflecting the likelihood of settlement of tax dues by the taxpayer based on objective criteria. Stay of demand information should be uploaded electronically on the central server so that tax collectors can have system-generated prior intimations regarding expiry of stay orders. The power to write off dues at different levels of the organization should be raised with uniform limits for both direct and indirect taxes.
Both the Boards should frame detailed and reasonable documentation requirements for transfer pricing and customs valuation, to bring certainty and predictability for taxpayers. The processes in India should be aligned with global best practices. With self-assessment in place, import transactions should only be subjected to post-clearance audit. Valuation risks would be an important component of the risk matrix for audit selection.

Trade and business facilitation
As a trade facilitation measure, on-site post-clearance audit should be developed fully to enable Indian customs to move closer to international best practices. Intervention in the cargo clearance should be made on the basis of a risk matrix.

Documentation requirements for issuing a certificate to nonresidents u/s. 197 of the Income Tax Act should be well-publicized. The taxpayer should be told a priori the time that will be taken for the issue of the certificate, which should be reasonable. There should be facility for electronic filing of these papers so that the need for physical presence of the taxpayer is obviated.

Enforcement administration
There should be a dedicated structure for prosecution matters for more focused attention so that unexploited potential for creating deterrence against tax evasion is realized. The working of the Directorate of Intelligence and Criminal Investigation should be ICT-based with a good complement of personnel and other resources to make it reach its potential.

Implications
“The Indian tax administration is at its nadir. A fundamental and deep reform is urgently called for. There is no time to lose if investment is to be revived and its full potential reached, and an eventual tax revolt through capital flight or other direct protests is to be averted.”

The above conclusion from the TARC paints a grim picture of tax administration in India. The report contains refreshingly significant recommendations for a “comprehensive” transformation of tax administration that is founded on accountability and recognition of the taxpayer as a “customer.” It brings out that in modern tax jurisdictions, the goal of tax administration is not to maximize revenue but minimize compliance gaps and maximize voluntary compliance.

Too much emphasis on revenue results in multiple disputes which only block revenues and discourage voluntary compliance. The seriousness of rising disputes in India can be judged from the fact that for the financial year ending March 2012, the amount stuck in tax litigation in India for income tax, central excise and service tax at various levels was an astonishing INR5,500 billion (approximately US$92 billion). On transfer pricing alone, the adjustments made by the tax department in 2012-13 amounted to approximately US$12 billion. India has the distinction of having the largest number of transfer pricing disputes in recent years, with as many as 4,000 cases being contested in the Indian courts. By contrast, transfer pricing litigation in most advanced jurisdictions is a rarity. In the UK and Japan, for instance, only one or two cases in a year reach the court level.

The TARC Report comes at the right time. It is expected that the new Government, with new thinking, should consider the recommendations with a fresh eye. The TARC recommendations are fully consistent with the mandate of the new Government, i.e., to have a tax environment that is less adversarial and stripped of “tax terrorism,” as the now-Prime Minister himself described the system before the recent election. The Report provides a complete blueprint of the recommendations, which the Committee hope will be considered as a package, and not on a pick-and-choose basis. These recommendations are not unachievable benchmarks, but are doable. All that is needed now is conviction and commitment to reform the system.
India’s Union Budget includes proposals relating to dispute management

The Union Budget for 2014-15 was presented by the Finance Minister on 10 July. Given the current focus on reforming the Indian tax administration and the strong ongoing focus on dispute resolution, it was unsurprising that the Budget contained a range of proposals relating to dispute management.

You can read EY’s full analysis of the Union Budget at www.ey.com/BudgetConnect2014

Industry interaction
It is proposed that a high-level committee is set up, to interact with trade and industry on a regular basis and ascertain areas where clarity in tax laws is required. Based on the recommendations of the Committee that drafted the report, the two Boards - Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) – shall issue appropriate clarifications, where considered necessary, within a period of two months.

High-level committee to review retrospective amendments of 2012
A high-level committee will be constituted by the CBDT to scrutinize all fresh cases arising from the retrospective amendments of 2012 in respect of indirect transfers, before any action is initiated in such cases.

Authority for advance ruling
Currently, an advance ruling may be obtained from the Authority for Advance Rulings (AAR) concerning the tax liability of a nonresident. This facility is not available to resident taxpayers, except for public sector undertakings. It is proposed to enable resident taxpayers to obtain an advance ruling in respect of their income tax liability above a defined threshold. It is also proposed to strengthen the AAR by constituting additional benches.

Income Tax Settlement Commission
It is proposed to enlarge the scope of the Income Tax Settlement Commission so that more taxpayers may approach the Commission for settlement of disputes.

Transfer pricing
- APA scheme – With effect from 1 October 2014, it is proposed to introduce a “Roll Back” provision in the APA scheme, so that an APA entered into for future transactions may also be applied to international transactions undertaken in the previous four years, in specified circumstances.
- Range concept – To align transfer pricing regulations in India with leading practices elsewhere, it is proposed to introduce a range concept for determination of arm’s length price. However, the arithmetic mean concept will continue to apply where the number of comparables is inadequate. Appropriate rules will be prescribed in due course.
Multiple-year data - Instead of only one-year data currently allowed to be used for comparable analysis, it is proposed to allow the use of multiple-year data.

Empowerment of transfer pricing officers (TPO) - With effect from 1 October 2014, the TPO will now be an authority competent to levy the penalty, in addition to the Assessing Officer and the Commissioner (Appeals), if any person who has entered into an international transaction/specify domestic transaction fails to furnish any required document/information.

Revision of monetary limits for the filing of appeals

CBDT has issued an internal Instruction to revise the monetary limits for filing of appeals by the Department before Income Tax Appellate Tribunal (ITAT), High Court and Supreme Court. It is clarified that an appeal should not be filed merely because the ‘tax effect’ in a case exceeds the monetary limits prescribed. Filing of appeal in such cases is to be decided on merits of the case.

This instruction will apply to appeals filed on or after 10 July 2014. However, the cases where appeals have been filed before that date will be governed by the instructions on this subject, operative at the time when such appeal was filed.

The revised limits are given below:

<table>
<thead>
<tr>
<th>Appeals in income tax matters</th>
<th>Monetary limit (in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before ITAT</td>
<td>400,000</td>
</tr>
<tr>
<td>U/S 260A before High Court</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Before Supreme Court</td>
<td>2,500,000</td>
</tr>
</tbody>
</table>

For this purpose, “tax effect” means the difference between the amount of tax assessed on total income and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed (“disputed issues”). However, the tax will not include any interest, except where chargeability of interest itself is in dispute. In case of penalty orders, the tax effect will mean quantum of penalty deleted or reduced in the order to be appealed against.

The Assessing Officer shall calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every assessee.

If, in the case of an assessee, the disputed issues arise in more than one assessment year, an appeal may be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the monetary limit specified.
Japan update: Japanese Government announces plan to lower corporate tax rate to below 30%, while Japanese lower courts deliver controversial decisions involving the application of specific anti-avoidance rules

Japan’s tax system continues to evolve as Prime Minister Abe drives home his three-pronged “Abenomics” strategy to bring Japan out of deflation and into economic growth.

On 24 June 2014, the Japanese Cabinet endorsed the “2014 basic policies for economic and fiscal management” (Policy), which includes a plan to lower the Japanese corporate tax rate over several years to below 30%, beginning in 2015. But to compensate revenue losses resulting from the rate reductions, the Government also plans to broaden the tax base by reducing or eliminating certain credits and deductions. Further clarifications are expected later this year.

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CIT rate reduction
The Japanese Prime Minister Shinzo Abe has campaigned and stated that, to be more competitive internationally, the Japanese corporate tax system requires revamping to attract more inbound investments from non-Japanese companies and to retain Japanese companies’ operations in Japan. On 24 June 2014, his Cabinet approved the Policy that includes a plan to reduce the current 35.6% Japanese corporate tax rate over several years to below 30%, beginning in 2015. Although no official announcement has yet been made with respect to an ultimate tax rate, Prime Minister Abe informally indicated the first target rate could be as low as the current German rate of approximately 29.6%.

A one percentage point rate cut is estimated to reduce tax revenues by approximately JPY500 billion (US$5 billion). Accordingly, given current large fiscal deficits, the revenue losses need to be compensated by some other measures. The following items may be considered as means to counterbalance the revenue reductions:

- Repeal of tax incentives in Special Taxation Measures Law
- Reduction of the research and development (R&D) tax credit
- Extension of a net-operating loss (NOL) carry-forward period and a limitation on per year NOL utilization
- Limitation on dividend received deduction criteria for minority investments
- Replacing the more accelerated declining balance method with a straight-line method
- Disallowance of local taxes as taxable deductions
- Revision to the current definition of small and medium-sized companies (SMEs) eligible for tax benefits
- Increase of the reduced corporate tax rate applicable to SMEs
- Partial conversion of income-based enterprise tax to added-value-based enterprise tax
- Broadening applicability and imposition of business scale tax

The ruling party’s tax system research council will address how to implement tax rate cuts and measures to counterbalance lost revenues. Its conclusions will be included in a 2015 tax reform outline that is expected to be released later this year.

Japanese tax administration flexes its muscles on specific anti-avoidance rules

The court held that Article 132-2 would be applied to a case where the formality of the actions taken by a taxpayer technically satisfy the requirements for claiming a taxable reduction resulting from a corporate reorganization but allowing the taxpayer to recognize such taxable reduction is clearly against the intent and purpose of the tax measures for corporate reorganizations.

On 9 May 2014, the lower court held in another case in favor of the taxpayer by disallowing the Japanese tax authority to apply the anti-avoidance rules under Article 132 of the Corporate Tax Law and allowing the taxpayer to offset its NOL sustained by the parent company against the consolidated subsidiary’s taxable income (the 132 Case).

Both cases have been appealed to an upper court. Due to the nature of the cases, it is also expected a final decision would be made by the Supreme Court.

Background
The Japanese Corporate Tax Law currently contains three specific anti-avoidance rules (SAARs) applicable to: (1) closely held corporations (Article 132), (2) corporate reorganizations (Article 132-2) and (3) tax consolidations (Article 132-3).

Effective on or after 1 April 2016, there will be a fourth SAAR provision applicable to income attributable to permanent establishments of foreign corporations (Article 147-2). The SAARs may be invoked when the allowing of actions or transactions taken by a taxpayer would result in an unreasonable taxable reduction.

1. In general, a company with capital of JPY100 million or less is categorized as an SME.
2. Currently the business scale tax is imposed on companies with capital of more than JPY100 million.
The “132-2” Case

A Japanese corporate taxpayer (A Co) acquired 100% shares in another Japanese corporation (B Co) from its largest shareholder. After the acquisition, B Co was merged into A Co and A Co utilized the JPY54.2 billion (US$533 million) NOLs sustained by B Co against A Co’s post-merger taxable income.

Under Japanese Corporate Tax Law, a merger between a 100% parent and its subsidiary is generally treated as a tax-qualified (i.e., tax-free) merger and the NOL of the merged company would be carried over to the surviving parent company. However, if the parent-sub relationship (i.e., more than 50% shareholding relationship) was created within five years prior to the first day of the surviving company’s fiscal year in which the merger takes place, the surviving company would be subject to NOL deduction limitations unless certain conditions are satisfied.

One of the conditions requires that at least one person be appointed as a senior director of the surviving company, who had been a director of the merged company before the “more than 50% shareholding relationship” was created and been engaged in the business of the merged company as a senior director immediately before the merger.

In the 132-2 Case, the formality of the requirement was met by appointing the CEO of A Co as a vice president of B Co approximately two months before the acquisition. The Japanese tax authority denied the NOL deductions pursuant to Article 132-2 on the following grounds:

- The appointment of A Co’s CEO as a vice president of B Co only two months before the acquisition was unusual and irregular,
- The appointment was intended to meet the formality of the requirement solely for purposes of claiming taxable reduction.
- Allowing such action would create an unreasonable taxable reduction.

A Co contended that Article 132-2 could only be applied when a taxpayer’s action was economically unusual and/or irregular, lacking sufficient business purposes other than claiming taxable reduction. A Co argued that Article 132-2 should not be applicable as the CEO’s appointment was supported by the business purpose by having him directly involved in management of B Co.

The lower court stated in its decision that Article 132-2 would be applicable to the cases where:

- Actions are economically unreasonable and/or unusual solely to claim taxable reduction
  - or
- A taxpayer follows the strict formality to meet the requirement to avail itself to a taxable reduction resulted from the corporate reorganization, but allowing such taxable reduction is clearly against the intent and purpose of the tax measures for corporate reorganizations, irrespective of whether sufficient business reasons exist.

The lower court held for the Japanese tax authority.
The “132” Case

A Japanese corporate taxpayer (X Co) acquired 100% shares in another Japanese operating company (Y Co) from their parent company (Z Co) and became a parent of the Japanese group companies. After the transaction, Y Co redeemed in several transactions some of its own shares from X Co, causing X Co to recognize tax losses, which created JPY400 billion NOL. Subsequently, X Co elected to file a consolidated tax return with Y Co and other subsidiaries and offset Y Co income against X Co NOL. The Japanese tax authorities denied the NOL deduction by applying Article 132 SAAR. The tax authorities argued that allowing the NOL utilization would result in an unreasonable taxable reduction because interposing X Co had neither business reasons nor substance. Further, tax avoidance motives could be observed in the series of transactions including the share buy-backs.

The lower court, however, sided with the taxpayer based on the following:

- X Co’s existence could not necessarily be viewed as purposeless as X Co functioned as an acquisition vehicle for acquiring other Japanese companies.
- It is difficult to conclude that no proper business reason and purposes existed for interposing X Co between Z Co and Y Co as X Co is a holding company of various Japanese subsidiaries.

Further, the court disagreed with the Japanese tax authorities’ arguments on a lack of proper business reasons and a sole purpose of reducing tax burdens, stating several factors found by the court were inconsistent with the tax authorities’ arguments.

Implications

As both cases involve SAAR applications, they provide insights into the Japanese tax authorities’ interpretations of what may constitute unreasonable taxable deductions related to corporate reorganization. It should be noted that the court’s holding on the 132 Case seems to be mainly based on fact finding arguments.

All told, the overall pace of reform and change in Japan continues to be high. 2014 and 2015 beyond look set to continue this high pace and merit special attention from those with business operations in the country.
From a nonresident perspective, every company, trust or other juristic person must furnish an income tax return if the nonresident, among others, derived “service income” from a source in South Africa. Returns must be filed within 12 months from the date on which the financial year of a company ends. The obligation to file an income tax return is irrespective of whether a double tax agreement (treaty) would provide protection.

It is interesting to note that the requirements for nonresidents to submit tax returns are amended on a regular basis. For instance, the 2013 notice required a nonresident to file a return if it carried on business in South Africa through a permanent establishment. The 2014 notice seems to change that paradigm. The notice is more specific in its reference to “service income,” and it appears that SARS is adamant that taxpayers who derive South African sourced service income should file a return, irrespective of whether or not South Africa has taxing rights over the services income in terms of a treaty. Unfortunately, this constant change in SARS practice creates uncertainty and may catch some nonresidents unaware of pending obligations to file a tax return in a given year. In terms of section 67 of the Act, these nonresidents will also be required to register as taxpayers.

**Intensifying audits**

The change of practice is, however not unexpected, given SARS’ recent intensified audits of permanent establishments for inbound services (outgoing service fees). Recently (June 2014), SARS published a revised draft reportable arrangement list prescribing mandatory reporting of arrangements perceived to have characteristics that may lead to undue tax benefits. Among others, service fees of more than R5 million (approximately US$462,000) will be reportable if the list is promulgated.
1 January 2016, South Africa will introduce withholding tax on service fees. The withholding tax was promulgated, despite the fact that the majority of treaties to which South Africa is a party do not allocate taxing rights to South Africa in respect of service fees when a nonresident does not have a PE in South Africa. Considered in context, the additional information gathered through tax returns will place SARS in a position to intensify audits of PEs created through services rendered in South Africa. Unfortunately, "service income" is not defined in the 2014 notice; the withholding tax on service fees provisions of the Act defines "service fees" as any amount received in respect of technical, managerial or consulting services. Likewise, the Act does not define when services will be regarded as "sourced" in South Africa, despite providing specific source rules for other income streams. As a result, common law principles established through judicial precedent must be applied to determine source.

**Impacts and actions**

Going forward, it is important that fees received from South Africa are reviewed to determine whether or not they are derived from a source in South Africa and may therefore result in the need to file a return. This analysis would need to be done irrespective of whether there is treaty protection since the treaty will not shield the nonresident from the administrative requirement to file a return. In a treaty situation it remains important for the taxpayer to be in a position to demonstrate that there is treaty protection in the event of queries from SARS.

**Proposed international tax changes released for comment**

On 17 July 2014, the Government of South Africa released the Draft Taxation Laws Amendment Bill 2014 (Draft TLAB) for comment. The Draft TLAB contains several amendments applicable to cross-border transactions.

**Transfer pricing**

South Africa currently has a self-assessment system of transfer pricing (including thin capitalization) based on the arm’s-length principle. Related party transactions must be recognized on an arm’s-length basis. As a secondary adjustment, the tainted value in a transaction that is not arm’s-length is currently deemed to be a “loan,” which bears notional interest.

Given administrative difficulties of complying with the deemed loan secondary adjustment, the Draft TLAB proposes to substitute it for a “deemed dividend” in specie paid by the South African taxpayer. Unlike ordinary dividends that trigger dividends withholding tax in the hands of the payee, the company paying a dividend in specie is liable for dividends withholding tax. If ratified, this amendment will come into effect on 1 January 2015.

**Interest deduction limitation rules**

South Africa currently has two sets of interest deduction limitation rules. The first are general interest limitation rules which are applicable to all connected party debt, in addition to the transfer pricing rules, while the second relates to the acquisition debt interest limitation rules and are applicable to intra-group reorganizations and liquidation distributions. The acquisition debt rules are already effective; while the general interest limitation rules will only come into effect on 1 January 2015.

In both instances, interest deduction is limited to an amount representing approximately 40% of adjustable taxable income (roughly akin to EBITDA). Provision is made for an increase in the 40% ratio if the repo rate exceeds 10%.

The Draft TLAB contains the following two main amendments to the above limitation rules:

- The adjusted taxable income is amended to exclude the balance of assessed losses from the current year’s adjusted taxable income. This will result in a higher adjusted taxable income, thus increasing the base on which the overall limitation interest deduction is calculated.
- The second amendment substitutes the 40% limitation for an adjustable formulary-determined percent, with a ceiling of 60% of the adjusted taxable income. The revised limit is intended to closely align the debt limitation rules with the cost of debt financing in the market, taking into account the average repo rate for the year plus 400 basis points. The prescribed formula is: $A = B * C / D$; whereby A represents the amount to be determined; B represents the number 40; C represents the average repo rate plus 400 basis points; and D represents the number 10. As indicated, the maximum amount that may be claimed may not exceed 60% of the adjusted taxable income. Whereas the current limitation would roughly permit an interest cover of approximately 2.5, the revised limit increases the permissible interest expense to an interest cover of approximately 1.7.

The above amendments, if ratified, will become effective from 1 January 2015 and apply with respect to interest incurred on or after that date. Despite extensive input from the tax community for the deferral of the general interest deduction limitation given the continuing debate on base erosion and profit shifting in South Africa and globally, National Treasury and SARS seem determined to bring the new rules into effect on 1 January 2015.

With a few months left to the effective date, it is important that connected party interest expenses are reviewed to identify the exposure.

**High tax exemption for CFC income**

Finally, under the current structure of the South African controlled foreign company (CFC) regime, a South African resident has to perform a high tax exemption calculation even if the CFC qualifies for the foreign business establishment (FBE) exclusion. This calculation makes the application of CFC rules even more complex, especially where multiple CFC calculations are at stake.

The Draft TLAB proposes that the net income of a CFC be deemed nil if either the high tax exemption or FBE exclusion is met. Theoretically, a taxpayer that has an FBE will therefore no longer be required to undertake the high tax exemption calculation. If ratified, the proposed amendment will come into effect on 31 December 2014 and apply to years of assessments ending on or after that date.

Comments on the Draft TLAB were requested by no later than 17 August 2014.
Spain releases draft tax reform bill

In 2013 the Spanish Government announced its intention to carry out a reform of the Spanish tax system, to go into effect in 2015 and 2016, with the aim of boosting the Spanish economy. Within this context, on 23 June 2014, draft bills modifying some of the most important Spanish tax laws were released. Following in the footsteps of many other countries, the draft bill gradually reduces the CIT rate from 30% to 25% in 2016 with an interim 28% rate applicable in 2015, while eliminating many tax deductions and other benefits. VAT rates are not included in the bill (despite a change being recommended by the Committee advising the Government) but there are some relevant changes focused on the importation of goods.

As an offset to the rate reduction, the Government proposes to broaden the taxable base by limiting the deductibility of certain expenses, such as the impairment of assets. While the general limitation to the tax deductibility of net financial expenses (30% operating profit) with the minimum deductibility threshold of €1 million is maintained, an additional limitation is proposed for leveraged acquisitions, consisting of a limitation on the deductibility of interest on loans to purchase shares, limited to 30% of the operating profit of the acquiring entity. Rules are included so that such limits apply where the acquired and acquiring entities are merged or join the same tax unity. Under the draft bill's transitory provisions this limitation could be interpreted so as to affect transactions implemented after 20 June 2014, although it remains to be seen how the final wording of these provisions will be enacted.

It should be noted that, in alignment with the above point, intra-group profit sharing loans are characterized as equity instruments for Spanish tax purposes.
Participation exemption changes
In response to the European Commission’s request to end the discriminatory taxation of investments in nonresident companies (Case 2010/4111), the Government proposes to extend the current participation exemption regime provided for dividends and capital gains derived from foreign subsidiaries to those derived from Spanish subsidiaries (with a scaled limitation for transfers taking place during 2015 and 2016), replacing the current domestic tax credit to avoid double taxation.

An additional proposal consists of changes to the participation exemption regime, so that this will require: (i) a minimum ownership percentage (5%) or cost of acquisition (€50 million) and a one-year minimum holding period in the subsidiary; (ii) for foreign subsidiaries only, a minimum level of (nominal) taxation of 10% under a foreign corporate tax system similar to the Spanish CIT. The legal presumption pursuant to which the current subject-to-tax test is deemed to be met when the foreign subsidiary is tax resident in a tax treaty country is eliminated.

Notably, the draft bill also eliminates the so-called “business activity test” (commonly referred to as the “85/15 rule”) as a requirement to access the participation exemption benefits, but introduces certain additional substance requirements. The proposed rules also introduce a new system for the calculation of exempt dividend and gains derived from multi-tiered structures, where some of the entities within the chain of ownership are not compliant with the participation exemption requirements. These rules also affect ETVE (Spanish international holding) structures.

Transfer pricing
Amendments introduced in the draft bill regarding the Spanish transfer pricing rules include changes in the related party definition (new 25% participation threshold), removal of the order for the use of the valuation methods and simplification of the documentation requirements for companies with a net turnover lower than €45 million.

Tax credits
The investment credit and the profit investment credit are both removed and replaced by a capitalization reserve that reduces the taxable base by 10% of the increase of the company’s net equity in a given year, provided it books a non-distributable reserve for the same amount.

Net operating losses (NOLs)
The draft bill amends the rules applicable to the utilization of NOLs, eliminating the current 18-year limitation and establishing a yearly quantitative limit of 60% of the positive taxable base for tax years starting on or after 1 January 2016; current limitations will continue to apply in 2015. However, a minimum €1 million threshold is set - so NOLs up to €1 million will be able to be used with no limits.

Changes to tax consolidation rules
In line with the decision issued on 12 June 2014 by the Court of Justice of the European Union (CJEU) whereby it concluded that the Dutch tax consolidation regime is not compatible with the EU freedom of establishment because it does not allow the so-called “horizontal tax consolidation,” the Spanish Government proposes to modify the Spanish tax consolidation rules, which are very similar to the Dutch provisions, to include where two Spanish companies have a direct or indirect, common nonresident shareholder, as long as the latter is not resident in a tax haven for Spanish tax purposes.

Nonresidents’ Income Tax (NRIT)
The temporarily increased domestic tax rates applicable to income obtained by non-Spanish tax residents acting in Spain without a permanent establishment (in the absence of applicable reduced tax treaty rates or other tax benefits) are reduced back to the original rates under the reform proposals. In addition, the 24% general tax rate will be progressively lowered to 19% for income obtained by European Union or EEA (European Economic Area) tax residents:

<table>
<thead>
<tr>
<th>Rate</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>General tax rate</td>
<td>24.75%</td>
<td>24%</td>
<td>24%</td>
</tr>
<tr>
<td>Tax rate applicable to EU and EEA residents</td>
<td>24.75%</td>
<td>20%</td>
<td>19%</td>
</tr>
<tr>
<td>Dividends, interest and capital gains general rate</td>
<td>21%</td>
<td>20%</td>
<td>19%</td>
</tr>
</tbody>
</table>
In line with the proposed amendments to the corporate income tax rate, the tax rate applicable to permanent establishments in Spain will be reduced from 30% to 28% in FY 2015 and to 25% from FY 2016 onwards.

The Spanish NRIT rules provide for a 0% withholding tax on dividend and royalty payments made to EU resident recipients, where certain requirements are met. These provisions include anti-abuse clauses that seek to avoid the application of the exemptions in those cases where the ultimate shareholder of the EU recipient is not an EU resident entity and the EU intermediate company is utilized primarily to benefit from the exemption.

The interpretation of the anti-abuse rule applicable to intra-EU dividend payments has generated considerable controversy. The Spanish government’s stated purpose of the legislation is to clarify the requirements which must be met for the exemption on dividend and royalty payments to apply where the EU recipient is majority-controlled by a non-EU shareholder and, at the same time, tighten the scope of cases that can benefit from these exemptions, requiring activity in the EU recipient entity other than holding activity.

As a result of a proposed change in the Personal Income Tax Law, share premium distributions made to non-Spanish resident shareholders may be treated as dividend distributions, in lieu of a return of basis, and therefore be subject to withholding tax under the general rules. Minority (less than 5%) shareholders in listed SOCIMIs (Spanish REITs) will be exempt from Spanish capital gains.

The draft bill also introduces certain amendments in the area of anti-abuse rules that are reflected in the OECD’s Base Erosion and Profit Shifting project. In particular, amendments are included in relation to the tax treatment of hybrid instruments and the Spanish controlled foreign companies (CFC) rules, including, for instance, additional substance requirements in the foreign CFC in order to avoid imputation of foreign low-taxed income.

While not covered in the reform proposals, the 23 May announcement by the Spanish Government that they had approved a bill changing Spanish Company Law is also of great interest and controversy. The bill has the stated aim of improving corporate governance practices of listed companies and, among many other measures, expands the scope of the duties of the board of directors to include the approval of any transaction deemed significantly relevant for tax purposes.

In addition, the bill also places a new range of responsibilities among the non-transferable duties of the board of directors: first, they must determine and manage the company’s tax risk policy; second, they must approve investments or transactions with a high tax risk; third, they must approve the incorporation or acquisition of special purpose vehicles or entities located in a tax haven; and finally, they must be responsible for the determination of the company’s tax strategy.

The bill also puts new responsibilities onto the audit committee; this includes a requirement to supervise the efficiency of the tax risk management control systems, as well as the obligation to inform the board of directors of the incorporation or acquisition of special purpose vehicles or entities located in a tax haven.

Finally, the bill requires that a description of the tax risk management control systems the company has in place must be made in the annual corporate governance report.
**VAT changes**

The draft bill proposes to allow certain importers to defer the payment of import VAT accrued as a result of the introduction of non-EU goods into Spain. Currently, importers are generally obliged to pay import VAT quotas accrued on the importation at the moment when the goods are Customs-released in Spain. The deduction of the quotas is to be made through the periodical VAT returns. It is therefore common that the importers bear a financial effect for the period between the payment and the effective deduction of the quotas.

The new procedure is aimed to correct this VAT inefficiency, in line with the more favorable regimes existing in other EU countries. The definition of “importers” who will be permitted to take benefit of the procedure, however, has not yet been determined and could potentially affect only to certified Authorized Economic Operator (AEO) companies.

In addition, the draft bill also reduces drastically the scope of the application of the VAT warehousing regime which suspends the VAT accrual for many types of goods. According to the draft bill, its use for goods with origin in a non-EU country will be restricted to a very limited variety of goods, such as potatoes, olives, cocoas, coffee, tea, rice, sugar, oil, etc.

**Potential effect on Spanish taxpayers and on international investment structures into Spain**

The proposed base-broadening, deduction-limiting rules, and the inclusion of widened anti-abuse provisions, if the rules are approved as released, will affect current investment structures, both inbound and outbound — inbound, for instance, in relation to the limitation to the deductibility of financial expenses in leveraged acquisitions, dividend withholding tax on dividends for non-EU investors using EU holding companies and on share premium distributions, or in respect of exit planning, since now the proposed rules allow for an exemption on gains also within Spain.

Outbound structures, including ETVE structures, may need to be reviewed in order to assess compliance with the new conditions for the application of the international participation exemption rules, especially on multi-layer corporate structures. Among other parameters, substance, level of taxation (in particular, where treaty eligibility will not be a safe harbor any more) and a new system of tracing of “bad income and gains” may be needed.

From a corporate governance perspective, the new requirements of boards and audit committees have courted much controversy from tax professionals in Spain, placing as they do so many new requirements on boards and audit committees who already have very full agendas.

All of these items will of course need to be closely monitored as the legislative proposals evolve within the parliamentary discussions. While it is not yet clear whether or not the proposals will be enacted during this legislative term and before scheduled elections in 2015, special attention should be paid to actions that may be advisable to take before the new rules enter into force.
Sweden pushes forward with the next phase of comprehensive tax reform

As we outlined in the November 2012 edition of this publication, it has been less than two years since Sweden unveiled a pair of tax proposals that reflect a trend being seen in many countries elsewhere: that of a significant reduction in headline corporate income tax rates (from 26.3% to 22%, effective 1 January 2013), with a corresponding limit on the tax deductibility of interest payments which will cover roughly half the cost of that rate reduction. On 12 June 2014 the Swedish Committee on Corporate Taxation (the Committee) presented a report to the Government, proposing a further set of major corporate tax changes regarding, among other things, the deduction of interest expenses impacted in the 2012 changes.

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The report of the Committee to the Government represents the first step in the legislative process and the proposals will need to be presented to Parliament by way of Government bills before the changes can be enacted on 1 January 2016 as suggested. A main proposal was delivered, as was an alternative proposal for the Government to consider.

Under the main proposal, the net of financial costs and financial income would not be deductible. Moreover, the Committee suggests a “financing allowance” amounting to 25% of the taxable income, which would in practice mean a reduction of the corporate income tax rate to 16.5%.

Further, the Committee proposes a new definition of financial costs for tax purposes which is very similar to the definition used in accounting. The term “financial cost” is proposed to include, inter alia:

- Interest and other, direct or indirect, costs for credits
- Loss on disposal and impairment of financial instruments
- Deductible dividends

The definition of “financial instrument” is intended to correspond to the definition used for accounting purposes. The term “financial cost” would comprise interest that is included in rental charges. Thus, the interest element would have to be separated from ordinary rental charges and not only from disbursements under financial leasing agreements, for example. Certain exceptions from the main rule are also proposed:

- In respect of real property rental payments, the interest element would only need to be separated in case of inter-company payments or sale and lease-back transactions.
- A simplification rule is proposed, under which the interest element of the leasing agreement would not need to be separated if the rental period does not exceed eight months, or if the total rental cost does not exceed SEK 300,000 on a group level. The simplified rule would not be applicable in relation to inter-company agreements or, in some cases, rental of real property.
- It is further proposed, as a result of the limitations, that the acquisition cost of assets that are depreciated under the Income Tax Act should not include capitalized financial costs.
- Net financial income and expenses would be able to be offset among affiliated companies which can exchange group contributions.
- Finally, the existing interest limitation rules relating to inter-company debt would be abolished.

The impacts

This main proposal aims to treat debt and equity in the same way by denying deductions for both dividends and net financial costs. However, it should be further analyzed to what extent this could imply a lack of neutrality in other ways as the proposal will in some cases favor equity-financed investments over debt-financed investments.

Moreover, the proposed limitation applies not only to interest, but to all financial costs. The reasoning set forth by the Committee is that this route would go further to prevent aggressive tax planning by way of conversion of interest expenses into other types of expenditures.

In practice, the financing allowance provides a reduction of the corporate income tax rate to 16.5%. Credit institutions will not, however, benefit from this rate due to a proposed imputed income computed as 0.24% of total liabilities, and referred to as a new Bank Tax in the media.

Alternative proposal

The Committee has also provided an alternative proposal which has many similarities to the main proposal. Under the alternative proposal, however, net financial costs would be deductible with an amount equivalent to 20% of EBIT. This alternative proposal does not include a “financing allowance.” Instead, a reduction of the corporate income tax rate to 18.5% is proposed. In contrast to the main proposal, it would (to some extent) be possible to carry-forward net financial costs. This alternative proposal would also mean that the current interest deduction limitation rules, which have been highly criticized for their complexity, would remain. The Committee’s report also contains a range of other proposals impacting business significantly:

- It is proposed that 50% of the existing tax loss carry-forward would be removed. This is a remarkable suggestion and should be further analyzed to determine whether the proposal is at all appropriate in view of the prohibition against retroactive legislation.
- As mentioned above, some financial companies (credit institutions and foreign credit institutions under the Banking and Financing Business Act) would report a taxable imputed income which is intended to neutralize the effects of the financing allowance. Furthermore, it is proposed that interest on subordinated debt should no longer be deductible.
- Non-life insurance companies will be subject to tax on an imputed income, which would be calculated as yield on allocations to contingency reserves.
- Companies would be able to exchange group contributions until the corporate income tax return is filed.

Next steps and final comments

Prior to becoming a law, the proposed changes will be sent for consultation to certain organizations, companies and authorities, who may provide input to the Ministry of Finance no later than 24 October 2014. After potential adjustments, a proposal will be referred to the Council on Legislation for consideration (Sw. “Lagrådsremiss”). Depending on the outcome, the Government will present a Bill to Parliament for adoption into law.

Elections will be held later this autumn which in theory could have an impact on the chances of adoption by Parliament, although the largest opposition party seems to have endorsed the proposal. It would, however, not be surprising if we see some amendments to the proposal anyway, since the wide definition of “interest” presumably could cause uncertainties and increased risk for dispute between taxpayers and the Tax Agency. Finally, the removal of 50% of the existing tax loss carry-forward remains under intense debate.
HMRC is seeking views by 31 October 2014 on the design of the new offence, which will be limited to individuals’ conduct in relation to their personal tax affairs. The consultation follows the publication in April 2014 of No Safe Havens, HMRC’s strategy for tackling offshore tax evasion.

A parallel consultation, also launched on 19 August, looks at extending the scope of offshore civil penalties and other sanctions to increase the deterrent against offshore non-compliance. It examines three options: extending the scope of the existing penalty regime for offshore non-compliance; deterring taxpayers from deliberately moving offshore assets to continue evading tax; and updating the existing offshore penalties regime to reflect the new global standard in tax information exchange.

UK heading towards new criminal sanctions for offshore tax evasion

On 19 August 2014, Her Majesty’s Revenue and Customs (HMRC) published a consultation paper regarding its plans to introduce a new “strict-liability” (i.e., no need to prove intent) criminal offense of failing to declare taxable offshore income and gains. The removal of the need to show an intention to evade tax opens up the possibility that individuals could inadvertently fall foul of the new rules and find themselves facing harsh sanctions.
A strict-liability criminal offense

In its consultation “Tackling Offshore Tax Evasion: A New Criminal Offence,” HMRC notes the progress made on international tax transparency. It points to the fact that, since the end of June, financial institutions in the Isle of Man, Guernsey, Jersey, and all the UK’s Overseas Territories with financial centers have been collecting information on UK residents’ offshore accounts to share with HMRC. It also highlights that financial institutions in a further 33 jurisdictions will do the same under the new Common Reporting Standard.

HMRC suggests that if taxpayers do not come forward to clear up their past non-compliance (possibly under time-limited disclosure facilities), or if they continue to fail to comply with their obligations, then they must expect tough consequences. One of these consequences should be the realistic threat of a criminal conviction.

The use of a strict-liability offense means that the prosecution would need only to demonstrate that a person failed to correctly declare the income or gains, and not that they did so with the intention of defrauding the Exchequer. The new offense would carry less serious sanctions than existing criminal offenses, albeit more serious than a civil penalty. HMRC would continue to investigate cases of fraud using existing powers, with a view to ensuring the most serious cases receive the most serious punishment.

The consultation sets out the proposals for a new criminal offense in more detail and asks a number of questions about: the scope of the offense; measures to ensure the proportionality of the offense, including a de minimis threshold; the level of sanction which should be attached to the offense and the need for legal and operational safeguards and defenses.

Strengthening deterrents

HMRC believes that criminal investigation and sanctions will play an increasingly prominent role in its response to offshore tax evasion. However it recognizes that the majority of cases are still likely to be investigated and settled through the civil processes.

This includes cases not covered by the scope of the new criminal offense – for example, because the revenue lost is below the qualifying threshold – and cases which, under its published criminal investigation policy, HMRC decides are not appropriate for criminal investigation. HMRC therefore sees the necessity for the civil penalties framework to provide a consistent, coherent and tough deterrent against offshore tax non-compliance.

The current offshore penalties regime has applied to liabilities arising from 6 April 2011. The level of penalty is based on the type of behavior that leads to the understatement of tax, and is linked to the tax transparency of the territory in which the income or gain arises. The 2013 Autumn Statement announced that HMRC would consult on extending the scope of offshore penalties and other civil sanctions to increase the deterrent against offshore non-compliance.

Accordingly HMRC is now seeking views on six options, across a broad range of issues:

- Extending the scope of the existing penalty regime for offshore non-compliance. This would involve extending the principle of increased penalties for offshore matters to include inheritance tax and undeclared income and gains arising in the UK but hidden offshore. HMRC cites inheritance tax as one of the most significant tax regimes avoided through the use of offshore territories and complex structures.

- Deterring taxpayers from deliberately moving offshore assets to continue evading tax. New measures are proposed which are intended to remove the benefit of moving funds to less tax transparent jurisdictions and to strengthen sanctions against this kind of behaviour. The options being considered are a new offshore surcharge (in addition to late-payment interest), an extension of the 20-year assessment time limit and an increase in penalties to reflect the number of times assets are moved. These measures should only apply where the assets are the proceeds of deliberate non-compliance and the movement is in response to the increased tax transparency of the jurisdiction in which the assets were located with the intention of continuing to hide them.

- Updating the existing offshore penalties regime to reflect the new global standard in tax information exchange. Individuals who hold or place the proceeds of tax evasion in a jurisdiction which has not adopted the new standard, with the hope of escaping scrutiny, should face tougher consequences.

Although the proposed measures are targeted at tax evasion, the breadth of the proposals means that a range of taxpayers may be impacted by the proposals if they are brought in. While it may be that the Government is willing to consult on the scope of the new penalties, it seems clear that it thinks a strengthening of the penalty environment is needed in some form.

Individuals who consider that they could be impacted by any new rules that are introduced should consider the following questions:

- In terms of any past tax to be paid, do I understand the potential settlement options available and have I fully considered these?

- In terms of possible future tax exposures, do I have a clear understanding of my offshore assets and a record of any advice obtained as to the tax position of those assets?

EY’s Tax Controversy & Risk Management team will be involved throughout the consultation process for these measures.

This represents the latest in the ongoing increase in focus by HMRC on ensuring that it has the powers and sanctions to reinforce the already strong compliance record of the UK. We can expect more of the same in the future.
IRS Large Business & International (LB&I) group issues Competent Authority statistics

On 30 April 2014, the US Internal Revenue Service (IRS) released the Large Business & International (LB&I) Division Competent Authority Statistics for the period covering 1 October 2012 through 31 December 2013.1 These statistics provide an update of the 2012 Mutual Agreement Procedure (MAP) results under the Advance Pricing and Mutual Agreement Program (APMA),2 including information on requests received and pending and resolved cases.3

Map background

A US citizen or resident can request assistance from the US Competent Authority and its treaty partner when the actions of one or both of the contracting states result or will result in taxation that is contrary to the provisions of the tax treaty. The competent authority process is a remedy to avoid the denial of treaty benefits and to avoid double taxation. Although resolution of an issue through the competent authority procedures may result in full relief from double taxation, the full range of outcomes includes:

- Full relief of double taxation when:
  - correlative relief is granted for the entire amount of the agreed adjustment;
  - competent authorities agree on an amount less than the originally proposed adjustment; or
  - the full adjustment is withdrawn by the taxing authority who originally proposed the adjustment.
- Partial relief of double taxation when the adjustment is not fully agreed on by both countries
- No relief of double taxation when competent authority assistance is denied or a resolution is not achieved

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1. Note that data for prior years was presented on a fiscal year basis but in 2013 the IRS moved to calendar year format. As a result, 2013, being the transition year, covers a 15-month period rather than 12 months as in prior Competent Authority annual reports.
2. As of February 2012, the IRS’s Competent Authority and Advance Pricing Agreement (APA) programs were merged into the newly created APMA.
3. APA information is reported separately in the APA statutory report.
The US Competent Authority cannot consider requests involving countries with which the US does not have an applicable tax treaty.

2013 MAP case closings
While the 2013 MAP statistics cover a period three months longer than reported for prior years, the number of cases resolved nevertheless reflects a significant increase relative to past years. In fact, the 2013 figures (159) surpassed the all-time high number achieved in 2010 (146 cases). Interestingly enough, while US-initiated adjustments constituted 17% of the total combined number of cases resolved in 2012, this number jumped to 25% in 2013. This percentage is more in line with the 2009 and 2010 statistics than with the past two years.

Increased US-based adjustments
In 2013, the US Competent Authority received a total of 266 allocation (transfer pricing) cases. Of this total, 218 (82%) of the cases were due to foreign-initiated transfer pricing audit adjustments and 48 (18%) of the cases were due to US-initiated transfer pricing audit adjustments. Foreign-initiated transfer pricing case adjustments were 72% of total cases filed in fiscal 2012. This increase in the percentage of foreign-initiated transfer pricing cases is driven by a flat number of US-initiated cases combined with a steep increase in the number of foreign-initiated cases filed.

Inventory allocation: transfer pricing cases only

<table>
<thead>
<tr>
<th>Year</th>
<th>US initiated adjusted</th>
<th>Foreign initiated adjusted</th>
<th>Year-end inventory</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009 (12 months)</td>
<td>24/30</td>
<td>134/55</td>
<td>329</td>
</tr>
<tr>
<td>2010 (12 months)</td>
<td>23/31</td>
<td>77/115</td>
<td>283</td>
</tr>
<tr>
<td>2011 (12 months)</td>
<td>25/18</td>
<td>141/119</td>
<td>312</td>
</tr>
<tr>
<td>2012 (12 months)</td>
<td>51/16</td>
<td>130/74</td>
<td>403</td>
</tr>
<tr>
<td>2013 (15 months)</td>
<td>48/40</td>
<td>218/119</td>
<td>524</td>
</tr>
</tbody>
</table>

Greater elimination of double tax/reduced MAP processing time
In 2013, the MAP program eliminated double taxation in the majority of the cases reviewed, whereas only 20% of the case resolutions by adjustment amounts resulted in no-tax-relief for the taxpayer. During 2013, US-initiated competent authority cases were processed in 23.8 months on average, a slight increase from the 2012 processing time of 23.1 months on average. In addition, the average time to process foreign-initiated Competent Authority cases also slightly increased from 26.6 months in 2012 to 26.9 months in 2013.

Processing time on all closed transfer pricing cases (average months)

<table>
<thead>
<tr>
<th>Year</th>
<th>US initiated adjustments</th>
<th>Foreign initiated adjustments</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>29.4</td>
<td>24.3</td>
<td>26.1</td>
</tr>
<tr>
<td>2010</td>
<td>25.6</td>
<td>30.8</td>
<td>29.7</td>
</tr>
<tr>
<td>2011</td>
<td>28.2</td>
<td>27.8</td>
<td>27.9</td>
</tr>
<tr>
<td>2012</td>
<td>23.1</td>
<td>26.6</td>
<td>26.0</td>
</tr>
<tr>
<td>2013</td>
<td>23.8</td>
<td>26.9</td>
<td>26.1</td>
</tr>
</tbody>
</table>

Implications
The highlight of the most recent Competent Authority annual report is the significant increase in the number of MAP cases closed in 2013. Also noteworthy is the number of MAP requests received in 2013, probably influenced by APMA’s recent success in providing relief from double taxation and expediting the processing time for APAs, combined with an increase of foreign-initiated adjustments. The number of MAP requests has been steadily increasing since 2010.

The 2013 competent authority relief statistics reflect positive results in that double taxation was eliminated for 82% of the dollar amount of the total adjustments at issue. In addition, although the total inventory of transfer pricing cases has significantly increased, the average processing time has not increased, both for US- and for foreign-initiated cases.

These positive signs coming from the APMA program reinforce the previously released report indicating the IRS closed a record-high 145 APA cases in 2013, more than triple the number of cases closed in 2011. With the APA process greatly improved and increased efforts to resolve backlog MAP cases with India, continued improvement in MAP processing times and case closure rates are expected in fiscal 2014.
Corporate income tax (CIT) rates

Table 1. Global CIT rates – largest 50 “economies” or “jurisdictions” by GDP, sorted by tax rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>GDP 2014 (US$ billions)</th>
<th>2014 CIT rate (national statutory rate only)</th>
<th>2014 CIT rate (national and subnational, average)</th>
<th>Worldwide vs. territorial taxation</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>15,653</td>
<td>35.00%</td>
<td>39.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>2,580</td>
<td>38.00%</td>
<td></td>
<td>Territorial</td>
<td>The initially proposed 1% tax on EBITDA (earnings before interest, taxes, depreciation and amortization) is replaced by an increase of the temporary additional contribution to CIT from 5% to 10.7%, that applies to companies (or tax consolidated groups) with an annual turnover exceeding €250 million. The increase would apply to fiscal years (FY) ending between 31 December 2013 and 30 December 2015. The maximum CIT rate would thus amount to circa 38% instead of the current 36.1%.</td>
</tr>
<tr>
<td>Japan</td>
<td>5,984</td>
<td>35.64%</td>
<td></td>
<td>Territorial</td>
<td>The Government has repealed the 10% special corporate reconstruction surtax a year early. The effective corporate tax rate (Tokyo area, including local taxes) will be reduced from 38.01% to 35.64% for taxable years beginning on or after 1 April 2014.</td>
</tr>
<tr>
<td>Argentina</td>
<td>475</td>
<td>35.00%</td>
<td></td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>231</td>
<td>35.00%</td>
<td></td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>2,425</td>
<td>34.00%</td>
<td></td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Venezuela</td>
<td>338</td>
<td>34.00%</td>
<td></td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>1,947</td>
<td>33.99%</td>
<td></td>
<td>Worldwide</td>
<td>Rate illustrated is applied to domestic companies, including surcharge and education CESS. Foreign companies pay tax of 43.26% including surcharge and education CESS.</td>
</tr>
<tr>
<td>Belgium</td>
<td>477</td>
<td>33.99%</td>
<td></td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>3,367</td>
<td>33.00%</td>
<td></td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>1,980</td>
<td>31.40%</td>
<td></td>
<td>Territorial</td>
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</tr>
<tr>
<td>Australia</td>
<td>1,542</td>
<td>30.00%</td>
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<tr>
<td>Spain</td>
<td>1,340</td>
<td>30.00%</td>
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<td>Territorial</td>
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<tr>
<td>Mexico</td>
<td>1,163</td>
<td>30.00%</td>
<td></td>
<td>Worldwide</td>
<td>An additional 10% CIT will be imposed on certain profits and dividends from 2014 onwards. Because the tax on dividends would be on the distributing company, there would be no tax treaty protection.</td>
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<tr>
<td>Nigeria</td>
<td>273</td>
<td>30.00%</td>
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<td>Worldwide</td>
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<tr>
<td>Philippines</td>
<td>241</td>
<td>30.00%</td>
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<td>Worldwide</td>
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<tr>
<td>South Africa</td>
<td>391</td>
<td>28.00%</td>
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<td>Territorial</td>
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<tr>
<td>Dominican Republic</td>
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<td>28.00%</td>
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<tr>
<td>Guatemala</td>
<td></td>
<td>28.00%</td>
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<tr>
<td>Norway</td>
<td>500</td>
<td>27.00%</td>
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<td>Territorial</td>
<td>Corporate tax rate is reduced from 28% to 27% with effect from 1 January 2014.</td>
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<tr>
<td>Egypt</td>
<td>255</td>
<td>26.50%</td>
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<td>Worldwide</td>
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<tr>
<td>Israel</td>
<td>247</td>
<td>26.50%</td>
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<td>Territorial</td>
<td>Increase in the standard CIT rate from 25% to 26.5% effective 1 January 2014.</td>
</tr>
<tr>
<td>Canada</td>
<td>1,770</td>
<td>15.00%</td>
<td>26.23%</td>
<td>Territorial</td>
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1. IMF World Economic Outlook Database – September 2012.
<table>
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<th>Country</th>
<th>Rate</th>
<th>Area</th>
<th>Description</th>
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<tr>
<td>Greece</td>
<td>26.00%</td>
<td>Territorial</td>
<td>Income from business activity acquired by entrepreneurs, private businesses and partnerships (OE) or limited partnerships (EE) with single-entry accounting books is subject to taxation at 26% for income up to €50,000 and at 33% for the portion of income exceeding €50,000. New private businesses and entrepreneurs (business start-up as from 1 January 2013) with income up to €10,000 are taxed at 13% for the first three years of operation. Corporate tax rate for corporations (AE), limited liability companies (EPE) and permanent establishments is increased to 26% (previously 20%).</td>
</tr>
<tr>
<td>China</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
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<tr>
<td>Indonesia</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Rate for the first €200,000 taxable basis is 20%.</td>
</tr>
<tr>
<td>Islamic Republic of Iran</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Reduction of the CIT rate from 33% to 25% except for foreign taxpayers without a branch office or permanent establishment in Colombia. Those taxpayers will continue to be subjected to a 33% tax rate on income and capital gains of Colombian source.</td>
</tr>
<tr>
<td>Colombia</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
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<tr>
<td>Malaysia</td>
<td>25.00%</td>
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<td>Algeria</td>
<td>25.00%</td>
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<tr>
<td>Denmark</td>
<td>24.50%</td>
<td>Territorial</td>
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<tr>
<td>Korea</td>
<td>24.20%</td>
<td>Worldwide</td>
<td>24.2% top tax rate includes a 10% surcharge applicable to taxable income in excess of KRW20 billion (US$18 million). While headline tax rates are the same in 2013, large companies with taxable income exceeding KRW100 billion will see the minimum tax rate raised from the current 15.4% to 17.6%.</td>
</tr>
<tr>
<td>Thailand</td>
<td>23.00%</td>
<td>Territorial</td>
<td>Thailand recently enacted a two-phased corporate tax rate reduction. Phase one reduction is from 30% to 23% and is effective for accounting periods beginning on or after 1 January 2012. Phase two reduces it down to 20% for accounting periods beginning on or after 1 January 2013 and 1 January 2014.</td>
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<td>Portugal</td>
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<td>Territorial</td>
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<td>Territorial</td>
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<td>22.00%</td>
<td>Territorial</td>
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<td>Slovak Republic</td>
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<td>Switzerland</td>
<td>7.80%</td>
<td>21.17%</td>
<td>Territorial</td>
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<tr>
<td>United Kingdom</td>
<td>21.00%</td>
<td>Territorial</td>
<td>Mainstream rate of corporation tax will be 20% from April 2015.</td>
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<td>Russia</td>
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<tr>
<td>Finland</td>
<td>20.00%</td>
<td>Territorial</td>
<td>Finland cut the rate by 4.5 percentage points as of 2014.</td>
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<td>16.50%</td>
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<td>Ireland</td>
<td>12.50%</td>
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<td>United Arab Emirates</td>
<td>0.00%</td>
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2014 CIT rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

Figure 1. 2012 Headline CIT rates – largest 50 “economies” or “jurisdictions” by 2011 GDP

Figure 2. “Economies” or “jurisdictions” taxing worldwide income

Figure 3. “Economies” or “jurisdictions” taxing territorially
The trend toward a reduction of statutory CIT rates started with the tax reforms in the United Kingdom and the United States in the mid-1980s, which broadened the tax base (for example, by making depreciation allowances for tax purposes less generous) and cut statutory rates. CIT rates have continued to be cut in recent years, accompanied by various base broadening measures, including limitations in interest (and other business expenses) deductibility, more limited utilization of losses and continuing to restrict depreciation allowances.

The table below shows that statutory CIT rates in OECD member countries dropped on average by more than 7 percentage points between 2000 and 2014, from 32.6% to 25.2% (a further 0.3% decrease from 2012). This trend seems to be widespread, as rates have been reduced in more than 90 countries globally. Within the OECD area, the rate has stayed constant in the United States, as well as in non-OECD countries such as Brazil. Almost 95% of OECD countries have reduced their CIT rates since 2000; only Chile and Hungary have 2014 rates that are higher than their 2000 rate.

A number of countries around the world (Denmark, Dominican Republic, Japan, Finland, Portugal, Slovak Republic, United Kingdom and Vietnam for example) continue to reduce rates in 2014, while other countries (Australia, The Netherlands, among others) seem to have now stretched their tax bases as far as they believe to be competitively and/or politically prudent. In a recent EY study of 61 countries, the number of countries reducing their statutory CIT rates outpaced those increasing it by a factor of more than 3 to 1.

Figure 1. Statutory corporate income tax rates, 2000 and 2014
## Americas

### Jurisdiction

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<thead>
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<th>Jurisdiction</th>
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<th>Tax controversy</th>
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<tr>
<td><strong>Tax policy and</strong></td>
<td><strong>leaders</strong></td>
<td><strong>Rob Hanson</strong></td>
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<tr>
<td><strong>Argentina</strong></td>
<td><strong>Michael Mundaca</strong></td>
<td><strong>Global Director – Tax Controversy</strong></td>
</tr>
<tr>
<td></td>
<td><a href="mailto:michael.mundaca@ey.com">michael.mundaca@ey.com</a></td>
<td><a href="mailto:rob.hanson@ey.com">rob.hanson@ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+1 202 327 6503</td>
<td>+1 202 327 5696</td>
</tr>
<tr>
<td><strong>Brazil</strong></td>
<td><strong>Ariel Becher</strong></td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>+54 11 4318 1686</td>
<td><a href="mailto:ariel.becher@ar.ey.com">ariel.becher@ar.ey.com</a></td>
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<tr>
<td></td>
<td>+55 11 2573 3309</td>
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<tr>
<td><strong>Canadá</strong></td>
<td><strong>Julio Assis</strong></td>
<td><strong>Julio Assis</strong></td>
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<td><strong>Greg Boehner</strong></td>
<td><strong>Gary Zed</strong></td>
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<td><strong>Fernanda Checa</strong></td>
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</table>
| Guatemala    | Rafael Sayagués  
rafael.sayagués@cr.ey.com  
+506 2208 9880 | Rafael Sayagués  
rafael.sayagués@cr.ey.com  
+506 2208 9880 |
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+506 2208 9880 |
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+972 3 623 2796 |
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+58 212 905 6672 | Alaska Moscato  
alaska.moscato@ve.ey.com  
+58 212 905 6672 |
## Asia-Pacific

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<tr>
<th>Jurisdiction</th>
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<td><strong>Australia</strong></td>
<td>Alf Capito</td>
<td>Howard Adams</td>
</tr>
<tr>
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<td><a href="mailto:alf.capito@au.ey.com">alf.capito@au.ey.com</a></td>
<td><a href="mailto:howard.adams@au.ey.com">howard.adams@au.ey.com</a></td>
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<td>Howard Adams</td>
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<tr>
<td><strong>China</strong></td>
<td>Becky Lai</td>
<td>Henry Chan</td>
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<td><strong>Hong Kong SAR</strong></td>
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<td>Joe Chan</td>
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<tr>
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<td>Kirsty Keating</td>
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<td>Wilfredo U. Villanueva</td>
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<tr>
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<td>Russell Aubrey</td>
<td>Siew Moon Sim</td>
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<td><a href="mailto:siewmoon.sim@sg.ey.com">siewmoon.sim@sg.ey.com</a></td>
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<tr>
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<td>+65 6309 8690</td>
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<tr>
<td><strong>South Korea</strong></td>
<td>Min Yong Kwon</td>
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About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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With the speed, volume and complexity of tax policy and legislative and regulatory change continuing to accelerate, accessing the leading global insights has never been more important. EY is pleased to make available a new Tax Policy and Controversy Briefing portal, providing earlier access to all articles in this publication and more, including interviews with minute-by-minute tweets of key news, daily tax alerts and more interviews with the leading stakeholders in the world of tax.

Access the new portal at: ey.com/tpcbriefing

Although the last few months have had less public discussion of BEPS, the OECD’s working parties have been using that time to negotiate and finalize the wording of the seven BEPS action items that were delivered on 16 September. The publication of these reports marks the beginning of what will surely be an extended period of assessment, discussion and potential implementation by countries around the world.
Business as usual elsewhere

Beyond the supranational, many countries have been active on the policy front since our last edition; Spain and Sweden (among many others) have both issued significant tax policy reform packages, as has India in the area of tax administration. Major corporate and international tax changes in Japan and South Africa are also described by our authors, while in Australia an independent tax reform commission is called for in a recent EY report. In the UK, meanwhile, the government is clearly pushing to change the nature of the relationship between taxpayers and HMRC, announcing a consultation in relation to new criminal sanctions for offshore tax evasion.

Spain’s tax reform

Spain’s tax reform proposals (which were preceded by a controversial bill that expands a Board of Directors’ duties to include the approval of any transaction deemed significantly relevant for tax purposes) are discussed in our interview with Miguel Ferre, Spain’s Secretary of State for Finance, following our earlier interview of UK Minister, David Gauke.

Foreshadowing a fall in the main rate of corporate income tax to 25% (from 30%) by 2016, Mr. Ferre says that “The proposals we will retain (from the report on tax reform) are those which make it possible to enhance tax consolidation and to favor business competitiveness.” Speaking of the policy choice to not raise VAT rates, he adds: “At a time when the Spanish economy is beginning to show signs of recovery, a new increase in VAT will entail a negative impact on consumption and therefore on economic activity.”

Inversions

While tax reform in the United States remains somewhat of a sleeping giant, much talk has been heard on the subject of corporate inversions to lower-taxed jurisdictions. This includes a procession of senators speaking during a Senate Finance Committee hearing where such inversions were described as a “virus” and a “fever”, as noted on page 50.

Tax revenues rising

More widely, we highlight a series of reports from the OECD and European Commission that, taken together, confirm that global tax revenues are reaching and even surpassing pre-crisis highs. We also kick off the first in a series of discussions with leading revenue authorities on how they use technology both now and in the future to manage their own risks and facilitate service delivery.

More pressure

This broad mix of developments (and many more on top) are all layering more pressure on the tax function than ever before. This is confirmed by the results of EY’s 2014 Tax risk and controversy survey, summarized on page 12, which finds that reputation risk, legislative risk and operational risk are together making previous survey results pale in comparison.

Continuing to monitor the developments in tax policy and controversy, and predicting outcomes where possible therefore remains the order of the day. We hope this publication goes some distance to help you do that and, as always, if you would like to suggest topics for future consideration, please do let either of us know.
Global updates

United States
- US Senator Levin introduces bill to tighten inversion rules under Section 7874

Mexico
- Mexican SAT issues final rules on maquiladora revenue sources and VAT relief

El Salvador
- El Salvador proposes tax reform

Chile
- Chilean Congress approves tax reform, including GIT rate rise

France
- France extends deadline for large companies to file Transfer Pricing Statement

Ireland
- Ireland launches public consultation regarding corporate tax regime

Spain
- Spain releases draft bill of Spanish tax system reform

Uganda
- Uganda issues 2014-15 budget

Tanzania
- Tanzania issues 2014-15 budget

Kenya
- Kenya issues 2014-15 budget
Czech Republic tax authority introduces mandatory intragroup transaction reporting.

Major corporate tax changes proposed in Sweden.

South Korea’s National Tax Tribunal holds indirect US shareholder is a beneficial owner.

Japanese Government announces plan to lower corporate tax rate to below 30%.

Singapore issues guidance on income tax treatment of hybrid instruments.

Philippine lawmaker proposes tax reform bill seeking to reduce corporate income tax rate.

Hong Kong SAR concludes first advance pricing agreement.

Australia votes to repeal carbon tax.

Italy introduces a tax credit for investments in new plants and equipment; increases notional interest deduction benefits.

Greece reforms mandatory contents of Transfer Pricing Documentation File.
Pascal Saint-Amans has been the director of the OECD’s Centre for Tax Policy and Administration, since the inception of the Base Erosion and Profit Shifting (BEPS) project. EY welcomed Mr. Saint-Amans to a breakfast event in Sydney, on 20 September, just four days after the OECD issued the first set of recommendations and the day after Mr. Saint-Amans attended the G20 Finance Ministers and Central Bank Governors’ meeting.

At our event, Alf Capito, Asia Pacific tax policy leader for EY asked Mr. Saint-Amans to share his insights on the journey travelled so far, the road map for the future and his thoughts on what it all means for business.
Interview

An interview with Miguel Ferre, Spain's Secretary of State for Finance.

Members of the Spanish Government join EY at an event in London.

Left to right:
- Mr. Federico Linares - Tax and Legal Managing Partner, Ernst & Young Abogados, S.L.
- Mr. Jose Manuel Gutierrez - Financial Counsellor, Spanish Embassy
- Mr. Miguel Ferre - Spanish Secretary of State for Finance
- Mr. Federico Trillo-Figueroa - Spanish Ambassador in London
- Mr. Jose Antonio Bustos - International Tax Services, Ernst & Young LLP
Miguel Ferre is Spain’s Secretary of State for Finance. He has a deep tax background and has driven the recent release of a comprehensive tax reform plan for Spain.

He has 17 years professional experience as a Government Finance Inspector, holding various positions in the Ministry of Finance. He has been Deputy Director General for International Tax Matters at the Ministry of Finance, was also responsible for work on tax harmonization in the European Union and participated as a member of the Spanish delegation at the Councils of Ministers ECOFIN. In addition, he was responsible for upholding Spanish interests on the OECD’s Committee of Fiscal Affairs in relation to international taxation. Previous to his government roles, Mr Ferre worked for PricewaterhouseCoopers.

He spoke with Jose Bustos at a recent EY event held in London.

**Jose Bustos:** The Spanish Government has recently presented its tax reform proposal. Prior to that, a Committee of Experts designated by the Spanish Government presented its report on potential tax reform options for Spain. How are your proposals aligned with that report?

**Miguel Ferre:** Firstly, it must be said that the report made by the commission of independent experts is not binding on the Government of Spain. Likewise, it must be taken into account that at the international level the request for reports with similar characteristics is common practice. These reports include independent analysis of potential measures for the governments to analyze their pros and cons and offer a base on which to build the tax reform to be finally adopted. Good examples of that are the Mirrless report, or the older Carter report.

Of course, we have to make sure these proposals are considered in line with the current Government policy and the Spanish economic situation. As regards direct taxation, a good deal of the Committee’s proposals have been adopted in relation to individual taxation. Concerning corporation taxes, the proposals kept are those which make it possible to enhance tax consolidation and to favor business competitiveness. Finally, in regard to VAT, the proposal to increase rates has not been considered appropriate at the current time, as the last increase in September 2012 is still quite recent.

**Jose Bustos:** What are the main messages for business in the Tax Reform Proposal?

**Miguel Ferre:** The main targets of this tax reform are the attraction of economic activity towards Spain and the improvement of our tax system’s competitiveness as compared to those countries around us. The general reduction of corporate tax rate systems and the presence of incentive measures promoting economic activity – which further reduce effective tax rates – such as the capitalization or equalization reserves, are clear examples of a policy obviously biased towards promoting economic activity in Spain and to ameliorate business financing. At the same time, we hope the reforms will create more legal certainty in the tax system, which is critical for any foreign investor, as well as simplifying elements of our main taxes. Overall, our intention is to achieve the framework necessary for investors to have the confidence to invest in a country such as Spain.

2. In the United States
On 16 September 2014, the Organisation for Economic Co-operation and Development (OECD) released a series of deliverables (the 2014 Deliverables) that address seven of the focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The documents released consist of a brief explanatory statement, final reports with respect to Action 1 (Digital Economy) and Action 15 (Multilateral Instrument), an interim report with respect to Action 5 (Harmful Tax Practices), and reports with agreed draft recommendations on Action 2 (Hybrid Mismatch Arrangements), Action 6 (Treaty Abuse), Action 8 (Transfer Pricing for Intangibles), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). In this article, we provide an overview of the OECD press conference and webcast, both held on the day of the deliverables’ release, plus an overview of each of the seven focus areas for which deliverables were published. For each of the seven areas of focus, we also provide a link to more detailed coverage on our EY.com website.

The webcast featured Pascal Saint-Amans, who leads the OECD’s tax work. Also participating were senior members of the OECD Secretariat that led the technical work on the 2014 Deliverables: Raffaele Russo, who has responsibility for the work on the digital economy and the multilateral instrument as well as overall responsibility for the BEPS project; Marlies de Ruiter, who has responsibility for the tax treaty, transfer pricing and financial transactions work; and Achim Pross, who has responsibility for the international co-operation and tax administration work.

A collaborative effort between governments

During the webcast, Saint-Amans described the recommendations presented in this first set of deliverables as being a result of a collaborative effort between governments from OECD and G-20 member countries, with input from more than 80 developing countries and from the business community and other stakeholders. He noted that that the recommendations set forth in the deliverables released are not yet final and may be subject to some revision given the interrelationship between the focus areas covered in the 2014 Deliverables and the focus areas covered by the other BEPS Actions which have target delivery dates of September and December of 2015. The reports released were described by Saint-Amans as reflecting agreement by the participating countries on the present status and future steps to be taken with respect to the covered Actions, while the draft recommendations released were described by Saint-Amans as “soft legislation” that contain the countries’ consensus and commitment with respect to rules to be developed to address the matters dealt with by those Actions.

The 2014 Deliverables were presented at the upcoming G20 Finance Ministers’ meeting, held in Cairns, Australia on 20-21 September and will be further considered at the G20 Leaders’ meeting in November 2014. Below is an overview of each of the 2014 Deliverables.
Action 1 – Addressing the tax challenges of the digital economy

The report on Action 1 (the Digital Economy Report) builds on the objectives reflected in the discussion draft released by the OECD on 24 March 2014 (the Digital Economy Discussion Draft), which focused on the key features of the “new” business models in the digital economy, how those features may exacerbate BEPS risk in a global economy, and what broader direct and indirect tax challenges are raised by the digital economy. Moreover, the Digital Economy Discussion Draft provided an overview of potential options for addressing the tax challenges of the digital economy, along with a framework for evaluating these options. The alternatives discussed in the Digital Economy Discussion Draft included: (i) modifying permanent establishment (PE) rules (i.e., preparatory and auxiliary exemptions, PE nexus based on significant digital presence, and virtual PE), (ii) introducing withholding tax regime for digital transactions, and (iii) modifying existing value added tax (VAT) regimes.

The Digital Economy Report largely follows the discussion in the Digital Economy Discussion Draft. It continues to acknowledge that it would be impossible to ring-fence the digital economy (a key point repeated during the OECD webcast) and also underscores that the landscape is still moving rapidly, therefore making it a challenge to anticipate all potential issues. It also continues to stress the importance of the fair, equitable and efficiency principles introduced by the Ottawa Taxation Framework Conditions. The Digital Economy Report includes a new chapter that discusses the fundamental principles of taxation and, in doing so, reconsiders some of proposed approaches for addressing the tax challenges of the digital economy. Specifically, the Digital Economy Report: (i) reiterates that PE exemptions for preparatory and auxiliary activities should not be available for core activities; (ii) discusses how to deal with tax planning by businesses engaged in VAT-exempt activities; (iii) addresses the importance of data and its impact on transfer pricing; and (iv) identifies the need to adapt CFC rules. The Digital Economy Report indicates there remain certain areas of disagreement among stakeholders (e.g., import of data in driving value for tax purposes), but that there is consensus that action is needed to clarify PE issues in the Digital Economy (presumably, to be addressed more in Action 7) as well as the need to address consumption taxes on business-to-consumer transactions.

Importantly, the OECD indicated that as the recommendations on the other Actions Items are finalized, the OECD will evaluate how the outcomes affect the broader tax challenges raised by the digital economy and will complete an evaluation of the options to address them. This work will be concluded by December 2015 and a supplementary report reflecting the outcomes of the work will be finalized at that time.

Read more on the report on Action 1 at: www.ey.com/BEPSAction1

Replay EY webcasts discussing the latest BEPS developments

EY held a series of webcasts discussing the September 2014 BEPS recommendations, and replays are now available to view at your convenience. To access the webcasts, please visit www.ey.com/webcasts
Action 2 – Neutralizing the effects of hybrid mismatch arrangements

The document on Action 2 (the Hybrid Mismatch Report) includes two sets of recommendations to address hybrid mismatch arrangements. Part I contains recommendations on domestic law rules to address arrangements that result in double non-taxation or long-term tax deferral. Part II contains recommended changes to the OECD Model Tax Convention to deal with the use of dual resident entities and transparent entities to obtain treaty benefits and to address the interaction between the domestic law recommendations and the provisions of the OECD Model Tax Convention.

The recommendations for domestic law reflect the approach originally described in the discussion draft released on 19 March 2014 (the Hybrid Mismatch Discussion Draft), with some important refinements. First, the OECD recommends the enactment of linking rules that seek to relate the tax treatment of a specific hybrid entity or arrangement in one jurisdiction to the tax treatment of such entity or arrangement in the other jurisdiction. Second, the report recommends a “rule order” under which primary and defensive rules would operate to address double non-taxation outcomes and avoid double taxation. Third, reflecting extensive comments received from stakeholders, the report limits the scope of the recommended rules by using the “bottom up approach.” More specifically, the recommended rules would apply to hybrid arrangements involving related parties and members of the same controlled group and to certain “structured” arrangements. Moreover, for this purpose, the threshold for related party status is increased to 25%, from 10% as proposed in the Hybrid Mismatch Discussion Draft.

The recommendations with respect to the OECD Model Tax Convention include (i) a change to Article 4 of the Model Tax Convention to deal with dual resident entities; (ii) a new provision in Article 1 and changes to the Commentary to address fiscally transparent entities; and (iii) various proposed changes to address treaty issues that may arise from the recommended domestic law changes.

The Hybrid Mismatch Report indicates that the OECD is continuing its work on Action 2 to develop guidance on the implementation of the recommended rules. In addition, the report notes that there are some specific areas where further refinements in the recommended domestic law rules may be needed, including the treatment of certain capital market transactions such as on-market stock-lending and repos and the treatment of imported hybrid mismatches. Moreover, concerns regarding the application of the rules to intra-group hybrid regulatory capital will be explored further. Similarly, additional work will be done on how income inclusions under CFC regime should be treated for purposes of the report. It is anticipated that this additional work will be finalized in September of 2015 and that the output will likely be in the form of commentary and transitional rules.

Action 5 – Countering harmful tax practices

Action 5 of the OECD BEPS project committed the OECD’s Forum on Harmful Tax Practices (FHTP)1 to revamp the work previously done by the OECD on harmful tax practices of countries. In this regard, the FHTP is to deliver three outputs:

1. A review of member country preferential regimes
2. A strategy to expand participation to non-OECD member countries
3. Consideration of revisions or additions to the existing framework for analyzing whether regimes are harmful

The interim report on Action 5 (the Harmful Tax Practices Report) discusses the progress on the first output. The work of the FHTP focused on designing a substantial activity test for any preferential regime and on improving transparency between tax administrations related to the existence and mechanics of preferential regimes, such as by mandating compulsory spontaneous exchange of information on rulings. The second and third outputs are expected by September and December 2015, respectively.

In the review of preferential regimes, the FHTP concentrated first on intellectual property (IP) regimes. It suggested that a “nexus approach” would be most appropriate when determining whether the substantial activity test is met. Under this approach the application of an IP regime would be dependent on the level of R&D activities carried out by the taxpayer. Discussions of the approach are continuing. In the next stage the FHTP will evaluate all existing IP regimes of OECD and associated countries to determine whether or not they require “substantial activity.” In addition, the approach that will ultimately be agreed on will need to be extended to tax regimes not related to

Read more on the report on Action 2 at: www.ey.com/BEPSAction2

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1. The FHTP was created in 1998 when the OECD started its work in the field of harmful tax competition with the publication of the report “Harmful Tax Competition: An Emerging Global Issue.”
IP. With respect to the goal of improving transparency, the FHTP developed a framework for compulsory spontaneous exchange of information by tax administrations on taxpayer-specific tax rulings and Advance Pricing Agreements (APAs). The framework would require rulings (or summaries of such rulings) on preferential regimes that meet certain criteria to be exchanged spontaneously with the competent authorities of the tax jurisdictions involved. The framework also deals with questions such as time-limits, legal basis, confidentiality and the type of information to be exchanged. An ongoing monitoring and review mechanism, including annual review by the FHTP, will be put in place to ensure countries’ compliance. The FHTP expects to issue a progress report on the adherence to the framework in 2015.

1. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.
2. Clarify that treaties are not intended to be used to generate double non-taxation.
3. Provide tax policy considerations for contracting states to consider before entering into a tax treaty with another country.

To prevent the granting of treaty benefits in inappropriate circumstances, particularly through treaty shopping arrangements, the report recommends the inclusion of anti-abuse rules in the OECD Model Tax Convention. The report includes a “limitation on benefits” (LOB) provision, similar to those found in US tax treaties, and a general anti-abuse rule (GAAR), similar to the “main purpose” test found in UK tax treaties, based on the principal purposes of transactions or arrangements (a principal purpose test or “PPT” rule). In contrast to the Treaty Abuse Discussion Draft, the Treaty Abuse Report acknowledges that the adoption of both the LOB and PPT rules, together, might not be appropriate for all countries. Therefore, the report suggests that at a minimum, countries should: (i) affirm through an express statement in their tax treaties that they intend to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and (ii) adopt either (A) the LOB and the PPT rules, (B) the PPT rule, or (C) the LOB rule supplemented by a mechanism (such as a restricted PPT rule applicable to conduit financing arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would address conduit financing arrangements not already addressed in tax treaties.

The LOB provision includes many of the same tests as those included in the LOB provisions of existing US tax treaties. Notably, the LOB provision in the Treaty Abuse Report includes a derivative benefits test. The Treaty Abuse Discussion Draft had discussed derivative benefits tests but had raised concerns about the implications of such a test.

The Treaty Abuse Report also adds a proposed change to the OECD Model Tax Convention addressing the availability of collective investment vehicles (CIVs) and other funds. It further states that there is more work to be done in this area. In addition, the report indicates that further work will be needed with respect to the precise contents of the anti-abuse rules, in particular the LOB rule. Finally, the report indicates that the proposed OECD Model Tax Convention provisions and related Commentary should be considered as drafts that are subject to improvement prior to the release of the final version in September 2015.

Read more on the report on Action 5 at: www.ey.com/BEPSAction5

Action 6 – Preventing the granting of treaty benefits in inappropriate circumstances

The draft recommendations under Action 6 (the Treaty Abuse Report) reflect the recommendations made as part of the discussion draft published on 14 March 2014 (the Treaty Abuse Discussion Draft). The Treaty Abuse Report includes proposals to:

Read more on the report on Action 6 at: www.ey.com/BEPSAction6
**Action 8 – Transfer pricing aspects of intangibles**

The draft recommendations under Action 8 (the Transfer Pricing Aspects of Intangibles Report) contain revised standards for transfer pricing of intangibles and additional standards with respect to comparability and transfer pricing methods.

The first part of the Transfer Pricing Aspects of Intangibles Report contains amendments to Chapter I (The Arm’s Length Principle) of the OECD Transfer Pricing Guidelines relating to the transfer pricing treatment of location savings and other local market features, assembled workforce, and the existence of multinational enterprise (MNE) group synergies. The second part of the report contains an entirely revised Chapter VI (Special considerations for intangibles) of the OECD Transfer Pricing Guidelines. It contains guidance on: (i) the definition of intangibles, (ii) identifying and characterizing specific controlled transactions involving the use or transfer of intangibles, and (iii) determining arm’s length conditions in cases involving intangibles. The Transfer Pricing Aspects of Intangibles Report also contains interim guidance on ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles, the application of profit split methods, and arm’s length pricing when valuation is highly uncertain at the time of the transaction. The interim guidance will be finalized in connection with the 2015 BEPS work on risk, recharacterization, and hard to value intangibles.

Key features of the Transfer Pricing Aspects of Intangibles Report, and key differences compared to previous work in connection with Action 8, include:

- The definition of an intangible, which is similar to that contained in the discussion draft of 30 July 2013 but which includes a new definition of “marketing intangibles.”
- New guidance providing that it is not necessary to define when goodwill or going concern value may or may not constitute an intangible. If features of a business allow a company to charge higher prices, such contribution should be compensable without regard to the labeling.
- Interim guidance on ownership, the thrust of which is that legal ownership as such and the funding of the development of an intangible without performing important functions would not create an entitlement to the full intangible related return. The allocation of returns should be in line with value creation.
- New guidance on how profits or losses relating to unanticipated events should be shared between MNE group members contributing to the development, enhancement, maintenance and protection of the intangible.
- The use of valuation techniques as part of the five OECD transfer pricing methods or as a useful tool.
- New and revised examples to illustrate the revised guidance.

In the next several months, additional work will be undertaken in connection with risk, recharacterization, and hard to value intangibles, which will lead to partial revisions of Chapters I, II, VI, VIII and IX of the OECD Transfer Pricing Guidelines. In this process, so-called “special measures” which deviate from the arm’s length principle may be considered. Some examples of potential special measures have been included in the report.

Read more on the report on Action 8 at: [www.ey.com/BEPSAction8](http://www.ey.com/BEPSAction8)

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**Action 13 – Guidance on transfer pricing documentation and country-by-country reporting**

The draft recommendations under Action 13 (the Transfer Pricing Documentation and CbC Report) contain revised standards for transfer pricing documentation and a template for country-by-country reporting, to be included in the OECD Transfer Pricing Guidelines in the place of the existing Chapter V. The Transfer Pricing Documentation and CbC Report is aimed at ensuring better transparency for tax administrations by providing them with adequate information to conduct transfer pricing risk assessments and at improving the consistency of requirements for taxpayers. The transfer pricing documentation standards and the country-by-country reporting standards will be revisited by the OECD members no later than the end of 2020 “with a view to continuously improving the operation of those standards.”
The country-by-country reporting template requires MNEs to report the amount of revenue (related party and unrelated party), profits, income tax paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets annually for each tax jurisdiction in which they do business. In addition, MNEs are also required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity conducts.

The guidance on transfer pricing documentation requires MNEs to include a high-level overview of their global business operations and transfer pricing policies in a “master file” that would be made available to all relevant country tax administrations. Specific information would be required for intangibles and intercompany financial activities. Moreover, the transfer pricing guidance will require that detailed information on all relevant material intercompany transactions be included in a “local file” in each country.

The Transfer Pricing Documentation and CbC Report contains some significant changes compared to the discussion draft released on 30 January 2014. For example, the country-by-country reporting template will require information to be reported on a jurisdiction by jurisdiction basis rather than on an entity by entity basis. Moreover, certain detailed information on payments and receipts for intercompany royalties, interest and services will not be included on the country-by-country report, but instead will be reported in the transfer pricing documentation local file. Furthermore, the country-by-country report will not be made a part of the transfer pricing documentation master file.

Additional work will be undertaken by the OECD over the next months with respect to implementation and filing of the master file and the country-by-country report. The Transfer Pricing Documentation and CbC Report states that “due regard will be given to considerations related to protection of the confidentiality of the information required by the reporting standards, the need for making the information available on a timely basis to all relevant countries, and other relevant factors.” Guidance in this respect is expected to be delivered in early 2015.

**Read more on the report on Action 13 at:**
www.ey.com/BEPSAction13

**Action 15 - Developing a multilateral instrument to modify bilateral tax treaties**

The report on Action 15 (the Multilateral Instrument Report) examines the feasibility and desirability of a multilateral instrument as a way to implement treaty measures developed under the other Actions. The report considers that such an instrument is desirable because it would achieve swift implementation of these measures by avoiding the need to individually negotiate existing bilateral tax treaties and it would allow for a consistent outcome. The Multilateral Instrument Report acknowledges that there can be obstacles to a multilateral instrument from a technical (public international law and international tax law) and political perspective. Drawing from numerous examples of multilateral treaties in areas other than tax, it concludes that these obstacles can be overcome so that the instrument appears to also be feasible.

The Multilateral Instrument Report suggests that the scope of such multilateral instrument should at this stage only include treaty based outputs of the BEPS project. It further identifies a number of provisions that are “multilateral in nature” and could thus be included as such in a multilateral instrument (e.g., a multilateral mutual agreement procedure and provisions on dual-residence, hybrid mismatch arrangements, and treaty abuse). Other provisions (e.g., changes to the permanent establishment definition) would need to take bilateral specificities into account and should thus offer more flexibility for contracting parties. Stressing the urgency of creating a multilateral instrument, the Multilateral Instrument Report proposes to convene an International Conference in 2015 under the aegis of the OECD and the G20. The International Conference would be open to all interested countries and would develop the content of the multilateral instrument. The proposed mandate of the International Conference should be limited in time to two years and in scope by focusing only on the treaty related BEPS outputs once finalized.

**Read more on the report on Action 15 at:**
www.ey.com/BEPSAction15

**Concluding thoughts**

The release of the 2014 Deliverables represents a significant development in the OECD BEPS project. The reports and recommendations reflect agreements reached by the OECD and G20 member countries. The documents also describe further OECD work that will continue into 2015 in all of these focus areas. At the same time, the OECD has reiterated its commitment to issue output with respect to the remaining BEPS Actions by the end of 2015.

While the OECD continues its work on the BEPS Action Plan, countries around the world are already acting to address concerns about BEPS through legislative and regulatory changes and changes in administrative practices. Companies will want to keep informed about developments in the OECD BEPS project and related developments in the domestic tax laws and practices in the countries where they operate or invest.
Intense media interest in particular has driven new and significant concerns about tax-related reputation risk. Stories and investigations alleging tax avoidance have become even more prevalent in newspapers and TV programs around the world since we last conducted this survey in 2011. As a result, it is not surprising that 89% of the largest companies surveyed (those reporting annual revenues in excess of US$5 billion) say that they are now somewhat or significantly concerned regarding media coverage of taxes, up from 60% in 2011. Conversely, just 9% say they are unconcerned now, compared to 40% in 2011.

More tangibly, the intense media focus has galvanized policy makers into action. Lawmakers have reacted to news stories by convening parliamentary hearings, proposing legislation and supporting efforts by the Organisation for Economic Co-operation and Development (OECD) to recommend 15 specific areas for coordinated action to protect countries’ tax bases.

Our survey respondents say they are feeling the effects. For example, 74% of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.

Some countries have already taken steps to implement concepts related to base erosion and profit shifting (BEPS) in the form of new legislation, establishing “working groups” to review existing frameworks and formulate new ones, and in some cases suspending advance pricing agreements (APAs) or applying future BEPS concepts to previously executed transactions. Even if directionally consistent with the BEPS project, these early actions may actually threaten the coherence of the overall project, creating more uncertainty, greater risk and an erosion of trust between tax authorities and taxpayers.

At the same time, governments continue to pursue day-to-day legislative change and tax reform at the national level. Additional layers of complexity are added as governments strive to balance tax competition with raising enough revenue to fund ongoing spending commitments.

Four major sources of tax risk identified

- **Reputation risk:** 89% are somewhat or significantly concerned about the media coverage of the taxes some companies are paying or their seemingly low effective tax rates. Our survey shows just how rapidly reputation risk has become a key concern. Companies need to act deliberately and assertively to manage this complex and sensitive issue rather than being put in a situation where they must react to reputational challenges from a defensive posture.

- **BEPS and legislative risk:** 74% felt that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach. Concern about the outcomes of the BEPS project pervaded our survey responses. To that end, much attention has focused on the OECD BEPS Action Plan. But unilateral actions by individual governments may be an even bigger source of risk, with the potential to create “global tax chaos” that both the OECD and businesses want to avoid.

- **Enforcement risk:** 69% felt that tax audits had become more aggressive and frequent in the last two years. Our survey indicated more aggressive, focused tax enforcement and a sense that mutually constructive relationships between taxpayers and authorities may be becoming strained.

- **Operational risk:** 75% cited insufficient resources to cover tax function activities as their leading source of operational risk. Our survey indicated that as pressures continue to build, many companies may lack the appropriate resources to effectively manage the first three issues. This growing operational risk spans people, processes and technology.

To learn more about the survey results, read our [2014 tax risk and controversy survey highlights](#) at [www.ey.com/taxriskseries](#).

2014 Tax Risk and Controversy Survey benchmarking

On this site, you can benchmark yourself against a selection of the survey questions as answered by your peers. Benchmarking against geographic location and company revenue is also available, and you will be able to print a copy of your benchmark report at the conclusion.
On 21 July 2014, the OECD published the first edition of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (The Standard). The Standard includes the text of the Model Competent Authority Agreement, the Common Reporting Standard and the Commentaries thereon as read on 15 July 2014 after the approval of The Standard by the Council of the OECD. The document, which is 311 pages in length, is available at:


The Standard was developed at the request of the G20 in order to create a global standard for the automatic exchange of financial account information. It builds upon the draft model Standard released on 13 February 2014.1 The Standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions that are required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

The Standard is formed of three sections:

- Part I provides an introduction to The Standard
- Part II contains the text of the Model Competent Authority Agreement (Model CAA) and the Common Reporting and Due Diligence Standard (CRS)
- Part III contains the Commentaries on the Model CAA and the CRS as well as a number of Annexes

Financial institutions will need to implement The Standard from 1 January 2016, with the first exchanges of information beginning by the end of September 2017. The Standard draws extensively on earlier work of the OECD in the area of automatic exchange of information. It incorporates progress made within the European Union, as well as global anti-money laundering standards, with the intergovernmental implementation of the Foreign Account Tax Compliance Act (FATCA) having acted as a catalyst for the move toward automatic exchange of information in a multilateral context.

As financial institutions will need to implement The Standard from 1 January 2016, the publication of the Commentaries in Part III is to be welcomed as they provide more detail on the requirements that will be demanded of financial institutions.

As of 19 March 2014, 44 “early adopter” jurisdictions had announced their intention to adopt The Standard2 with the first exchange of information beginning by the end of September 2017. Attention must therefore now be focused on examining the next steps of domestic tax authorities who will be responsible both for translating The Standard into domestic law and for considering its implementation among financial institutions. Until more details are published at the domestic level, a degree of uncertainty on implementation issues will remain.

Given that the Standard has been built upon the foundations laid by FATCA, financial institutions should review the full OECD documentation in detail and assess whether current and planned FATCA processes and systems may be leveraged in order to ease the additional compliance burden. The additional volume of due diligence required and multi-lateral country requirements mean that significant work is likely to be required, however.

More information on the Standard is available in a detailed EY Global tax alert available at:


The International Monetary Fund (IMF) report *Spillovers in International Corporate Taxation* looks at how national tax decisions can have international impacts, examining how tax systems influence the global economy in general and developing economies in particular.

The report highlights those features of the international tax architecture which raise issues for developing countries, identifies some possible policy responses and suggests some radical alternatives. Offered as a complement to the OECD’s BEPS work program, the report also refocuses on the question of “fragile” concepts of “residence” and “source” which underpin current international tax arrangements.

The world of tax policy is becoming crowded; with more players seek to influence how the world’s tax systems operate. While previously taxation was seen as a core part of “fiscal sovereignty,” in a globalizing economy, international organizations are increasingly influencing how the world’s tax systems operate.

The BEPS project of the G20 and, OECD’s and the United Nation’s a wider perspective than that of just the developed world have played a strong role recently. But in late June, we saw published another foray into the field of international taxation, this time from the IMF, or more precisely from the staff members of the IMF’s Technical Assistance team.

So how does this new report differ and what does it add to the debate?

The IMF approach
The report looks to complement the work being undertaken in the G20 and the OECD, but also seeks to differentiate its contribution by reminding readers of the experience that the IMF has in providing technical assistance.

The report is unconstrained by the highly political origins of the BEPS project and the IMF has gone further to look at some of the fundamental concepts and processes underpinning the current international tax architecture.

The IMF’s focus is on “spillovers” the impact that one country’s tax policies have on another country. The report distinguishes between “base spillovers,” where one country’s actions directly affect another’s corporate income tax base (for example, by reducing taxable income through debt financing) and “strategic spillovers” where one country’s actions induce changes in other countries’ tax policies (i.e., tax competition, such as reductions in corporate income tax rates).

The big picture
This focus on spillovers allows the IMF to engage with two crucial “big picture” questions:

1. Does the current tax architecture help or hinder economic growth? Does the current model of competition and the current framework for managing relationships between tax systems increase or decrease overall welfare?
2. Who are the winners and losers under the current system? In particular, what is the effect of the current arrangements on the prospects of developing countries?

The elephant in the room
At the heart of the IMF document is the recognition that there are fundamental concerns about the viability of the current international architecture for allocating taxing rights between the source country (where investment and production takes place) and the residence country (where a company is based). To some extent, this is touched on in the discussion on the digital economy action item in the BEPS project, which itself appears unlikely to conclude on fundamental changes. Freed from the constraints of consensus, the Staff of the IMF have sought to bring alive the challenge, noting that 42% of the value of US goods traded in 2012 was in intra-firm transactions, which are harder intellectually to allocate between source or residence.

The paper notes that the allocation of rights is especially important for low-income countries. As source countries, flows for them are commonly very asymmetric. It argues that deeper notions about the fair allocation of tax revenue and powers across countries are at issue and the current initiatives do not address some of these concerns. Failing to address this, it warns, may increasingly give rise to unilateral national measures that risk further undermining the coherence of the international system.

The impact of spillovers
The report sets out the various ways in which one country’s international tax decisions can affect other countries. These include impacts on FDI flows (where low effective tax rates attract inward flows); on the corporate tax base (either through shifts in real investment or profit shifting); and on tax-setting incentives (where the response to tax changes elsewhere may be to change tax rules at home).

As to the scale of these effects, the report suggests that base spillover effects – due to shifts in real activities and profit shifting – are both large and significant, although these are described as “suggestive conclusions” rather than hard findings. For strategic spillovers, the report points to the decline in corporation tax rates over the last 30 years and the recent proliferation of intellectual property “boxes.”

On welfare implications, the complexities of identifying the effects are even greater and the report suggests these issues should be further explored in the IMF’s own consultations with tax authorities and through more work in the G20 process.

Suggestions on approach
Turning to the impact of spillovers on developing countries, the report identifies a range of ways in which the current international system impacts on developing countries and points to approaches that could be adopted in response.

The impacts include: the use of tax treaty networks to reduce tax payments (where the IMF says developing countries would be well-advised to sign treaties only with considerable caution); the potential for avoidance of tax on capital gains on natural resources and some other assets in their jurisdiction by the realization of these gains (i.e., the transfer of ownership) in low tax jurisdictions; a lack of effective provisions to guard against the use of borrowing to shift profits to lower tax jurisdictions and a need for capacity
building, simplified rules and guidance in the area of transfer pricing. Finally the report identifies that these issues may themselves detract a country’s focus from the development of its own domestic tax policies.

The approaches that the IMF report says could be adopted in response include:

- Encouraging developing countries (which will largely be capital importing countries) to be cautious about entering into any bilateral tax treaty and to evaluate whether it realizes sufficient gains from increased FDI to offset any revenue loss. It notes that limitation on benefit provisions can provide important protection.

- On the issue of taxing indirect transfers of interest (i.e., transfer of ownership to a low tax jurisdiction), the paper notes that this is of particular importance to developing countries. While it acknowledges arguments which suggest that taxing such transfers are not necessary (on the basis that the accumulated and expected earnings have been or will be taxed), the paper concludes that, as countries do seek to tax such transfers, they need to strengthen their laws, by, for example, by ensuring that “immovable property” is adequately defined and extending taxing rights into multi-tiered structures.

- In a relatively short section on interest deductibility, the paper notes that this is also an area of particular concern and that restrictions can be “relatively straightforward” and have considerable potential for addressing avoidance through debt shifting.

- Regarding the arm’s length principle, the paper defends this in principle, before arguing that it is difficult to operate in practice. Here the recommendation is for a comprehensive agenda covering anti-avoidance rules, more detailed guidance, improved public data availability and capacity building.

More radical suggestions

The report closes with a run-through of the possible alternatives to the existing international architecture, focusing on:

- Minimum domestic taxation as a means of bolstering the tax base of developing countries by charging tax on measures “less subject to manipulation than taxable income.” While noting such schemes can lead to complexity and distortions, the report highlights that they nevertheless offer a possible response for developing countries.

- The trend of a move away from worldwide and toward more territorial systems of taxation, arguing that territoriality can amplify profit shifting and intensify tax competition, causing particular concerns for developing countries. It argues that spillovers are likely to be less frequent under a worldwide tax system (without deferral). In what may be a hint of its focus in the future, the IMF paper notes that tough controlled foreign company rules can be a close substitute.

- In what might be a blow to the European Commission, the paper is relatively lackluster on the options of formulary apportionment. It argues that such a system (as forms the European Commission’s proposal for a common consolidated corporate tax base) is seen as an alternative that might be attractive to developing countries, but is beset by difficulties around weightings and definitions and general operation. Again, focusing on the practical aspects of international taxation, the paper comments that in any case such a system is unlikely to be adopted internationally.

- There is a more positive approach taken to Formulary Profit Split, which might offer a hybrid approach combining the best aspects of formula apportionment and arm’s length principles.

- The IMF paper also comments briefly on the radical suggestion of a destination-based corporate tax, which is somewhat akin to VAT. It argues that this has the very strong appeal of having only minimal cross-country spillovers, but says that there are a number of unresolved issues (including the treatment of services and consistency with the WTO prohibition on direct tax equivalents of export subsidies).

Impact?

So what is the significance of all this? On one level, this report revisits some familiar BEPS issues, but applies an analytical perspective to explore the issues rather than a political lens to classify and categorize them. Indeed, this report may be seen by some as a critique of the lack of radicalism in the BEPS Action Plan and may offer a rallying point for those who wanted it to go further. For developing countries and their advocates, of course, the report offers a welcome refocusing of the tax competition debate.

In terms of the big picture questions that the report seeks to address, it certainly delivers a clear set of messages on the issues for developing countries and provides an analytical base to support its arguments. On overall economic welfare impact, the conclusions are less clear cut, but the report does enough to lodge this as an issue that needs to be returned to, and suggests doing so in the IMF’s consultations with tax authorities.

In a field where we have seen a fair amount of institutional competition between the OECD and the EU to set both the standard and the pace of change in international taxation, the IMF has flexed its analytical muscles. It has drawn on its deep well of experience through its technical assistance program and has suggested that the debate so far is only addressing part of the question.

What impact will this report have? It’s hard to say quite yet and the underlying analytical basis for the IMF’s conclusions will no doubt receive much scrutiny. But it is clear that anyone with an interest or a stake in the BEPS process, or in the tax and development discussion, could do worse than to spend awhile getting behind the headlines of this report.

A second part of the Report will be made available to the G20 DWG in September 2014 and will describe how the DWG can assist developing countries to address the challenges posed by BEPS.

The Report states that the G20 had directed the OECD to develop a report identifying the main BEPS challenges in developing countries and determine how these challenges relate to the OECD/G20 BEPS Action. It was compiled based on consultations with developing countries and the experience of international organizations in working with developing countries.

The OECD consultations identified that BEPS reduces resources available to developing countries, especially countries that disproportionately rely on tax revenue from multinational corporations (MNCs). It also states that BEPS undermines the effectiveness and credibility of developing countries’ tax systems. The Report notes that the BEPS challenges faced by developing countries may be different in both scale and nature than those faced by developed countries. Therefore, BEPS measures for developing countries may need to be tailored to their particular circumstance.

The Report asserts that while the tax planning strategies MNCs deploy in developing countries may be less sophisticated, legislation in those countries may be inadequate to address BEPS. It also states that it is difficult for tax authorities to gather relevant taxpayer information due to inadequate reporting rules, poor compliance and enforcement, and ineffective processing systems for capturing information. Tax authorities are often resource constrained, leading to inadequate staffing and the inability to retain skilled staff. Many developing countries lack effective procedures for settling tax disputes with large taxpayers related to complex cross-border transactions. Governments also may not have the political support necessary to make legislative changes and deploy resources to counter BEPS. Finally, the Report asserts that, while beyond the scope of the BEPS Action Plan, investment-targeted tax incentives granted to MNCs are eroding tax bases, often with little demonstrable benefit to the granting countries.

The OECD also found that developing countries have identified high-priority BEPS Actions, including excessive and unwarranted payments for intercompany financing, services (such as information technology, legal, management or technical advice services), or intangible property (IP); the contractual shifting of risk and IP in supply chain restructuring to low-tax jurisdictions; the inability to obtain the information needed to assess BEPS risk and hence to take effective action to counter such activity; and treaty shopping. The Report notes there is strong support by several developing countries for some form of a country-by-country reporting template.
Life at the intersection of tax and technology: how technology is entering a new era - and the impact it is having on tax administration

A discussion with members of the Australian Taxation Office

“Technology evolves rapidly and then, just when global and local tax systems start to address the resulting new business models, technology evolves again.” These are some words that Channing Flynn, EY’s Tax leader for the technology sector, said to me a few months ago. Their simplicity describes the very magnitude and impact of the technological transformation that is under way today.

Robert Ravenello
Deputy Commissioner Service Delivery, Australian Taxation Office

David Allen
Assistant Commissioner Internal Engagement and Transparency, Australian Taxation Office

Matthew Hay
Assistant Commissioner, Strategic Program, Australian Taxation Office
Rob Thomas: David, to help us set the context, are you able to share any information about what kind of volume and types of data the Australian Taxation Office (ATO) typically exchanges with any other countries?

David Allen: We’ve been doing a lot of work in the last couple of years on two dimensions of information exchange. The first has been our focus on the requests we’re sending to other countries. We’ve had a program of working with our compliance business lines to ensure that they understand what our treaty arrangements are with other countries and the processes for doing the information exchange. We have managed to increase the overall number of exchanges, which has been very important for us closing our gap of understanding with what is happening with cross-border transactions.

We have also been looking more closely at the value of information exchanges - and, as a consequence, understanding the overall value of the treaty network. For the last financial year we calculated that just under half a billion dollars was directly linked to exchanges with other jurisdictions. The other part of this is that we are working closer with our key jurisdictions. We are building up personal relationships and trying to facilitate requests to Australia as well. (Editor’s note: see table for further information.)

Rob Thomas: As we move from a bilateral, on-request information exchange model to one that is focused more on multilateral and automatic exchange, what kind of impact is that having on the ATO and how are you preparing to receive what could potentially be exponentially larger volumes of data?

David Allen: A lot of our focus has been around the implementation of the Common Reporting Standards (CRS). This week we have got a series of meetings with industry on CRS so we can understand the smartest way to implement. To date, we haven’t fully put our mind to how we are going to use opportunities.

It is fair to say that we have had a traditional focus on domestic third party data - to do things such as verify and pre-populate tax returns. We have also used this data to drive much of our data analytics and our risk assessment methodology. Having a reliable and extensive set of data from offshore allows us to extend our thinking on taxpayer assurance, risk assessment tools and reducing the need for taxpayers to fill in tax returns. So although there has been some blue sky thinking, we are just at the starting line. The challenge is, rather than each tax administration inventing its own analytics tools and algorithms for CRS data, how do we develop a multilateral approach instead?

Australia's information exchange network
Australia has exchange of information relationships with 106 jurisdictions through 45 DTCs, 37 TIEAs. Australia is a signatory to the Convention on Mutual Administrative Assistance in Tax Matters.

On 19 June 2014, the Australian Treasury released a discussion paper, Common Reporting Standard for the automatic exchange of tax information, for comment. The paper follows various actions by the OECD under their BEPS action plan item 5. The discussion paper seeks stakeholder views on timing and financial institutions’ potential implementation and compliance costs, as well as suggestions on how to minimize the implementation and compliance costs.

Australia’s Country Specific and Spontaneous exchanges in relation to the Project DO IT voluntary disclosure regime

<table>
<thead>
<tr>
<th>Country</th>
<th>Incoming exchange requests</th>
<th>Outgoing exchange requests</th>
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<tbody>
<tr>
<td>Cayman Islands</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>China</td>
<td>1</td>
<td>4</td>
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<td>65</td>
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<tr>
<td>United States</td>
<td>17</td>
<td>27</td>
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Sources: OECD Exchange of Tax Information Portal, Australian Taxation Office
Rob Thomas: It’s interesting to see the trend of increasing multilateralism firstly in both information exchange, joint and simultaneous audits. There’s a push for multilateralism in cooperative compliance, and now the possibility of multilateral risk assessment and data analytics.

David Allen: I think that’s right; we’ve not yet come to an answer, but it gives us the opportunity to think afresh about the way we approach risk management. We need to think not where we are today but where we will be in five years, 10 years and 20 years; the world is globalized now, and will be exponentially more so in 20 years.

Rob Thomas: Moving on to the use of data analytics in assessing risk; how do you approach using analytic techniques in the risk-based selection of tax interventions and risk assessments? As the technology changes, and the amount of data that is available to you changes, how are you using data analysis?

David Allen: It’s a very complicated question because we use data analytics in different ways across the organization, depending on the taxpayer segment, the industry and other factors. So it’s a bit of a multi-pronged answer, but I think it is fair to say that we’ve invested heavily in the organization, firstly in tailoring our tax return to capture information that we think is relevant to doing a risk analysis.

We’ve also developed additional schedules to the tax return, to particular market segments where we might have particular concerns or where there’s more complexity. The most obvious one is our International Dealings Schedule which has been completely reworked in the last couple of years and which very much tried to pick up an understanding about what we perceive as risk. We use our data analytics from that information to really try and apply our risk management approach. In doing that we then try to differentiate risks, identifying those areas where we have most concern to which we generally will apply a review or an audit. Risk differentiation also allows us to develop other strategies to support the system including through customer communications, improving participation and nudge-type strategies.

Australia announces “Project Do It” for voluntary disclosure of offshore income

The Australian Taxation Office (ATO) announced in March 2014 an initiative, Project DO IT: Disclose Offshore Income Today. It provides eligible taxpayers the opportunity to voluntarily disclose unreported foreign income and assets before these are identified by ATO activity. The ATO offers significant penalty and other concessions to encourage disclosure, including of structures established by earlier generations. To date (end of July 2014), the project has resulted in 250 disclosures.

Project DO IT is a major opportunity to reduce the risk of penalties, other sanctions and reputation damage which have occurred for some Australian and overseas businesses, families and individuals whose unreported foreign income has been identified by tax authorities. The fast approaching deadline means that taxpayers need to consider whether action is necessary.

Read EY’s full analysis at:
We are seeing this shift in the large business market where we are realigning our focus and resources from post-lodgement audits to real time activity.

In terms of the future, the Commissioner has set as a priority analytics to drive increased level of assurance, increased focus on risk assessment and, more importantly, our move into real time use. One of our biggest risks at present is dealing with issues that happened one, two, three years ago or more. Aged issues present challenges in identifying the parties, following up, getting the right information and collecting the debt.

We are seeing this shift in the large business market where we are realigning our focus and resources from post-lodgement audits to real time activity. As a consequence, we are developing different skill sets, a different way of looking at information and dealing with the taxpayer in real time - and resolving issues in real time as well.

**Robert Ravanello:** I think you’ve picked up the importance of both structured and unstructured data. As we get more sophisticated, unstructured data will become a more important part of our future.

There’s a “sophistication spectrum” for data analytics;
- “Reporting” - what happened
- “Understanding” - why it happened
- “Identifying” - given a known risk, identifying who this might apply to
- “Predicting” - using analytics to find new and emerging risks

As we improve our capability, we will use analytics to identify and prevent issues before they happen. That’s where we would really like to be.

**Rob Thomas:** Could you give me an overview of where the strategy for service delivery is heading and maybe how does technology in particular enable that - particularly for large corporate taxpayers?

**Robert Ravanello:** From a service delivery perspective, our key strategy is to reduce the cost of compliance and move to more contemporary service approaches. The days of paper interactions and the associated long response times are, I think, a thing of the past. People are now looking for real time interactions and greater certainty. It goes to what David said earlier about having that real time analytics to give you certainty.

It’s Government policy in Australia that digital be the default method of interaction. By December 2017, digital options for interactions must be available where there are 50,000 or more interactions per year, so we’re definitely in that group. We have a program of work to identify interactions across all channels - paper, phone, face to face, digital - to prioritize future investments.

It’s not just digitizing what we’ve currently got; we’re looking to re-engineer processes. Sometimes that’s possible within the existing legal framework and sometimes we will be approaching Government to suggest changes to the law so that we can re-engineer processes.

We’ve also started mapping standard charts of accounts to our income tax returns, looking at what return information can be generated from a standard chart of accounts, and where it can’t be generated, what sub-ledgers or what additional breakdown would be required to create information in returns.

By leveraging a business’s natural system, their software systems, we can reduce their cost of compliance and increase certainty.

**Matthew Hay:** I would also echo that for the corporate and business community, we are very much looking to leverage software. As well as doing the work around how we can leverage the chart of accounts in someone’s accounting system more effectively to satisfy tax reporting obligations, we are also progressing an initiative called “Single Touch Payroll,” which is quite similar to, I think, a UK initiative known as “Real Time Information” - again, looking at using the digital environment to enable business to satisfy employer obligations with the tax office at the time of their payroll events, be they weekly, fortnightly or monthly. So from a services perspective, from small, right through to large businesses, a key focus is how we can leverage their natural business systems and natural business process environments to make some of their tax reporting and tax payment obligations a bi-product of what they are already doing in running their business.

**Robert Ravanello:** There’s another point in relation to “Single Touch Payroll.” The social welfare system in Australia is dependent on knowing the income details of citizens. Real time income reporting will remove the need for citizens to notify changes in salary and wage income, resulting in more accurate payments, reducing under- and overpayments.

**Rob Thomas:** A great point to end on - the ATO is playing its part in joined-up Government, making the Australian economy more efficient!
Replay EY’s global tax webcast: 2014 tax risk and controversy survey highlights

Tax risks are rapidly increasing year-on-year. Reputation risk, the OECD’s Action Plan on BEPS, complex new national legislation and more robust tax enforcement worldwide are all putting greater pressure on tax function resources, processes and technology.

These are the main findings in our report Bridging the divide, drawn from responses from 962 tax and finance executives in 27 jurisdictions who took part in our 2014 Tax risk and controversy survey.

A panel of professionals explored the challenges revealed in the survey and gained insight into some of our key findings:

- A 21% increase in more frequent and aggressive tax audits for large multinational companies
- Far greater focus by tax authorities on cross-border transactions
- Signs that some countries see the OECD’s BEPS project as a reason to change their enforcement approach ahead of any OECD recommendations passing into national law
- Concern among the largest global companies regarding media coverage on the taxes they are paying
- Expectations of an increase in tax risks over the next two years, with greater impact on tax function resources and operations

Is your company prepared to meet the new challenges? To find out, replay the webcast at:

A key driver behind the OECD/G20 BEPS project was to change the international tax architecture in unison and thereby reduce risks to international trade. Unilateral action risks creating double taxation, something that the OECD has long sought to avoid.

However, since the Action Plan was published we have seen a range of BEPS-inspired policy changes across the globe and across the broad categories of cross-cutting, coherence, substance and transparency. To some extent, this is to be expected, as the BEPS discussions have helped to ensure a shared understanding of tax risks.

**Action on cross-cutting issues**

We might be forgiven for thinking that Action 1 – on the digital economy – is among the least well suited to unilateral action, given how quickly the sector changes. But at the same time, digital is one of the sharpest political pressure points around BEPS, with key players featuring prominently in the public debate. To date, we have seen various changes, from adopting a broader interpretation of the permanent establishment (PE) rules in countries such as Spain and India, to the consideration of a tax on the purchase of online advertising space in France. This latter idea has not been pursued but the Government has called for the OECD to redefine PE at a treaty level.

**Action on “Coherence” issues**

Going solo on Actions 2 and 4 (hybrid mismatches and interest deductibility) always looked more likely as a number of countries already operate rules in this area. The risk, of course, is that moving first will expose movers to competition from non-movers, with diversions in investment flows. Nevertheless, we have seen unilateral action through tax reform in Mexico which included rules targeting certain interest, royalty and technical services payments to related parties where payments are not taxed. Elsewhere, the Board of Taxation in Australia released a consultation paper inviting comment on whether there can be improvements made to address any inconsistencies between debt and equity rules in other jurisdictions. Proposals in Japan include denying participation exemption of foreign source dividends that are deductible in the source country. And in a show of mini-multilateralism, the EU has amended the Parent and Subsidiary Directive to address hybrids.

Action 3 – strengthening controlled foreign companies (CFC) rules – is another case where the risk of unilateral action exists and we have seen new or strengthened CFC rules coming in across a slew of countries including Australia, Chile, China, Greece, Israel and New Zealand. Russia has proposed CFC rules applying to entities in which the Russian taxpayer (individual or legal entity) has an influence or a direct or indirect holding of more than 10%, that are resident in specific “blacklisted” countries.
Action on “Substance” issues

Action 6 covers treaty abuse and we have seen an increased focus here in jurisdictions as diverse as China, Israel and Vietnam (all have issued anti-treaty shopping guidance with strict beneficial ownership criteria). Meanwhile, India has seen an increased focus by tax authorities on claims for treaty benefits. The Mexican Tax Reform also includes a provision that could restrict access to treaties or impose additional administrative requirements.

On the definition of permanent establishments (PE) - Action 7 - there have been national moves in Belgium and the Slovak Republic where the permanent establishment definition has been broadened, including by introducing the concept of a service PE.

There has been a good deal of activity on transfer pricing (Actions 8, 9 and 10), with changes in Poland, Mexico, France, Australia and the Netherlands. While these may not stem directly as a result of the BEPS project, they are generally consistent with its goals. Moreover, the BEPS influence is clear in the generally heightened scrutiny being applied to intangibles, business restructurings and/or high-risk transactions.

Actions of “Transparency” issues

This area of disclosure of avoidance schemes (Action 12) has been one of the quieter areas for unilateral moves, with the French Finance Bill 2014 provisions to introduce an obligation to disclose aggressive tax planning arrangements giving rise to difficulties with the Constitutional Court. Even so, both the Czech Republic (requiring taxpayers to disclose their aggressive tax planning arrangements and setting up a Specialized Tax Authority for large taxpayers to encourage transparency and disclosure) and Canada (with an Offshore Tax Informant Program) have been active in this area.

In contrast, country-by-country (CbC) reporting is an area where there is strong support for multilateral action. While the European Commission has moved forward with the reporting of CbC for banks under CRDIV, countries are waiting for September’s release and the subsequent recommendations on implementation.

Conclusions

What this leaves us with is a very mixed picture where different jurisdictions are moving forward at different speeds and to different destinations. The result may be a whole that is much less than the sum of its parts.

So why is this happening? To a certain extent it was inevitable that, once BEPS had raised the profile of base erosion issues, pressure would build for early action. Faced with this, national governments may well be tempted to go for political wins today, rather than waiting for BEPS actions to gain approval.

But does it really matter?

It does, and potentially quite a lot. If the real value of BEPS lies in its capacity to deliver a coherent, comprehensive framework that will offer certainty to both policy makers and businesses as they navigate their way around the global economy, then a fragmentary approach clearly heads in the opposite direction. This then has two further negative implications. First, it creates an uncertain and unstable climate for business. Second, it could weaken the longer-term prospects for securing multilateral fixes as jurisdictions settle for self-protection rather than wait for collective security. And of course, as was underlined in the recent IMF report on spillovers, national decisions on tax policy can have international consequences.
Committee international
corporate inversions

The Senate Finance Committee hearing on international tax issues on 22 July 2014 was dominated by discussion of corporate “inversions,” as Chairman Ron Wyden’s (D-OR) call to “immediately cool down the inversion fever” was met with a set of parameters by Ranking Republican Orrin Hatch (R-UT). Other senators suggested limiting the deductibility of interest expense for inverted companies given the potential for earnings stripping.

Committee leaders, who had maintained that inversions should be addressed only in tax reform, opened the door to more immediate action in the week running up to the hearing. “Absent tax reform being enacted immediately, what happens if the inversion virus leads to 20 more inversions over the summer?” Chairman Wyden asked during the hearing, adding that there is some speculation that the inversion trend could spread to a wider range of industries.

Sen. Hatch reiterated that he feels there may be steps Congress could take to at least partially address this issue in the interim, but said such legislation should not be retroactive or punitive; should be revenue neutral; should move the United States “towards, or at least not away from,” a territorial tax system; should not enhance the bias toward foreign acquisitions; should not impede overall progress toward comprehensive tax reform; and “should not be inconsistent with our House colleagues’ approach.”

Sen. Chuck Schumer (D-NY) said it is “absolutely critical” to develop and process legislation that goes beyond legislation proposed thus far and restricts the deductibility of interest expense for inverters. Sen. Schumer said he supports the provision in legislation (S. 2360) introduced by Sen. Carl Levin (D-MI) in May to require that more than half of the stock of the merged company be owned by stockholders who were not stockholders of the US corporation in order for the merged company to be treated as foreign for US tax purposes. He has concerns with the bill’s “managed and controlled” provision, however.

Sen. Schumer pushed back against calls to address the issue in reform, saying, “if we wait for tax reform, we’re going to have lots more inversions and ... it’s going to take far too long if we ever get to tax reform at all.”

Sen. Sherrod Brown (D-OH) also expressed concern about earnings stripping with respect to intercompany debt and asked what can be done now to create a “temporary tripwire” that will allow legitimate mergers but prevent arbitrage-driven inversions. Witness Robert Stack, Deputy Assistant Treasury Secretary for International Tax Affairs, pointed to the President’s budget proposals on interest expense, intangibles income, and hybrid arrangements as reflecting the urgent need to protect the US tax base.

Republican Sen. Chuck Grassley (R-IA) pressed Stack on a delivery date for Treasury’s report on inverted corporations mandated under the American Jobs Creation Act, and suggested the report be completed before any new anti-inversion legislation is enacted. Stack could not provide a timetable for the report but nonetheless said it is not necessary to wait given the pace at which new transactions are occurring.

Sen. Grassley said that unlike most transactions in the early 2000s involving low-tax countries, current transactions involve major trading partners with competitive systems and rates – substantive transactions that come with risk and benefits for the companies and involve factors other than taxes. One area that should be studied further is the role tax rules that allow inverted companies to strip earnings out of the United States play in the decision for companies to invert, he said.

Sen. Rob Portman (R-OH) said he fears targeted legislation could “make it even harder to be an American company,” exacerbating the problem, and the United States could end up with a hollowed-out corporate tax base. Rather than a short-term measure, Portman advocated solving the underlying problem through tax reform, but said there must be a push from the Administration. Sen. John Thune (R-SD) also expressed skepticism about short-term anti-inversion legislation and instead advocated reforming the tax code.
The Honorable Dave Camp  
Chairman  
Committee on Ways and Means  
U.S. House of Representatives  
Washington, DC 20515  

Dear Chairman Camp:  

A corporate inversion is a transaction in which a U.S.-based multinational group restructures so that the U.S. parent of the group is replaced by a foreign corporation, typically located in a low-tax country. Such transactions allow firms to reduce their level of worldwide taxation, but in the aggregate, they function to hollow out the U.S. corporate income tax base.  

The President has called for undertaking business tax reform as a way to improve the investment climate in the United States and to support the creation and retention of high-quality American jobs. Short of undertaking a comprehensive reform of the business tax system, there are concrete steps that Congress can take now that would address this urgent issue.  

In recent months, there have been reports of a number of corporate inversion transactions designed to change the tax domicile of a U.S.-based multinational firm with minimal change in its business operations. These transactions involve the purchase of a foreign corporation (generally in a country with a much lower corporate tax rate and generous rules for shifting income between countries), the transfer of tax domicile to the foreign firm's country of incorporation, and the shifting of tax liability for the combined firm to the new foreign tax domicile.  

Recently announced transactions cover a wide range of industries including pharmaceuticals, retail, consumer, and manufacturing. The firms involved in these transactions still expect to benefit from their business location in the United States, with our protection of intellectual property rights, our support of research and development, our investment climate, and our infrastructure, all funded by various levels of government. But these firms are attempting to avoid paying taxes here, notwithstanding the benefits they gain from being located in the United States.  

The best way to address this situation is through business tax reform that lowers the corporate tax rate, broadens the tax base, closes loopholes, and simplifies the tax system. But, even as we work to do that, we should prevent companies from effectively renouncing their citizenship to get out of paying taxes. That is why President Obama included in his Fiscal Year 2015 Budget a proposal to ensure that companies could not change their corporate tax domicile without a change in control of the company itself. Senators Ron Wyden and Carl Levin and Congressmen Sander Levin and Chris Van Hollen have supported this idea in Congress and have put companies on notice that any transaction that takes place after early May 2014 will not have the desired effect of lowering future U.S. tax liabilities. Congress should enact legislation immediately - and make it retroactive to May 2014 - to shut down this abuse of our tax system.  

What we need as a nation is a new sense of economic patriotism, where we all rise or fall together. We know that the American economy grows best when the middle class participates fully and when the economy grows from the middle out. We should not be providing support for corporations that seek to shift their profits overseas to avoid paying their fair share of taxes. I hope that you will support these legislative initiatives to reverse the trend towards corporate inversions.  

Jacob J. Lew  

Identical letter sent to:  
The Honorable Sander Levin  
The Honorable Ron Wyden  
The Honorable Orrin Hatch
Progress toward adoption of several major tax proposals, all of which have been on the Council’s table for several years, remains slow under the Greek presidency. But the picture is very different in the areas of state aid investigations and anti-tax avoidance measures.

11 June saw the European Commission announce that it had commenced three in-depth investigations to examine whether “tax rulings” issued by national tax authorities in Ireland, The Netherlands and Luxembourg with regard to the corporate income tax to be paid by certain companies conflicts with the EU rules on state aid by providing selective advantages to a company or group of companies.

Since September 2013, the Commission has been investigating under EU state aid rules certain tax practices in several Member States, following media reports alleging that some companies have received significant tax reductions by way of “tax rulings” issued by national tax authorities. Tax rulings as such are not problematic: they are comfort letters by tax authorities giving calculated or on the use of special tax provisions. However, tax rulings may involve state aid within the meaning of EU rules if they are used to provide selective advantages to a specific company or group of companies.

The Commission in particular is scrutinizing tax rulings which are used to confirm transfer pricing arrangements. If tax authorities, when accepting the calculation of the taxable basis proposed by a company, insist on a remuneration of a subsidiary or a branch on market terms, reflecting normal conditions of competition, this would exclude the presence of state aid. However, if the calculation is not based on remuneration on market terms, it could imply a more favorable treatment of the company as compared to the treatment other taxpayers would normally receive under the Member States’ tax rules. This may constitute state aid.

The opening of an in-depth investigation gives interested parties, as well as the three Member States concerned, an opportunity to submit comments.

Tax harmonization
Under the Greek Presidency, discussions in the first half of 2014 continued in the Council working group on a number of legislative proposals designed to introduce new harmonized taxes (the Common Consolidated Corporate Tax Base and the Financial Transaction Tax) or to amend existing harmonized taxes (Energy Taxation, the Standard VAT Declaration and the proposal concerning VAT on Vouchers). However, no really significant progress has been made on any of these proposals, although the Council has noted that, in the case of the VAT on vouchers proposal, agreement would be desirable before the introduction of new B2C place of supply rules on 1 January 2015, given the significant use of vouchers for e-service and telecommunication transactions.
Anti-avoidance measures
The picture is somewhat different, however, in the case of those proposals which are designed to reduce possibilities of avoidance, evasion or fraud. As previously indicated in our last EU update, after six years of negotiations, the amendments to the Savings Tax Directive were finally adopted on 24 March. These are intended to plug a number of loopholes in the scope of the Directive, thus preventing certain forms of evasion, and will be a cornerstone of the EU’s legislative structure for implementing the new global standard on automatic exchange of information.

The next stage in the process, which is now well under way, is the negotiation with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, of amendments to the EU’s agreements with those countries to ensure that they continue to apply measures equivalent to those in the EU, particularly in respect of automatic exchange of information. The Commission, which is leading the negotiations, has been asked to report on progress to the Council before the end of the year.

In a similar vein, the Council also adopted on 8 July an amendment to the Parent/Subsidiary Directive that will prevent the double non-taxation of dividends distributed within corporate groups deriving from hybrid loan arrangements. Under the amendment, which Member States must implement by 31 December 2015, the Member State where the parent company is established will refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary. The amendment is part of a broader proposal that the Council agreed to split in order to allow early adoption of the new rule on hybrid loans, while enabling work to continue on the introduction of a common anti-abuse provision. Member States are divided on this latter aspect. More information on the adoption of the amendment can be found in an EY Global Tax Alert dated 20 June.1

Administrative co-operation
Council has not yet reached agreement on two other initiatives designed to enhance administrative cooperation. The first is the proposal to amend Directive 2011/16/EU on administrative cooperation in the field of taxation (the DAC) in order to upgrade and broaden automatic exchange of information in the area of direct taxation, especially for financial income. The intention is to align EU law with the emerging new OECD standard (the Common Reporting Standard). The second is the Commission’s request to be granted a mandate to open negotiations for an agreement between the EU and Norway and Russia, respectively, on administrative cooperation, combating fraud and recovery of claims in the field of VAT.

Tax policy coordination
The Code of Conduct Group
Discussions are continuing on an ongoing basis in the Code of Conduct Group on the rollback and standstill of harmful tax regimes, but no new significant agreement has been reached, particularly in respect of the issue of regimes such as the UK patent box. The Group is also examining ways of tackling undesirable effects of mismatches involving intra-EU hybrid entities.

Base erosion and profit shifting (BEPS)
A new area of EU tax policy coordination has emerged in connection with the OECD’s/G20’s BEPS initiative. The Council has stressed the need for the EU to coordinate its position in order for the EU as a whole to cooperate closely with the OECD and the G20 to develop internationally agreed standards for the prevention of BEPS. Among the areas which are being examined is the interaction between aspects of the EU’s legislative framework (including the EU Treaty Freedoms) and the various BEPS initiatives.

The European Semester
Taxation is one of the key policies monitored through the “European Semester” process - a yearly cycle of economic policy coordination and monitoring of Member States’ progress toward the targets set in “Europe 2020,” the European Union’s 10 year growth and jobs strategy.

Each year, the Semester starts with the publication of the Annual Growth Survey, which sets the priorities to boost growth and job creation for the year to come. The Annual Growth Survey highlights areas of taxation where the Commission considers there is scope for improvement and guides Member States in implementing growth-friendly tax reforms. The 2014 Survey has suggested the following priorities in the field of taxation:

- Broadening tax bases and removing “ill-targeted” exemptions, rather than increasing tax rates. In particular, this priority is aimed at encouraging Member States to move toward a simpler and more efficient VAT system.
- Shifting the tax burden away from labor - in particular for the low-skilled and young workers - toward tax bases linked to consumption, property and pollution.
- Improving tax compliance by combatting fraud and evasion, by coordinating action to tackle tax planning and tax havens, by ensuring greater efficiency of tax administration and by simplifying compliance procedures.
- Reviewing tax schemes which lead to debt bias.

The Semester culminates in late Spring with the adoption of tailored advice to Member States - known as “country specific recommendations.” These are not legally binding but are subject to peer review and monitoring in regular ministerial-level council meetings where individual Member States are called upon to explain why they may not have acted on a specific recommendation. Twenty-two Member States received tax-related recommendations in 2014.

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In this edition, we examine how technology and globalization are having an impact on indirect taxes and on how tax and trade administrations and businesses are dealing with the challenges of the digital age.

Mismatches in the application of VAT to international trade can cause issues of double taxation and unintended non-taxation. We report on the OECD Global Forum on VAT and the adoption of the International VAT/GST Guidelines.

We consider how new VAT rules for the digital sector are being introduced around the world, focusing on the EU and South Africa and the proposals for the digital economy being put forward by the OECD. Pedro Meneguetti, Assistant Secretary for Finance for the Minas Gerais State Finance Office in Brazil, speaks to us about how the state’s tax administration uses data analysis tools to carry out more effective tax audits.

Technology and globalization are rapidly changing how we live and how we do business, making cross-border trade far easier and far more prevalent in all sectors.

And we report on how the South African tax authority (SARS) is using data analytics and sophisticated systems-based audits.

How can businesses respond to these trends? The executive summary of our recent report Managing indirect tax data summarizes our findings on how businesses can respond to the challenge of “big data” to reduce risks and gain valuable insights and control.

We also look at the particular indirect tax management issues that arise in the Asia-Pacific region. Our article sets out some of the indirect tax challenges that companies face while operating in this part of the world, which includes very developed VAT/GST systems (such as in Australia, New Zealand and Singapore) and new and developing systems (such as in China and Malaysia).

We also consider ways that companies can proactively manage indirect taxes to go from dealing with day-to-day operational and compliance issues to incorporating indirect tax planning into corporate strategy.

In our country update section, we outline several developments that may increase taxpayers’ compliance obligations, including the differing opinions about the VAT rules on finance leases in Bulgaria, the impact of missing trader fraud in Russia and the need for bona fide companies to verify their suppliers’ credentials, the possibility that extra dutiable costs may apply to imports into Canada, and the new trade certification rules in Mexico.

Finally, we updated our snapshot map of recent developments around the world. See our articles to find out more, or contact us for in-depth insight on the issues affecting your organization.

Download a copy at

www.ey.com/tax
First to hit the airwaves, in late December 2013, was the OECD’s annual revenue statistics publication2 which in turn flows through into the OECD’s well-respected statistics database which is available on the internet.3

As noted, perhaps the key indicator in the report was that the average tax burden in OECD countries increased by 0.5 percentage points, to 34.6% in 2012. This followed rises of 0.2 and 0.3 percentage points in 2010 and 2011, reversing the decline from 35% to 33.6% between 2007 and 2009. This is still below the most recent peak year of 2007 when the OECD-wide tax revenue to GDP ratios averaged 35%.

The ratio of tax revenue to GDP rose in 21 of the 30 countries for which 2012 data are available, and fell in only 9 countries. The number of countries with increasing and decreasing ratios was similar to that seen in 2011, indicating a continuing trend toward higher revenues.

Between 2011 and 2012, the largest tax ratio increases were in Hungary (1.8 percentage points) and in Greece (1.6 points). Other countries with substantial rises in their tax to GDP ratio between 2011 and 2012 were Italy and New Zealand (1.4 points), plus Belgium, France and Iceland (1.2 points). While the report points out that economic growth fuels growth in tax revenues where the tax regime is progressive, it is interesting to note that the results from many of these countries would seem to mirror the austerity measures which remain in place in a number of jurisdictions. Again, this highlights the importance of understanding where a country is on the policy spectrum and what drivers are influencing the formation of policy.

Among those countries experiencing falls in tax revenues as a percentage of GDP, the largest was in Israel, with a decline from 32.6% to 31.6%. Portugal and the United Kingdom showed falls of 0.5 percentage points – again, perhaps highlighting both the economic fortunes of those two countries during the global financial crisis and their tax policy stance since.

It will be interesting to see whether Israel’s 2014 CIT rate rise from 25% to 26.5% (itself the largest percentage rise among the countries tracked in EY’s 2014 Tax policy outlook) has an impact on future data.

One particular phrase in the report confirms the importance of monitoring the tax policy environment as part of ongoing tax function activities: “Discretionary tax changes have also played a role, as many countries raised tax rates and/or broadened tax bases. Discretionary tax changes played a greater role in a handful of European countries where GDP levels actually declined in 2012.” So in effect, the impact of these discretionary measures was amplified.

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Denmark has the highest tax-to-GDP ratio among OECD countries (48% in 2012), followed by Belgium and France (43.5%). Mexico (19.6% in 2012) and Chile (20.8%) have the lowest tax-to-GDP ratios among OECD countries.

The increase in the United States, from 24.0% of GDP in 2011 to 24.3% in 2012, was lower than that seen in the OECD area as a whole, while compared with 2007 (pre-recession) tax-to-GDP ratios, the ratio in 2012 was still down by more than 3 percentage points in four countries – Iceland, Israel, Spain and Sweden. The biggest fall has been in Israel – from 36.4% in 2007 to 31.6% in 2012.

The tax burden in Turkey increased from 24.1% to 27.7% between 2007 and 2012. Four other countries (Belgium, France, Luxembourg and Mexico) reported increases of more than 1.5 percentage points over the same period. Denmark has the highest tax-to-GDP ratio among OECD countries (48% in 2012), followed by Belgium and France (43.5%). Mexico (19.6% in 2012) and Chile (20.8%) have the lowest tax-to-GDP ratios among OECD countries. They are followed by the United States which has the third-lowest ratio in the OECD region at 24.3% and Korea at 26.8%.

Finally, the report indicates that revenues from personal and corporate income taxes are now recovering, following the sharp falls seen during the 2008-09 crisis period. Data for 2011 - the latest year for which a breakdown of revenues by category of tax is available for all OECD countries - shows that the 33.5% share of these taxes in total revenues remains below their 35.9% share in 2007. The share of social security contributions has increased by 1.6 percentage points, to an average of 26.2% of total revenues.

OECD revenue statistics in Asian countries 2014

A second report from the OECD4 applies OECD analysis methodologies to two non-OECD countries, Malaysia and Indonesia, in order to provide a comparison of their tax structures with two OECD member countries in the Asia-Pacific region (Japan and South Korea).

The report notes that tax revenues as a proportion of national incomes in Indonesia and Malaysia are substantially lower than in Korea and Japan. In 2011 (the latest available year for all countries covered in the Report), the ratios in Indonesia and Malaysia ranged from 12%-16% compared with 26%-28% in the two countries that are OECD members. The OECD average was higher still, at 34.1%.

The tax ratios in this group of four Asian countries have all risen since the year 2000 but they are still lower than the average for OECD countries as a whole. Since 2000, there have been increases of 4 percentage points in Indonesia (9% to 13%) and Korea (23% to 27%) and of 2 to 3 percentage points in Japan (27% to 29%) and Malaysia (14% to 17%). This compared with the OECD average estimated at 34.6% in 2012.

For business, the information on tax structures in this report is of particular interest. Taxes on incomes and profits represent 44% of tax revenues in Indonesia and 71% in Malaysia. This compares with 30% in both Japan and Korea and a 34% average for OECD countries. The relatively high proportion of revenues coming from income and profits in Indonesia and Malaysia is partially offset by the smaller collection of revenues from social security contributions. Within the income and profits segment, revenues from corporations account for 77% of total income taxes in Malaysia and 70% in Indonesia.

European Commission report: taxation trends in the European Union

Rather than just approaching pre-crisis revenue levels, the June 2014 report Taxation trends in the European Union5 highlights the fact that the tax-to-GDP ratio for the European Union6 not only exceeded pre-crisis levels in 2012, but is also set to continue growing in 2013. In 2012, tax revenues as a percentage of GDP increased in 22 EU Member States as well as Norway, remained stable in Cyprus and decreased in six Member States – Portugal (–0.9% of GDP), Slovakia and the United Kingdom (both –0.3% of GDP), Lithuania and Sweden (–0.2% of GDP) and Romania (–0.1% of GDP) – as well as Iceland (–0.5% of GDP).

One of the main reasons for this is set out in the first heading of the very first chapter of the report: “The EU remains a high tax area.”

The report sets out that in 2012 (again, the latest year for which full data are available), the overall tax ratio in the 28 Member States amounted to 39.4% in the GDP-weighted average. This is three percentage points higher than the OECD average, and nearly 15 percentage points of GDP over the level recorded for the US and around 10 percentage points above the level recorded by Japan.

In fact, as the report itself notes, the tax ratio in the EU is high not only compared to those two countries but also compared to other advanced economies; among the major non-European OECD members for which recent detailed tax data is available, Canada (30.4% of GDP in 2011) and New Zealand (31.5% of GDP in 2011) have tax ratios exceeding 30% of GDP, while tax-to-GDP ratios for Australia and South Korea (2011 data) were well below 30% (26.5% and 25.9%, respectively7).

6. The report also includes data for Iceland and Norway, both members of the European Economic Area or EEA.
The importance of consumption taxes is noted in the report data: consumption taxes increased from 10.7% of GDP in 2009 to 11.1% of GDP in 2010 and remained relatively stable to stand at 11.2% of GDP in 2012. This was mainly due to increases in VAT rates in many Member States, resulting in higher VAT revenues, as well as resumed domestic demand in most Member States.

For business, the report notes that taxes on capital in 2012 represented 8.2% of GDP across the 28 Member States, up from 7.9% in 2011 and continuing the upward trend demonstrated since 2010.

The two main components of capital taxes – taxes on the income of corporations and taxes on stocks of capital/wealth have shown a similar upward trend over the same two-year period. The report notes that, since the mid-1990s, corporate income tax revenues have shown a rather variable trend in spite of the steady fall in corporate tax rates. After falling sharply in 2008-09 (in response to the fall in demand), they have since recovered, though not to their 2007 peak. Corporate income tax revenue for across the European Union represented 2.6% of GDP in 2012, compared with the 2007 peak of 3.4%. Unfortunately, the EU report does not report on the composition of each Member State’s tax revenue, making comparisons with OECD data impossible.

Interestingly, the report notes that although Member States raise roughly equal shares of revenues from direct taxes, indirect taxes and social contributions, the more recent joiners to the European Union, with the notable exception of Malta (41.3%), typically display a lower share of direct taxes in the total. The lowest shares of direct taxes are recorded in Croatia (17.1% of the total), Lithuania (18.0%), Bulgaria (18.8%), Hungary (19.2%) and Slovakia (19.7%). All of these countries have, of course, adopted flat rate tax regimes.

### Conclusion

It may be reasonably concluded that continuing economic growth in many parts of the world will drive tax revenue collection forward, as will the ongoing programs that many revenue authorities are putting in place to enhance collection activities. But the actual composition of tax revenues also continues to change in each and every country as governments tweak their tax policies in response to long-term trends, domestic needs and, of course, activities like the G20/OECD’s BEPS project.

Much like the data discussed in these three reports, it will be fascinating to understand the OECD’s own economic analysis of the impact of the BEPS recommendations (under BEPS Action 11 - Development of data on BEPS and actions addressing it) when it appears in 2015, and then to see whether the projected impacts flow through to countries’ own revenue collections in due course. It is a little odd that the economic analysis of the impact of base erosion and profit shifting is coming some months after the first set of recommendations are made on how to tackle it. But that is probably another article altogether ...

For tax leaders in the private sector, the messages in these reports may not be explicit but they are still important - virtually everyone is continuing to adjust their tax policies. Adopting a robust, accurate way to monitor and assess the changes in your key jurisdictions is an important preparation for the journey ahead.
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<tr>
<th>Country</th>
<th>Tax Revenues 2011</th>
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<td>Spain</td>
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Source: OECD revenue statistics database: data extracted on 17 Jul 2014

*2011 is the last year for which full and complete OECD data is available spanning both data points
Australia’s tax system needs work and reform. However, based on recent years’ approaches to reform and the intensely political environment surrounding tax reform, changes are unlikely to come easily. This parallels the experience of various other countries. On 17 June, EY in Australia launched its report “Tax reform: A better way - The case for an Australian Tax Reform Commission.” The EY report focuses on how to improve the processes and institutions responsible for Australia’s tax system to achieve sustainable tax reform. EY recommends an independent Australian Tax Reform Commission, with clear responsibilities and institutional power, to develop and review tax reforms for the governments of the day.

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The EY report is available at

An EY webcast discussing the report is available at:
https://event.on24.com/eventRegistration/EventLobbyServlet?target=registration.jsp&eventid=810727&sessionid=1&key=CC57850B0407884CF0DBADAC76364C05&sourcepage=register
Australia's tax system is a key influencer of Australia’s success as a nation and a society. Many recent reports and presentations, including by Australia's Treasury, highlight that Australia's tax system fails to raise sufficient revenue, fails to support the international competitiveness of Australian businesses, fails to address the growing needs of the states and is beholden to the short-term needs of the electoral cycle.

Without reform of the tax system, the Government faces persistent and ultimately unsustainable budget deficits. A driving factor behind these deficits is the aging population, which will make greater claims on the retirement and health care budgets but contribute less to government tax revenue. The Government announced measures in the 2014-15 Budget to rein in these deficits. However, these appear unlikely to be fully implemented.

Australia’s tax system leans heavily on personal income tax, company tax, and a goods and services tax that excludes many fast-growing categories of expenditure. This tax base gap means the tax burden is borne heavily by some sectors but not by others and also leads to volatile revenue streams. This tax base gap is significant given projected budget deficits for many years in the absence of reform.

With the ongoing globalization of the world economy, Australia’s tax system is failing to support the international competitiveness of Australian business. Tax is an important part of the cost structure (and so competitiveness) of businesses. And tax is also a key factor that international businesses (whether Australian-based or foreign) take into account when choosing where to operate and invest.

On the tax rate side, Australia's personal income tax rates rise higher sooner than many countries in which a global workforce can choose to live. Australia’s company tax rate was well below the OECD average in 2001 but is now well above it, at 30%, versus the 2014 OECD average of 25.2%.

Instead of the desired broad-base: low-rate system, Australia has a narrow-base: high-rate system.

Australia’s tax system has a major challenge for both the state and Federal Governments: the “vertical fiscal imbalance.”

States have significant spending commitments but limited direct revenue streams. They rely on grants from the Commonwealth Government.

This makes for unclear responsibilities for both services and duties. State government incentives are not aligned with the Commonwealth, affecting the delivery, the political will and the capacity to implement tax reforms.

Again, improved tax policy settings could improve the productive and allocative efficiency of the Australian economy. Productivity performance determines the economic well-being of Australians in the long run, and recent productivity performance has been lagging.

So Australia’s tax system needs structural reform. There are constant calls for tax reform from across the community. But Australia lacks a strategic tax reform infrastructure, the “pathway” to achieve reform. The EY paper identifies the gap and recommends action.

Australia’s tax system can arguably be described as “unresponsive.” It has failed to react sufficiently quickly to recent developments in the domestic and international context and the law itself is a tangle. Thousands of pages of applicable rules interact and complicate, muddying the job of the tax system’s administrators and inhibiting their ability to simplify. The problems are compounded by recent over-reliance on tax announcements and inadequate delivery of these. The result is uncertainty for businesses and individuals, affecting confidence and perceptions.

So the tax system needs urgent repair and maintenance just to ensure that it remains fit for purpose.

The Government plans a strategic tax reform initiative, which will lead to a white paper to take to the election in 2016. Working backwards that will see a green paper in 2015 and potentially issues papers seeking public input, to emerge in 2014.

EY hopes that our ideas contribute to the reform process and the ongoing wider debate about Australia’s tax system.

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**Fig 1: Commonwealth and states’ revenue and spending imbalances**

![Graph showing Commonwealth and states’ revenue and spending imbalances](source: Towards Responsible Government, The Report of the National Commission of Audit, Phase One, page xviii)
The current tax reform landscape

The tax reform landscape is crowded with participants: business, the community, advocacy groups, different levels of government and their agencies and political parties.

Politcal support must exist if tax reform is to be sustainable. But it is often in the interests of opposition or minority parties to oppose government tax reforms regardless of their merits.

Australia has many institutions, bodies and committees with a stake in tax reform. These bodies themselves have recognised the need for change.

Tax reform outcomes would be improved if better processes and clearer responsibilities were established, to elicit from interest groups and government entities their views as early and as often as possible.

Lessons from history

The EY report distills many lessons from Australia’s history of tax reform, covering the various types of tax reform, including policy-based reforms focused on revenue raising, reforms focused on achieving behavioral change and the repair and maintenance of existing rules.

These lessons include:
- A long gestation period for tax reform is useful. A significant period of deep public interest and lengthy debate assists successful reform. Reforms introduced “out of thin air” without advance policy consultation tend not to endure. A gestation period is useful to outline the potential reforms, to enable discussion and to build public acceptance of reform. So there is benefit from regular long-term strategic reviews of the tax system where all options are considered, without immediate political pressure to jump to any reform.
- The Resources Super Profits Tax (RSPT) and its successor Minerals Resources Rent Tax were linked to a sharp rise in the price of commodities and a perceived need to “share the benefits” arising from claimed inadequate tax collections from the sector. But the perceived tax gap was not well explained or accepted and the RSPT was undeveloped and introduced without proper consultation, resulting in political and policy turmoil. Those experiences showed that, even if an initially attractive policy is developed, further consultation is needed for the reform to be a success. This confirms the need for robust consultation in respect of specific reform packages.

EY recommends that long-term strategic reviews, with potential “blue sky thinking,” should be performed by and released publicly by a body separate from the operational arms of government, to better involve stakeholders with less political controversy.
- Bundling reforms into packages helps, provided the identification of the winners and losers is credible. A body independent of the operational arm of government can help give credibility to this process without removing ultimate government decision making authority. The tax system needs constant repair and maintenance. The backlog of unlegislated reforms at the 2013 change of government showed the need for a clear process and responsibility for repairs to existing tax law. It highlighted the political, management and governance problems in Australia’s tax reform processes. The list is also a warning not to overreact or overreach: various announcements to deal with apparent anomalies and/or loopholes were overblown, or unworkable, with remedies out of proportion with the problem.

Tax reform: A better way

EY recommends that the Government establish an Australian Tax Reform Commission (the Commission). The Commission could be responsible and accountable to the Government for:
- Regular scheduled whole of tax system strategic reviews
- Consultation on specific tax reform packages and advice to government
- Yearly tax reform maintenance reviews
- Post-implementation reviews of legislation and regulations
EY recommends that the Federal Government encourage the states to support and participate in the establishment and activities of the Commission.

EY is wary of perceptions of “creating yet more bureaucracy.” But recent experience shows the much greater economic cost of inadequate tax reform processes and governance.

**Recommendation 1**

That the Government establish an Australian Tax Reform Commission (the Commission) as the Australian Government’s independent research and advisory body on tax reform matters.

Its role would be to help citizens and governments make better decisions about tax reform. The activities of the Commission should help identify opportunities for consensus and the risks to tax reform. The Commission would seek public submissions from stakeholders, interact with stakeholders at public forums and perhaps accept secondments from stakeholder institutions.

The Commission’s responsibilities should include those currently performed by the Board of Taxation, which has performed well but has no formal status or institutional power. The responsibilities could also include some activities currently performed by the Revenue Group of the Australian Treasury Department.

The Commission would not impinge on the Government’s ultimate decision making authority.

The Commission should be formed as a statutory authority under its own Act, following the models of the Australian Law Reform Commission and the Productivity Commission. It would be an independent entity under the Treasury Portfolio.

Its statutory independence would not only permit frank and fearless advice but encourage public confidence in the quality and impartiality of that advice.
Conclusion

Australia needs fearless, bold tax leadership and needs it now.

An independent, a-political Tax Commission, we believe, is the answer for much-needed tax reform.
Tax has been in the news a lot recently, with coverage of the “fair share of tax” debate over how much corporations pay dominating the front pages of the world’s newspapers. But even the most offbeat of news stories can have a tax angle, as one man who raised more than $55,000 to make potato salad soon discovered.

In July, Zack Danger Brown of Columbus, Ohio, made international headlines for his fundraising effort using Kickstarter, which describes itself as “the world’s largest [crowd]funding platform for creative projects.” (We are not sure if “Danger” is actually his real middle name). Pledges poured in from more than 5,000 people around the world who were promised recipe books, potato salad hats, even a potato salad-themed haiku depending on the amount of money they donated.

But while the story was gaining steam (Brown was interviewed on the US national television show Good Morning America, among others) the tax accountants started calculating – and bickering.

The Tax Foundation, a nonprofit, Washington, D.C.-based organization, soon announced that Brown’s potato salad phenomenon would ultimately cost him US$21,000 in US income taxes. As evidence, it quoted Kickstarter’s own policy, which states:

“In the U.S., funds raised on Kickstarter are considered income... A creator can offset the income from their Kickstarter project with deductible expenses that are related to the project and accounted for in the same tax year. For example, if a creator receives $1,000 in funding and spends $1,000 on their project in the same tax year, then their expenses could fully offset their Kickstarter funding for federal income tax purposes.”

The Tax Foundation concluded, “While the pledges continue to stream in, it’s important to remember there will be a tax bill on any profit Brown retains,” the group reported. Its analysis generated headlines in The Washington Post and Business Insider, among others.

The Tax Foundation claim touched off a bit of debate. “My Advice To Kickstarter Potato Salad Guy: Don’t Write That Tax Check Just Yet,” Forbes columnist and tax lawyer Kelly Phillips Erb wrote in her own blog post. “Here’s the scoop: income isn’t income because Kickstarter suggests that it is,” Erb wrote.

“I would submit that a lot of the folks who are donating aren’t doing so because of the signed jar of mayonnaise,” Erb continued. “They’re doing it because of Brown. Whether they’re paying for goods or services – or just sending in money for a fun cause that has some bells and whistles attached – will make a huge difference come tax time. I suspect that some of these pledges could be considered income but I think there’s a good argument that it’s not all income.”

So intangibles rear their head yet again! And to think most arguments over potato salad revolve around whether to use mayonnaise or salad dressing as the base.

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The percentage of Canadian-initiated cases remained high, at 88% of cases completed in 2013–14, down slightly from the historical high level of 92% of completed cases in 2012–13. Comparatively, the percentage was 88% in 2010–11, 80% in 2009–10 and 83% in 2008–09. These high levels continue through the pipeline, following an increase in the CRA’s international audit resources in the mid-2000s.

Going forward, given the inherent time lag between transfer pricing audits and the completion of the MAP resolution process, the percentage of foreign-initiated cases is expected to increase as other countries – most notably the US – focus more attention on international audits and assign more resources to them. In 2009, the US Internal Revenue Service confirmed its commitment to boosting its international enforcement efforts, and announced it planned to significantly increase the number of agents assigned to the audit of international issues. As US cases work their way through the system, we expect that these additional US resources will begin to impact the MAP program in Canada and become more evident in future program report statistics.

Canada’s MAP report reflects continued improvement

On 9 June 2014, the Canada Revenue Agency (CRA) released its Mutual Agreement Procedure (MAP) Program Report for the fiscal year ending 31 March 2014, covering the period from 1 April 2013 to 31 March 2014. The report provides an overview of the operations of the MAP program, including statistical analysis of cases completed and in progress, covering cases dealing with resolution of double taxation or taxation not in accordance with a bilateral tax treaty.

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Percentage of Canadian-initiated cases remains high

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Continuing improvement in timelines
The time required to complete these Canadian-initiated cases has decreased significantly, again to an average of 22.63 months. This is down from 26.13 months in the prior fiscal year.

This decrease reflects continued improvement in the early-phase evaluation of the Canadian position, which took an average of 3.47 months in fiscal 2013-14, compared to an average of 5.36 months in 2012-13 and 10.43 months in 2011-12. This continued improvement brings the program very close to meeting its target of 12 months to complete the initial phases (acceptance, preparation and evaluation of the Canadian position) and within the overall target of completing negotiation of a case within 24 months for Canadian-initiated cases.

The time to complete foreign-initiated cases increased to 30.9 months from 21.93 months in 2012-13, primarily due to a longer negotiation phase. This variance is likely not significant given the small number of foreign-initiated cases completed in both years, varying negotiation procedures and communication patterns with different competent authorities, and the potential statistical influence of one or two longstanding cases being completed in the year.

Overall, the closing inventory of negotiable cases stood at 257 cases at the end of the fiscal year, up somewhat from 235 cases at the end of 2012-13. With regard to transfer pricing cases, which represent the majority of the MAP cases, the ending inventory increased from 209 in 2012-13 to 232 at the end of the current fiscal year. While the ending inventory of double tax cases was up, almost 19% more files were taken in than in the prior year (127 versus 107) and approximately 7% more cases were completed (105 versus 98).

Few cases not receiving relief from double taxation
Of the 105 cases negotiated with other jurisdictions, two (2%) did not obtain complete relief from double taxation, down from 8% in 2012-13. This rate reflects a traditional level for the program, where rates below 10% have historically prevailed.

In one case, the taxpayer concurred with a CRA Appeals Branch decision, and the other competent authority was not able to grant correlative relief in the circumstances. In the other case, it is reported that the taxpayer did not respond to the competent authority settlement offer. Encouragingly, neither case appears to fall into the category of the respective competent authorities simply being unable to come to an agreement. Nonetheless, these cases particularly exemplify the need for taxpayers to pay close attention to the process and technical requirements of the Income Tax Act and applicable tax treaties as they move through the dispute resolution process, in order to fully protect their rights and maintain the highest probabilities of obtaining double tax relief.

Still silent on arbitration
As in prior years, the report notes the existence of the arbitration feature under the Canada-US treaty. We understand that there have been several cases that have been through the arbitration process so far. While it would have been informative to provide at least general information about the Canadian Competent Authority’s experience in arbitration to date, without breaching the confidentiality provisions of the arbitration process, the report remains silent on that front.

Continuing high volume of non-negotiable MAP cases
The report indicates that the Canadian Competent Authority resolved 2,818 non-negotiable MAP cases, compared to 1,977 in 2012-13 and 813 in 2011-12. Non-negotiable cases are those that do not require the Canadian Competent Authority to negotiate with another jurisdiction, and usually pertain to excess withholding tax, pension issues, capital gains deferral agreements and other items.

The report does not provide an explanation for the continued increase in the volume of these cases, but we understand that it is likely due simply to improved recognition by taxpayers and representatives of the ability to claim a refund of withholding tax in certain situations. The refund analysis for these files is performed by a field office, and the Canadian Competent Authority’s role is generally limited to review of the finding and ensuring the request meets the relevant treaty’s time limits.

TNMM remains the most prevalent methodology to settle transfer pricing cases
Transfer pricing cases represented 84% of the 105 completed negotiable cases. Among completed transfer pricing MAP cases, the transactional net margin method (TNMM) was applied in 47% (35 out of 75 cases where a transfer pricing method was used to resolve the case).

Among these TNMM cases, operating margin was the most commonly used profit-level indicator, in 42% of the 75 cases, followed by total cost plus (4%), Berry ratio (3%) and return on assets (2%). Along with similar results in the APA program, they show the continued attractiveness of the TNMM as a basis to determine transfer prices.

Other methods used to settle cases include cost plus (27%), comparable uncontrolled price or transaction (15%), resale price (4%) and profit split (4%) in descending order of frequency.

These percentages are largely in line with those in previous years.

Summary
While the program continues to experience an environment of government restraint and tight resources, the results in the 2013-14 MAP report indicate continued progress in improving the operations and efficiency of the MAP program. As the primary dispute resolution mechanism for taxpayers to resolve their international disputes, these continued improvements are important and welcomed.

France's tax evolution: slow pace of change continues - but not for tax enforcement

The peaceful climate of the summer vacation season will likely not reach the French Government, beset with budgetary constraints and a tense social environment. In May, the European Commission revealed its forecasts for the French deficit and growth - a deficit of 3.9% of GDP and a growth rate that may be 1.5% lower than the Eurozone average. These figures, unfortunately, were lower than the Government’s own forecasts.

The newly appointed Finance Minister, Michel Sapin, explained this discrepancy as being an underestimate of the effects of the responsibility and solidarity pact, undertaken to face challenges related to the budgetary situation, the functioning of the labor market and external competitiveness. To achieve those objectives, a large number of measures were put in place to simplify the tax system, reduce the tax burden suffered by companies and by lowest income households, while simultaneously fighting against fraud and aggressive tax planning.

New anti-hybrid regulation and its draft regulations

To address concerns around aggressive tax planning, the French legislature has acted ahead of similar OECD work by implementing new “anti-hybrid” financing provisions which were first included in the 2014 Finance Bill. The French Tax Administration (FTA) released draft regulations on these new provisions on 15 April 2014, which were subject to a public consultation process which lasted just two weeks - and in fact, were actually binding on the FTA since the day of their publication.
These provisions introduced in the 2014 Finance Bill under article 212, I (b) of the French Tax Code (FTC) also introduce a new interest limitation rule. The rule provides that interest paid by a French enterprise subject to corporate income tax (CIT) to a related French enterprise or a nonresident related enterprise is no longer tax deductible for French CIT purposes if the interest paid is not subject to tax at the level of the beneficiary company at a rate of at least 25% of the French CIT that would have been due under the standard French rules.

France’s CIT rate: the story continues

When the FTA released the draft regulations, the mostly intensely discussed issue was around exactly what the French CIT rate would actually be for purposes of the provisions. Parliamentary debates clearly indicated that the CIT rate for the purposes of the “anti-hybrid” financing provisions should be 25% of the standard French CIT rate of 33.33%, i.e. 8.33%. This explains the unpleasant surprise experienced when it was learned that, for the Tax Administration (FTA), that notion of the French CIT rate refers to the standard French CIT rate (i.e., 33.33%) increased by applicable additional CIT contributions/surcharges (i.e., a 3.3% social security surcharge and the 10.7% exceptional contribution (surtax)) that is currently in place. This effectively leads to a maximum effective tax rate of approximately 38% (or 34.43% in the case that the exceptional contribution to CIT would not be due). Therefore, the CIT reference rate for the purpose of the minimum taxation test could be equal to either 8.33%, 8.61% in the case where the social security surcharge only applies or 9.5% where the social security surcharge and the exceptional contribution to CIT would apply. It should be noted that the application of the surcharges and additional contributions depends on the turnover of the company. It can therefore be assumed that the effective CIT rate applicable to the company at stake is the one that will be used for reference.

Alongside this difference of views, many professionals voiced concerns around the lack of precision regarding the treatment of interest that must be reintegrated. The issue here is whether they have to be reclassified as deemed dividend and as a matter of fact be subject to a possible withholding tax and to the 3% tax surcharge on distributions.

As well as new subjects for technical discussion, the “anti-hybrid” provisions show the determination of the French authorities to prosecute abuses regarding double exemption situations. Particular attention is given to issues raised by situations at an international level (OECD and European Union) where this issue is also being studied in detail. In this context, France has been leading the way, but its new provisions will need to be tested to confirm their compatibility with future recommendations made by these institutions. This international commitment highlights the need to preserve the tax base at a critical time for public finances.

An additional transfer pricing documentation obligation

On 8 December 2013, the French Government adopted a new, additional transfer pricing documentation requirement, codified under Article 223 quinquies B of the French Tax Code, obliging certain taxpayers to file a “reduced” – but mandatory – transfer pricing documentation within six months of the official deadline for filing their tax return. More recently, the deadline was postponed to 20 November for companies whose financial year ends on 31 December.

The new law applies to all tax returns filed after 8 December 2013 and thus in practice applies to multinational companies eligible to Article L13AA of the French Procedure Tax Code (with notably the €400 million thresholds of total net sales before taxes, or total gross assets or companies hold directly or indirectly by a company above these thresholds) and that have a financial year ending 30 September 2013 or thereafter.

There continues to be great uncertainty surrounding this new obligation, as no official tax return form nor any formal guidance have been issued by the French Tax Authorities. This uncertainty was allayed to a certain degree in June 2014 when the FTA released an unofficial and draft version1 of the new tax return form to professional organizations with the stated objective of seeking comments from industry.

In addition to a general description of the group, taxpayers will have to provide specific information regarding the French entity, specifically a presentation of the transfer pricing methods used for determining arm’s length transfer prices and a summary of changes that occurred in the last fiscal year.

Even if these obligations do not require detailed functional or economic analyses (as information may already be available in the companies’ “general” transfer pricing documentation), the draft version of the tax return form casts major doubts over issues as crucial as the language it should be written in. Indeed, it specifically states that the information should be submitted in French, whereas the “general” transfer pricing documentation may be submitted in English and doing so does not expose the taxpayer to penalties. Therefore, in addition to the administrative costs this new obligation creates, there may be some additional compliance costs incurred.

The introduction of this “reduced” contemporaneous transfer pricing documentation requirement should be regarded as a new risk assessment tool being rolled out by the FTA. In addition, as tax returns can be filed three years (or more) before they are subject to audit, taxpayers are advised to consider the link that will be made by the FTA between this new Transfer Pricing Statement, which is submitted with or shortly after the tax return, and the Transfer Pricing Report, which is handed over in case of tax audit only.

Reduction of the tax burden, simplification of the tax code: the draft of Amended Finance Bill and the Amended Social Security Financing Bill for 2014

French Parliamentarians have not been idle as the summer season approached; an active debate has been taking place in regard to the Draft Amended Finance Bill for 2014. This bill should be seen as part of the “Responsibility and solidarity pact” strategy, with the repeatedly expressed objective to lower the tax burden for companies and lowest income households.

Adopted as first reading 1 July 2014 by members of the National Assembly and recently rejected by the Senate (the National Assembly will have to review the draft but has final word in case of disagreement with the Senate), the bill contains a number of important measures.

The first significant package of measures is relative to an increase of fines incurred in several cases, all related to the standardization of accounting practices. The first fine relates to failures to submit the appropriate format of computerized accounting data. In such a case, the fine incurred would jump from €1,500, as currently applicable, to €5,000 or up to 10% of the tax reassessment, when applicable. The second relates to failures to submit cost accounting or consolidated financial statements within a tax audit of the accounting records. In that case, the fine incurred, with more than a tenfold increase, would be equal to €20,000, compared to just €1,500 currently.

A second significant package includes proposals to reduce several contributions, mainly within the draft of Amended Social Security Financing Bill for 2014. Firstly, implementing one of the announcements of the “Solidarity pact,” the draft bill provides for a reduction of the social solidarity contribution that would be applicable for the contribution paid in 2016, based on the turnover derived in calendar year 2015. Companies with a turnover exceeding €760,000 are currently subject to this contribution of 0.16% assessed on their turnover. The proposed reduction would take the form of a €3,250,000 basis rebate applied on turnover that would lead to a reduction of the social contribution by €5,200 for companies with a turnover exceeding this threshold.

In essence, the measures provided by the draft law on social security contributions due by employees on salaries should exempt companies from paying most contributions on salaries equal to the minimum wage, starting 2015.

As the set of measures laid down by the “Solidarity pact” cannot be implemented all at once, the explanations under the draft Amended Finance Bill confirm that, as announced by the Government in April, the standard CIT rate will be reduced from its current rate of 33.33% to 28% in 2020, with an intermediate step in 2017.

Despite all these proposed changes, it is already possible to forecast a new evolutionary path for the French tax landscape as soon as the end of this year. Indeed, with the latest economic expectations anticipating that the budget deficit and growth rate targeted by the French Government will not be reached, it is very likely that year-end adjustments will be put in place in the Finance Bills of December. “Watch this space,” as the old adage says.
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India's Tax Administration Reform Commission issues first report on tax reform, recommending broad and deep changes

With the objective of recommending fundamental reforms exclusively in the area of tax administration and enhancing its effectiveness and efficiency in line with the global leading practices, in late 2013 the Government of India established a Tax Administration Reform Commission (TARC) comprised of senior Government officials and private sector tax professionals under the chairmanship of Dr. Parthasarathi Shome. The first report (Report) from the TARC was made available to the public in June 2014. The Report is comprehensive and expresses an overwhelming need for reform in India's tax administration; it also contains various recommendations to achieve the desired tax reforms. These recommendations are the result of extensive discussions with a wide range of groups and stakeholders.

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Efforts undertaken in the past to improve tax administration in India have typically been limited in scope and targeted at immediate requirements. The focus has more often been on revenue collection, and the need to fundamentally reform the tax administration was ignored. In fact, there has been no comprehensive, in-depth reform in India’s tax administration in many years. The TARC was, therefore, established to examine and review the application of tax policies and tax laws in the context of global leading practices and to recommend measures that would enhance the effectiveness and efficiency of India’s tax administration.

The TARC has issued a detailed Report that discusses the current status of tax administration in India, highlights the global leading practices and offers recommendations that are suited to the Indian context to make the administrative machinery more responsive and efficient. The Report spans almost 600 pages and extensively discusses the need for customer focus, concerns on structure and governance of the tax department, people function, dispute management and resolution, internal business processes and use of information and communications technology (ICT).

**Customer focus**

The Report recognizes that one of the core functions of any tax administration is not only to help taxpayers comply with their obligations but also to make them feel like “valued customers” who are being treated professionally with respect and fairness. However, this is not the current state in India. For example, taxpayers currently have to approach a number of different departments for registration of different activities or functions, all of which result in the issuance of various identification numbers. There is no dedicated taxpayer service structure and taxpayer services are delivered in a diffused manner.

To improve the experience of taxpayers and to align the taxpayer services with prevailing leading practices, the TARC recommends the following:

- Creation of a dedicated organization, resources and personnel to deliver taxpayer services with customer focus. Such services would be delivered jointly under one umbrella, i.e., apex boards of direct taxes (Central Board of Direct Taxes or CBDT) and indirect taxes (Central Board of Excise & Customs or CBEC) for large taxpayers. For other taxpayers, i.e., medium and small, the operations of the apex boards (Boards) can continue separately.
- More specialized and intensive training for the officers and staff of the tax administration in order to improve customer orientation.
- A minimum of 10% of the tax administration’s budget should be allocated toward ICT-based taxpayer services. Sufficient funds must also be allocated to conduct customer research and surveys.
- With respect to taxpayers’ grievances, the decision of the ombudsman should be binding on tax officers. It is recommended that non-Government professionals should also be inducted into such post.
- The other TARC recommendations for enhanced customer focus are: providing pre-filled tax returns to all individuals, who would have the option to accept or modify the return; seeking regular stakeholder consultations on tax issues; enabling taxpayers to track online the status of their application of refund/grievance under a central system generating a unique identification number; and continuous benchmarking of tax administration in relation to taxpayer services.

**Structure and governance of tax administration**

While the two current tax boards (CBDT and CBEC) and the respective departments under them have broadly similar structures and processes for their governance, they work independently of each other. There is no synergy between them, either in data sharing or in carrying out key functions where such synergy would result not only in value to the departments and taxpayers but also in elimination of duplication of work and infrastructure.

The TARC, therefore, recommends that:

- The two Boards work to achieve better tax governance and, in the next five years, move toward a unified management structure with a common Board for both direct and indirect taxes called the Central Board of Direct and Indirect Taxes (CBDIT).
- Functions such as human resource management and vigilance, finance, ICT, infrastructure and logistics and compliance verification can also be covered under the unified management structure.
- The integration can begin for the large business segment by setting up a large business service (LBS) unit which can be integrated and operated jointly by both Boards. The two Boards would be responsible only for policy dimensions of tax administration, while the directorates under them would be responsible for operations in the field formations.
- A functional orientation to promote specialization.
- A common approach for developing a robust and comprehensive enterprise risk management framework is recommended to be adopted by the two Boards.
• There should be one Knowledge, Analysis and Intelligence (KAI) center for both Boards and its role should be recognized and used for policy and operational effectiveness.

• The tax administration should have functional and financial autonomy and independence from Governmental structures, given its special needs. To achieve this, various independent councils or units, such as the Governing Council, Independent Evaluation Office, Tax Council, Common Tax Policy and Analysis unit and KAI center should be set up. The post of revenue secretary is recommended to be abolished with the respective functions allocated to the two Boards so as to empower them to carry out their assigned responsibilities efficiently.

• All regulation and tax policy measures such as exemptions, are mandated to be reviewed periodically to see whether they remain relevant to contemporary socio-economic conditions. This requires robust processes which need to be institutionalized. As a first step, a thorough review of the existing rules, regulations and notifications is recommended. Going forward it should be a standard practice to build a sunset clause into each rule, regulation and notification.

People function
The TARC report recognizes a wider need to facilitate better understanding among tax officers of complex business transactions. In this regard, the following recommendations are made:

• It is imperative to train tax officers and staff and to encourage them to specialize in specific tax areas. Further, specialization in other areas, such as dispute resolution, taxpayer services, human resource, finance, tax analysis and ICT management, is also recommended to render services to high-quality tax intermediaries and taxpayers.

• A carefully designed recruitment and promotion plan and comprehensive performance appraisal process is recommended for an efficient tax administration workforce. There should be a provision for lateral entry of experts in key roles and specialized areas, including on a contract basis for five years.

• All key operations of tax officers are suggested to be shifted to the digital platform to ensure uniform and reliable measurement of their performance.

Dispute management
The TARC recognizes that the credibility of tax administration depends to a very great extent upon the credibility of its dispute resolution mechanisms in terms of how quick, consistent, transparent and fair the dispute resolution mechanism is in the eyes of taxpayers. The quality of tax administration is also influenced by its ability to ensure that avoidable disputes do not occur or are not prolonged. This requires clarity in laws, rules and procedures and adoption of a transparent and collaborative approach toward taxpayers.

In the context of India's current dispute management mechanism, the Report acknowledges the following:

• Members of the two Boards (Central Board of Direct Taxes and Central Board of Excise and Customs) are expected to design policy, but have little policy experience.

• Members’ risk aversion leads to low productivity or low motivation to provide guidance or clarity. Boards’ decisions or pronouncements in the form of legislative changes, binding circulars, clarificatory guidance notes or press releases are few and far between, and even then are under external force.

• Risk aversion permeates down and leads to infructuous tax demands. For example, when an officer is convinced about a demand s/he has made but the Controller and Accountant General’s (CAG) auditor has disagreed with it, the Boards have issued standing instructions that a “protective demand” must be issued by the officer.

• Some taxpayers express helplessness against rude or arbitrary behavior of officers with little assigned accountability in practice.

• There is a complete absence of economic, statistical, behavioral or operations research-based analysis of policy or of taxpayers prior to making major or minor legislative or subordinate legislation-based (rule-based) decisions.

• A blind revenue target causes unjust pressure on good taxpayers. Also, revenue targets have an adverse impact on tax officer equilibrium.

• Wrong use of tax avoidance instruments for revenue generation: ordinarily, transfer pricing examination between associated enterprises should be used as a tool to minimize tax avoidance. In India, transfer pricing measures are used for revenue generation, which comprises a completely incorrect approach. This is revealed through the allocation of revenue targets to transfer pricing officers (TPOs) from transfer pricing adjustments. This is unheard of internationally.

• Lack of accountability in raising tax demands without accompanying responsibility for recovery has led to India experiencing by far the highest number of disputes between the tax administration and taxpayers, with the lowest proportion of recovery of tax, while arrears in dispute resolution are pending for the longest time periods.
• Practically, it has been observed that the Dispute Resolution Panel (DRP) rarely affirms a position different from the one proposed by the AO. Further, the absence of independent experts within the DRP, tight timelines for the filing of objections by a taxpayer and the fact that the DRP is available to only limited categories of taxpayers – cases of international taxation and those of transfer pricing - are some of the issues which curtail the efficacy of the DRP as an alternative dispute resolution forum.

Quoting the (in)famous Vodafone judgement\(^1\) by the Supreme Court which held that Indian tax authorities did not have territorial jurisdiction to tax offshore transactions and therefore that the taxpayer was not liable to withhold the taxes, the Report observes that an overnight change in the interpretation of a provision, which earlier held ground for to rake up settled positions. This approach to retrospective amendments has resulted in protracted disputes, apart from having deeply harmful effects on investment sentiment and the macro economy.

In view of the above, TARC recommends:

• Clarity in law and procedures, timely intervention by the Boards to clarify contentious matters, avoidance of tax demands which are not based upon merit, pre-dispute consultation, and proper control over quality of show cause notices, demands or questionnaires issued to the taxpayers and an approach to resolve conflicts before conclusion of audits.

• Retrospective amendments should be avoided as a principle.

• The fundamental approach should be collaborative and solution oriented.

• A functionally independent structure should be set up for dispute management with adequate infrastructural support.

• To minimize the potential for disputes, clear and lucid interpretative statements on contentious issues should be issued regularly which would be binding on the department.

• The current practice of raising demands irrespective of merits should be discontinued. Pre-dispute consultation should be followed as a practice before issuing a tax demand notice.

• Disputes should be resolved within the time limit specified in enactments and consequences should be provided in case those time lines are not adhered to.

• Ordinarily no appeal should be filed by a tax officer against an order of a commissioner (Appeals), except where the orders are ex-facie perverse. All corporate cases and cases of a complex nature should be decided by a three-member commissioner (Appeals) panel. Other cases should be dealt with by an individual commissioner (Appeals). If the case is not decided within the prescribed time frame, the taxpayer’s appeal would be deemed to have been allowed.

• The DRP in income tax should be comprised of full-time panelists. Their mandate should be expanded to include corporate cases of domestic companies. A similar mechanism should be introduced for dispute resolution in indirect taxes, where a group of three commissioners would decide complex cases involving extended period of limitation, related party transactions and taxability of services. Processes for alternate dispute resolution, arbitration and conciliation should be statutorily introduced in both direct and indirect taxes legislations.

• Settlement Commission should act as part of taxpayer services and be made available to the taxpayer to settle disputes at any stage.

• Appeals to High Courts and the Supreme Court should only be on a substantial question of law. On disposal of a case by High Court, if the judgment is accepted by the department and on disposal of a case by Supreme Court, an instruction should be issued to all authorities to withdraw appeal in any pending case involving the same issue.

• Both the Boards must immediately launch a special drive for review and liquidation of cases currently clogging the system by setting up dedicated task forces for the purposes. This task force would be required to review and liquidate all cases pending in departmental channels for more than a year. This one-time exercise should be completed within a period of one year.

\(^1\) Vodafone International Holdings BV vs. Union of India, (2012) 204 Taxman 408/17 taxman.com 202 (SC)
Other internal processes considered

**Scrutiny in direct taxes and audit in indirect taxes**

In all tax cases, hearings by personal presence should be avoided; data can be sought through e-system wherein the taxpayer can upload the data. A personal hearing should be sought only in complex cases. There should be specialization in scrutiny and audit work, capability of people involved being developed through training and re-training. The two Boards should develop a standard audit protocol, with clear emphasis that the assessing officers must follow the principles of natural justice and respect the taxpayer’s right to privacy and dignity.

Audit Commissionerates in the CBEC should undertake an integrated audit, covering central excise and service tax, as well as on-site customs post-clearance audit in the case of accredited clients as the records and books to be verified are common to all the taxes administered by CBEC.

The TARC also recommends assigning the audit function to a specific Audit Commissionerate in major cities for carrying out an integrated audit of customs, central excise and service tax, joint audits by field formations of CBOT and CBEC to shorten the examination processes and reduce costs, and putting in place broad-based selection filters for a risk assessment matrix.

**Refunds**

Refunds should be granted within a strict time frame under a separate budgetary head to ensure transparency and adequate allocation. Refunds should be automatically accompanied with applicable interest. The rate of interest on refunds has to be the same as that charged by the tax department.

Refunds pursuant to a favorable appeal should be paid in time or allowed to be set off against tax liability of subsequent years. Tests to determine unjust enrichment in indirect taxes should be limited to cases involving direct passing on of amounts claimed as refunds. An easier and simplified refund filing and processing mechanism (preferably online) for service exporters has to be introduced.

**Foreign tax credit (FTC)**

CBDT should publish clear FTC guidelines, which should also cover the timing differences between different tax jurisdictions.

**Tax collections**

There should be a separate unit for tax collection. Risk assessment models should be set up to compute risk scores for each new tax debt, reflecting the likelihood of settlement of tax dues by the taxpayer based on objective criteria. Stay of demand information should be uploaded electronically on the central server so that tax collectors can have system-generated prior intimations regarding expiry of stay orders. The power to write off dues at different levels of the organization should be raised with uniform limits for both direct and indirect taxes.
Both the Boards should frame detailed and reasonable documentation requirements for transfer pricing and customs valuation, to bring certainty and predictability for taxpayers. The processes in India should be aligned with global best practices. With self-assessment in place, import transactions should only be subjected to post-clearance audit. Valuation risks would be an important component of the risk matrix for audit selection.

As a trade facilitation measure, on-site post-clearance audit should be developed fully to enable Indian customs to move closer to international best practices. Intervention in the cargo clearance should be made on the basis of a risk matrix. Documentation requirements for issuing a certificate to nonresidents u/s. 197 of the Income Tax Act should be well-publicized. The taxpayer should be told a priori the time that will be taken for the issue of the certificate, which should be reasonable. There should be facility for electronic filing of these papers so that the need for physical presence of the taxpayer is obviated.

There should be a dedicated structure for prosecution matters for more focused attention so that unexploited potential for creating deterrence against tax evasion is realized. The working of the Directorate of Intelligence and Criminal Investigation should be ICT-based with a good complement of personnel and other resources to make it reach its potential.

The above conclusion from the TARC paints a grim picture of tax administration in India. The report contains refreshingly significant recommendations for a “comprehensive” transformation of tax administration that is founded on accountability and recognition of the taxpayer as a “customer.” It brings out that in modern tax jurisdictions, the goal of tax administration is not to maximize revenue but minimize compliance gaps and maximize voluntary compliance.

Too much emphasis on revenue results in multiple disputes which only block revenues and discourage voluntary compliance. The seriousness of rising disputes in India can be judged from the fact that for the financial year ending March 2012, the amount stuck in tax litigation in India for income tax, central excise and service tax at various levels was an astounding INR5,500 billion (approximately US$92 billion). On transfer pricing alone, the adjustments made by the tax department in 2012-13 amounted to approximately US$12 billion. India has the distinction of having the largest number of transfer pricing disputes in recent years, with as many as 4,000 cases being contested in the Indian courts. By contrast, transfer pricing litigation in most advanced jurisdictions is a rarity. In the UK and Japan, for instance, only one or two cases in a year reach the court level.

The TARC Report comes at the right time. It is expected that the new Government, with new thinking, should consider the recommendations with a fresh eye. The TARC recommendations are fully consistent with the mandate of the new Government, i.e., to have a tax environment that is less adversarial and stripped of “tax terrorism,” as the now-Prime Minister himself described the system before the recent election. The Report provides a complete blueprint of the recommendations, which the Committee hope will be considered as a package, and not on a pick-and-choose basis. These recommendations are not unachievable benchmarks, but are doable. All that is needed now is conviction and commitment to reform the system.
India’s Union Budget includes proposals relating to dispute management

The Union Budget for 2014-15 was presented by the Finance Minister on 10 July. Given the current focus on reforming the Indian tax administration and the strong ongoing focus on dispute resolution, it was unsurprising that the Budget contained a range of proposals relating to dispute management.

You can read EY's full analysis of the Union Budget at www.ey.com/BudgetConnect2014

Industry interaction
It is proposed that a high-level committee is set up, to interact with trade and industry on a regular basis and ascertain areas where clarity in tax laws is required. Based on the recommendations of the Committee that drafted the report, the two Boards - Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) - shall issue appropriate clarifications, where considered necessary, within a period of two months.

High-level committee to review retrospective amendments of 2012
A high-level committee will be constituted by the CBDT to scrutinize all fresh cases arising from the retrospective amendments of 2012 in respect of indirect transfers, before any action is initiated in such cases.

Authority for advance ruling
Currently, an advance ruling may be obtained from the Authority for Advance Rulings (AAR) concerning the tax liability of a nonresident. This facility is not available to resident taxpayers, except for public sector undertakings. It is proposed to enable resident taxpayers to obtain an advance ruling in respect of their income tax liability above a defined threshold. It is also proposed to strengthen the AAR by constituting additional benches.

Income Tax Settlement Commission
It is proposed to enlarge the scope of the Income Tax Settlement Commission so that more taxpayers may approach the Commission for settlement of disputes.

Transfer pricing
- APA scheme – With effect from 1 October 2014, it is proposed to introduce a “Roll Back” provision in the APA scheme, so that an APA entered into for future transactions may also be applied to international transactions undertaken in the previous four years, in specified circumstances.
- Range concept – To align transfer pricing regulations in India with leading practices elsewhere, it is proposed to introduce a range concept for determination of arm’s length price. However, the arithmetic mean concept will continue to apply where the number of comparables is inadequate. Appropriate rules will be prescribed in due course.
Multiple-year data – Instead of only one-year data currently allowed to be used for comparable analysis, it is proposed to allow the use of multiple-year data.

Empowerment of transfer pricing officers (TPO) - With effect from 1 October 2014, the TPO will now be an authority competent to levy the penalty, in addition to the Assessing Officer and the Commissioner (Appeals), if any person who has entered into an international transaction/specified domestic transaction fails to furnish any required document/information.

Revision of monetary limits for the filing of appeals

CBDT has issued an internal Instruction to revise the monetary limits for filing of appeals by the Department before Income Tax Appellate Tribunal (ITAT), High Court and Supreme Court. It is clarified that an appeal should not be filed merely because the ‘tax effect’ in a case exceeds the monetary limits prescribed. Filing of appeal in such cases is to be decided on merits of the case.

This instruction will apply to appeals filed on or after 10 July 2014. However, the cases where appeals have been filed before that date will be governed by the instructions on this subject, operative at the time when such appeal was filed.

The revised limits are given below:

<table>
<thead>
<tr>
<th>Appeals in income tax matters</th>
<th>Monetary limit (in Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before ITAT</td>
<td>400,000</td>
</tr>
<tr>
<td>U/S 260A before High Court</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Before Supreme Court</td>
<td>2,500,000</td>
</tr>
</tbody>
</table>

For this purpose, “tax effect” means the difference between the amount of tax assessed on total income and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed (“disputed issues”). However, the tax will not include any interest, except where chargeability of interest itself is in dispute. In case of penalty orders, the tax effect will mean quantum of penalty deleted or reduced in the order to be appealed against.

The Assessing Officer shall calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every assessee.

If, in the case of an assessee, the disputed issues arise in more than one assessment year, an appeal may be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the monetary limit specified.
Japan update: Japanese Government announces plan to lower corporate tax rate to below 30%, while Japanese lower courts deliver controversial decisions involving the application of specific anti-avoidance rules

Japan's tax system continues to evolve as Prime Minister Abe drives home his three-pronged “Abenomics” strategy to bring Japan out of deflation and into economic growth.

On 24 June 2014, the Japanese Cabinet endorsed the “2014 basic policies for economic and fiscal management” (Policy), which includes a plan to lower the Japanese corporate tax rate over several years to below 30%, beginning in 2015. But to compensate revenue losses resulting from the rate reductions, the Government also plans to broaden the tax base by reducing or eliminating certain credits and deductions. Further clarifications are expected later this year.

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CIT rate reduction
The Japanese Prime Minister Shinzo Abe has campaigned and stated that, to be more competitive internationally, the Japanese corporate tax system requires revamping to attract more inbound investments from non-Japanese companies and to retain Japanese companies’ operations in Japan. On 24 June 2014, his Cabinet approved the Policy that includes a plan to reduce the current 35.6% Japanese corporate tax rate over several years to below 30%, beginning in 2015. Although no official announcement has yet been made with respect to an ultimate tax rate, Prime Minister Abe informally indicated the first target rate could be as low as the current German rate of approximately 29.6%.

A one percentage point rate cut is estimated to reduce tax revenues by approximately JPY500 billion (US$5 billion). Accordingly, given current large fiscal deficits, the revenue losses need to be compensated by some other measures. The following items may be considered as means to counterbalance the revenue reductions:

- Repeal of tax incentives in Special Taxation Measures Law
- Reduction of the research and development (R&D) tax credit
- Extension of a net-operating loss (NOL) carry-forward period and a limitation on per year NOL utilization
- Limitation on dividend received deduction criteria for minority investments
- Replacing the more accelerated declining balance method with a straight-line method
- Disallowance of local taxes as taxable deductions
- Revision to the current definition of small and medium-sized companies (SMEs) eligible for tax benefits
- Increase of the reduced corporate tax rate applicable to SMEs
- Partial conversion of income-based enterprise tax to added-value-based enterprise tax
- Broadening applicability and imposition of business scale tax

The ruling party’s tax system research council will address how to implement tax rate cuts and measures to counterbalance lost revenues. Its conclusions will be included in a 2015 tax reform outline that is expected to be released later this year.

Japanese tax administration flexes its muscles on specific anti-avoidance rules

The court held that Article 132-2 would be applied to a case where the formalities of the actions taken by a taxpayer technically satisfy the requirements for claiming a taxable reduction resulting from a corporate reorganization but allowing the taxpayer to recognize such taxable reduction is clearly against the intent and purpose of the tax measures for corporate reorganizations.

On 9 May 2014, the lower court held in another case in favor of the taxpayer by disallowing the Japanese tax authority to apply the anti-avoidance rules under Article 132 of the Corporate Tax Law and allowing the taxpayer to offset its NOL sustained by the parent company against the consolidated subsidiary’s taxable income (the 132 Case).

Both cases have been appealed to an upper court. Due to the nature of the cases, it is also expected a final decision would be made by the Supreme Court.

Background
The Japanese Corporate Tax Law currently contains three specific anti-avoidance rules (SAARs) applicable to: (1) closely held corporations (Article 132), (2) corporate reorganizations (Article 132-2) and (3) tax consolidations (Article 132-3). Effective on or after 1 April 2016, there will be a fourth SAAR provision applicable to income attributable to permanent establishments of foreign corporations (Article 147-2). The SAARs may be invoked when the allowing of actions or transactions taken by a taxpayer would result in an unreasonable taxable reduction.

1. In general, a company with capital of JPY100 million or less is categorized as an SME.
2. Currently the business scale tax is imposed on companies with capital of more than JPY100 million.
The “132-2” Case

A Japanese corporate taxpayer (A Co) acquired 100% shares in another Japanese corporation (B Co) from its largest shareholder. After the acquisition, B Co was merged into A Co and A Co utilized the JPY54.2 billion (US$533 million) NOLs sustained by B Co against A Co’s post-merger taxable income.

Under Japanese Corporate Tax Law, a merger between a 100% parent and its subsidiary is generally treated as a tax-qualified (i.e., tax-free) merger and the NOL of the merged company would be carried over to the surviving parent company. However, if the parent-sub relationship (i.e., more than 50% shareholding relationship) was created within five years prior to the first day of the surviving company’s fiscal year in which the merger takes place, the surviving company would be subject to NOL deduction limitations unless certain conditions are satisfied.

One of the conditions requires that at least one person be appointed as a senior director of the surviving company, who had been a director of the merged company before the “more than 50% shareholding relationship” was created and been engaged in the business of the merged company as a senior director immediately before the merger.

In the 132-2 Case, the formality of the requirement was met by appointing the CEO of A Co as a vice president of B Co approximately two months before the acquisition. The Japanese tax authority denied the NOL deductions pursuant to Article 132-2 on the following grounds:

- The appointment of A Co’s CEO as a vice president of B Co only two months before the acquisition was unusual and irregular,
- The appointment was intended to meet the formality of the requirement solely for purposes of claiming taxable reduction.
- Allowing such action would create an unreasonable taxable reduction.

A Co contended that Article 132-2 could only be applied when a taxpayer’s action was economically unusual and/or irregular, lacking sufficient business purposes other than claiming taxable reduction. A Co argued that Article 132-2 should not be applicable as the CEO’s appointment was supported by the business purpose by having him directly involved in management of B Co.

The lower court stated in its decision that Article 132-2 would be applicable to the cases where:

- Actions are economically unreasonable and/or unusual solely to claim taxable reduction
- A taxpayer follows the strict formality to meet the requirement to avail itself to a taxable reduction resulted from the corporate reorganization, but allowing such taxable reduction is clearly against the intent and purpose of the tax measures for corporate reorganizations, irrespective of whether sufficient business reasons exist.

The lower court held for the Japanese tax authority.
The “132” Case
A Japanese corporate taxpayer (X Co) acquired 100% shares in another Japanese operating company (Y Co) from their parent company (Z Co) and became a parent of the Japanese group companies. After the transaction, Y Co redeemed in several transactions some of its own shares from X Co, causing X Co to recognize tax losses, which created JPY400 billion NOL. Subsequently, X Co elected to file a consolidated tax return with Y Co and other subsidiaries and offset Y Co income against X Co NOL. The Japanese tax authorities denied the NOL deduction by applying Article 132 SAAR. The tax authorities argued that allowing the NOL utilization would result in an unreasonable taxable reduction because interposing X Co had neither business reasons nor substance. Further, tax avoidance motives could be observed in the series of transactions including the share buy-backs.

The lower court, however, sided with the taxpayer based on the following:
• X Co’s existence could not necessarily be viewed as purposeless as X Co functioned as an acquisition vehicle for acquiring other Japanese companies.
• It is difficult to conclude that no proper business reason and purposes existed for interposing X Co between Z Co and Y Co as X Co is a holding company of various Japanese subsidiaries.

Further, the court disagreed with the Japanese tax authorities’ arguments on a lack of proper business reasons and a sole purpose of reducing tax burdens, stating several factors found by the court were inconsistent with the tax authorities’ arguments.

Implications
As both cases involve SAAR applications, they provide insights into the Japanese tax authorities’ interpretations of what may constitute unreasonable taxable deductions related to corporate reorganization. It should be noted that the court’s holding on the 132 Case seems to be mainly based on fact finding arguments.

All told, the overall pace of reform and change in Japan continues to be high. 2014 and 2015 beyond look set to continue this high pace and merit special attention from those with business operations in the country.
From a nonresident perspective, every company, trust or other juristic person must furnish an income tax return if the nonresident, among others, derived “service income” from a source in South Africa. Returns must be filed within 12 months from the date on which the financial year of a company ends. The obligation to file an income tax return is irrespective of whether a double tax agreement (treaty) would provide protection.

It is interesting to note that the requirements for nonresidents to submit tax returns are amended on a regular basis. For instance, the 2013 notice required a nonresident to file a return if it carried on business in South Africa through a permanent establishment. The 2014 notice seems to change that paradigm. The notice is more specific in its reference to “service income,” and it appears that SARS is adamant that taxpayers who derive South African sourced service income should file a return, irrespective of whether or not South Africa has taxing rights over the services income in terms of a treaty. Unfortunately, this constant change in SARS practice creates uncertainty and may catch some nonresidents unaware of pending obligations to file a tax return in a given year. In terms of section 67 of the Act, these nonresidents will also be required to register as taxpayers.

**Intensifying audits**

The change of practice is, however not unexpected, given SARS’ recent intensified audits of permanent establishments for inbound services (outgoing service fees). Recently (June 2014), SARS published a revised draft reportable arrangement list prescribing mandatory reporting of arrangements perceived to have characteristics that may lead to undue tax benefits. Among others, service fees of more than R5 million (approximately US$462,000) will be reportable if the list is promulgated. From

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**Intensifying focus on South African inbound services, proposed international tax changes released for comment**

On 25 June 2014, the South African Revenue Service (SARS), as required by section 66 of the Income Tax Act, issued its annual notice to specific entities to file returns for the 2014 year of assessment. The 2014 notice contains specific language in respect of “service income,” effectively highlighting a key enforcement focus area for SARS in the year ahead.

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1 January 2016, South Africa will introduce withholding tax on service fees. The withholding tax was promulgated, despite the fact that the majority of treaties to which South Africa is a party do not allocate taxing rights to South Africa in respect of service fees when a nonresident does not have a PE in South Africa.

Considered in context, the additional information gathered through tax returns will place SARS in a position to intensify audits of PEs created through services rendered in South Africa. Unfortunately, "service income" is not defined in the 2014 notice; the withholding tax on service fees provisions of the Act defines "service fees" as any amount received in respect of technical, managerial or consulting services. Likewise, the Act does not define when services will be regarded as "sourced" in South Africa, despite providing specific source rules for other income streams. As a result, common law principles established through judicial precedent must be applied to determine source.

**Impacts and actions**

Going forward, it is important that fees received from South Africa are reviewed to determine whether or not they are derived from a source in South Africa and may therefore result in the need to file a return. This analysis would need to be done irrespective of whether there is treaty protection since the treaty will not shield the nonresident from the administrative requirement to file a return. In a trial situation it remains important for the taxpayer to be in a position to demonstrate that there is treaty protection in the event of queries from SARS.

**Proposed international tax changes released for comment**

On 17 July 2014, the Government of South Africa released the Draft Taxation Laws Amendment Bill 2014 (Draft TLAB) for comment. The Draft TLAB contains several amendments applicable to cross-border transactions.

**Transfer pricing**

South Africa currently has a self-assessment system of transfer pricing (including thin capitalization) based on the arm's-length principle. Related party transactions must be recognized on an arm's-length basis. As a secondary adjustment, the tainted value in a transaction that is not arm's-length is currently deemed to be a "loan," which bears notional interest.

Given administrative difficulties of complying with the deemed loan secondary adjustment, the Draft TLAB proposes to substitute it for a "deemed dividend" in specie paid by the South African taxpayer. Unlike ordinary dividends that trigger dividends withholding tax in the hands of the payee, the company paying a dividend in specie is liable for dividends withholding tax. If ratified, this amendment will come into effect on 1 January 2015.

**Interest deduction limitation rules**

South Africa currently has two sets of interest deduction limitation rules. The first are general interest limitation rules which are applicable to all connected party debt, in addition to the transfer pricing rules, while the second relates to the acquisition debt interest limitation rules and are applicable to intra-group reorganizations and liquidation distributions. The acquisition debt rules are already effective; while the general interest limitation rules will only come into effect on 1 January 2015.

In both instances, interest deduction is limited to an amount representing approximately 40% of adjustable taxable income (roughly akin to EBITDA). Provision is made for an increase in the 40% ratio if the repo rate exceeds 10%.

The Draft TLAB contains the following two main amendments to the above limitation rules:

- The adjusted taxable income is amended to exclude the balance of assessed losses from the current year's adjusted taxable income. This will result in a higher adjusted taxable income, thus increasing the base on which the overall limitation interest deduction is calculated.
- The second amendment substitutes the 40% limitation for an adjustable formulary-determined percent, with a ceiling of 60% of the adjusted taxable income. The revised limit is intended to closely align the debt limitation rules with the cost of debt financing in the market, taking into account the average repo rate for the year plus 400 basis points. The prescribed formula is: $A = B \times C / D$; whereby $A$ represents the amount to be determined; $B$ represents the number 40; $C$ represents the average repo rate plus 400 basis points; and $D$ represents the number 10. As indicated, the maximum amount that may be claimed may not exceed 60% of the adjusted taxable income. Whereas the current limitation would roughly permit an interest cover of approximately 2.5, the revised limit increases the permissible interest expense to an interest cover of approximately 1.7.

The above amendments, if ratified, will become effective from 1 January 2015 and apply with respect to interest incurred on or after that date. Despite extensive input from the tax community for the deferral of the general interest deduction limitation given the continuing debate on base erosion and profit shifting in South Africa and globally, National Treasury and SARS seem determined to bring the new rules into effect on 1 January 2015.

With a few months left to the effective date, it is important that connected party interest expenses are reviewed to identify the exposure.

**High tax exemption for CFC income**

Finally, under the current structure of the South African controlled foreign company (CFC) regime, a South African resident has to perform a high tax exemption calculation even if the CFC qualifies for the foreign business establishment (FBE) exclusion. This calculation makes the application of CFC rules even more complex, especially where multiple CFC calculations are at stake.

The Draft TLAB proposes that the net income of a CFC be deemed nil if either the high tax exemption or FBE exclusion is met. Theoretically, a taxpayer that has an FBE will therefore no longer be required to undertake the high tax exemption calculation. If ratified, the proposed amendment will come into effect on 31 December 2014 and apply to years of assessments ending on or after that date.

Comments on the Draft TLAB were requested by no later than 17 August 2014.
Spain releases draft tax reform bill

In 2013 the Spanish Government announced its intention to carry out a reform of the Spanish tax system, to go into effect in 2015 and 2016, with the aim of boosting the Spanish economy. Within this context, on 23 June 2014, draft bills modifying some of the most important Spanish tax laws were released. Following in the footsteps of many other countries, the draft bill gradually reduces the CIT rate from 30% to 25% in 2016 with an interim 28% rate applicable in 2015, while eliminating many tax deductions and other benefits. VAT rates are not included in the bill (despite a change being recommended by the Committee advising the Government) but there are some relevant changes focused on the importation of goods.

As an offset to the rate reduction, the Government proposes to broaden the taxable base by limiting the deductibility of certain expenses, such as the impairment of assets. While the general limitation to the tax deductibility of net financial expenses (30% operating profit) with the minimum deductibility threshold of €1 million is maintained, an additional limitation is proposed for leveraged acquisitions, consisting of a limitation on the deductibility of interest on loans to purchase shares, limited to 30% of the operating profit of the acquiring entity. Rules are included so that such limits apply where the acquired and acquiring entities are merged or join the same tax unity. Under the draft bill’s transitory provisions this limitation could be interpreted so as to affect transactions implemented after 20 June 2014, although it remains to be seen how the final wording of these provisions will be enacted.

It should be noted that, in alignment with the above point, intra-group profit sharing loans are characterized as equity instruments for Spanish tax purposes.
**Participation exemption changes**

In response to the European Commission's request to end the discriminatory taxation of investments in nonresident companies (Case 2010/4111), the Government proposes to extend the current participation exemption regime provided for dividends and capital gains derived from foreign subsidiaries to those derived from Spanish subsidiaries (with a scaled limitation for transfers taking place during 2015 and 2016), replacing the current domestic tax credit to avoid double taxation.

An additional proposal consists of changes to the participation exemption regime, so that this will require: (i) a minimum ownership percentage (5%) or cost of acquisition (€50 million) and a one-year minimum holding period in the subsidiary; (ii) for foreign subsidiaries only, a minimum level of (nominal) taxation of 10% under a foreign corporate tax system similar to the Spanish CIT. The legal presumption pursuant to which the current subject-to-tax test is deemed to be met when the foreign subsidiary is tax resident in a tax treaty country is eliminated. Notably, the draft bill also eliminates the so-called “business activity test” (commonly referred to as the “85/15 rule”) as a requirement to access the participation exemption benefits, but introduces certain additional substance requirements. The proposed rules also introduce a new system for the calculation of exempt dividend and gains derived from multi-tiered structures, where some of the entities within the chain of ownership are not compliant with the participation exemption requirements. These rules also affect ETVE (Spanish international holding) structures. These same proposed changes have also been introduced in the foreign branch exemption rules.

**Transfer pricing**

Amendments introduced in the draft bill regarding the Spanish transfer pricing rules include changes in the related party definition (new 25% participation threshold), removal of the order for the use of the valuation methods and simplification of the documentation requirements for companies with a net turnover lower than €45 million.

**Tax credits**

The investment credit and the profit investment credit are both removed and replaced by a capitalization reserve that reduces the taxable base by 10% of the increase of the company’s net equity in a given year, provided it books a non-distributable reserve for the same amount.

**Net operating losses (NOLs)**

The draft bill amends the rules applicable to the utilization of NOLs, eliminating the current 18-year limitation and establishing a yearly quantitative limit of 60% of the positive taxable base for tax years starting on or after 1 January 2016; current limitations will continue to apply in 2015. However, a minimum €1 million threshold is set, so NOLs up to €1 million will be able to be used with no limits.

**Changes to tax consolidation rules**

In line with the decision issued on 12 June 2014 by the Court of Justice of the European Union (CJEU) whereby it concluded that the Dutch tax consolidation regime is not compatible with the EU freedom of establishment because it does not allow the so-called “horizontal tax consolidation,” the Spanish Government proposes to modify the Spanish tax consolidation rules, which are very similar to the Dutch provisions, to include where two Spanish companies have a direct or indirect, common nonresident shareholder, as long as the latter is not resident in a tax haven for Spanish tax purposes.

**Nonresidents’ Income Tax (NRIT)**

The temporarily increased domestic tax rates applicable to income obtained by non-Spanish tax residents acting in Spain without a permanent establishment (in the absence of applicable reduced tax treaty rates or other tax benefits) are reduced back to the original rates under the reform proposals. In addition, the 24% general tax rate will be progressively lowered to 19% for income obtained by European Union or EEA (European Economic Area) tax residents:

<table>
<thead>
<tr>
<th>Rate</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>General tax rate</td>
<td>24.75%</td>
<td>24%</td>
<td>24%</td>
</tr>
<tr>
<td>Tax rate applicable to EU and EEA residents</td>
<td>24.75%</td>
<td>20%</td>
<td>19%</td>
</tr>
<tr>
<td>Dividends, interest and capital gains general rate</td>
<td>21%</td>
<td>20%</td>
<td>19%</td>
</tr>
</tbody>
</table>
In line with the proposed amendments to the corporate income tax rate, the tax rate applicable to permanent establishments in Spain will be reduced from 30% to 28% in FY 2015 and to 25% from FY 2016 onwards.

The Spanish NRIT rules provide for a 0% withholding tax on dividend and royalty payments made to EU resident recipients, where certain requirements are met. These provisions include anti-abuse clauses that seek to avoid the application of the exemptions in those cases where the ultimate shareholder of the EU recipient is not an EU resident entity and the EU intermediate company is utilized primarily to benefit from the exemption.

The interpretation of the anti-abuse rule applicable to intra-EU dividend payments has generated considerable controversy. The Spanish government’s stated purpose of the legislation is to clarify the requirements which must be met for the exemption on dividend and royalty payments to apply where the EU recipient is majority-controlled by a non-EU shareholder and, at the same time, tighten the scope of cases that can benefit from these exemptions, requiring activity in the EU recipient entity other than holding activity.

As a result of a proposed change in the Personal Income Tax Law, share premium distributions made to non-Spanish resident shareholders may be treated as dividend distributions, in lieu of a return of basis, and therefore be subject to withholding tax under the general rules. Minority (less than 5%) shareholders in listed SOCIMIs (Spanish REITs) will be exempt from Spanish capital gains.

The draft bill also introduces certain amendments in the area of anti-abuse rules that are reflected in the OECD’s Base Erosion and Profit Shifting project. In particular, amendments are included in relation to the tax treatment of hybrid instruments and the Spanish controlled foreign companies (CFC) rules, including, for instance, additional substance requirements in the foreign CFC in order to avoid imputation of foreign low-taxed income.

While not covered in the reform proposals, the 23 May announcement by the Spanish Government that they had approved a bill changing Spanish Company Law is also of great interest and controversy. The bill has the stated aim of improving corporate governance practices of listed companies and, among many other measures, expands the scope of the duties of the board of directors to include the approval of any transaction deemed significantly relevant for tax purposes.

In addition, the bill also places a new range of responsibilities among the non-transferable duties of the board of directors: first, they must determine and manage the company’s tax risk policy; second, they must approve investments or transactions with a high tax risk; third, they must approve the incorporation or acquisition of special purpose vehicles or entities located in a tax haven; and finally, they must be responsible for the determination of the company’s tax strategy.

The bill also puts new responsibilities onto the audit committee; this includes a requirement to supervise the efficiency of the tax risk management control systems, as well as the obligation to inform the board of directors of the incorporation or acquisition of special purpose vehicles or entities located in a tax haven.

Finally, the bill requires that a description of the tax risk management control systems the company has in place must be made in the annual corporate governance report.
**VAT changes**

The draft bill proposes to allow certain importers to defer the payment of import VAT accrued as a result of the introduction of non-EU goods into Spain. Currently, importers are generally obliged to pay import VAT quotas accrued on the importation at the moment when the goods are Customs-released in Spain. The deduction of the quotas is to be made through the periodical VAT returns. It is therefore common that the importers bear a financial effect for the period between the payment and the effective deduction of the quotas.

The new procedure is aimed to correct this VAT inefficiency, in line with the more favorable regimes existing in other EU countries. The definition of “importers” who will be permitted to take benefit of the procedure, however, has not yet been determined and could potentially affect only to certified Authorized Economic Operator (AEO) companies.

In addition, the draft bill also reduces drastically the scope of the application of the VAT warehousing regime which suspends the VAT accrual for many types of goods. According to the draft bill, its use for goods with origin in a non-EU country will be restricted to a very limited variety of goods, such as potatoes, olives, cocoas, coffee, tea, rice, sugar, oil, etc.

**Potential effect on Spanish taxpayers and on international investment structures into Spain**

The proposed base-broadening, deduction-limiting rules, and the inclusion of widened anti-abuse provisions, if the rules are approved as released, will affect current investment structures, both inbound and outbound – inbound, for instance, in relation to the limitation to the deductibility of financial expenses in leveraged acquisitions, dividend withholding tax on dividends for non-EU investors using EU holding companies and on share premium distributions, or in respect of exit planning, since now the proposed rules allow for an exemption on gains also within Spain.

Outbound structures, including ETVE structures, may need to be reviewed in order to assess compliance with the new conditions for the application of the international participation exemption rules, especially on multi-layer corporate structures. Among other parameters, substance, level of taxation (in particular, where treaty eligibility will not be a safe harbor any more) and a new system of tracing of “bad income and gains” may be needed.

From a corporate governance perspective, the new requirements of boards and audit committees have courted much controversy from tax professionals in Spain, placing as they do so many new requirements on boards and audit committees who already have very full agendas.

All of these items will of course need to be closely monitored as the legislative proposals evolve within the parliamentary discussions. While it is not yet clear whether or not the proposals will be enacted during this legislative term and before scheduled elections in 2015, special attention should be paid to actions that may be advisable to take before the new rules enter into force.
Sweden pushes forward with the next phase of comprehensive tax reform

As we outlined in the November 2012 edition of this publication, it has been less than two years since Sweden unveiled a pair of tax proposals that reflect a trend being seen in many countries elsewhere: that of a significant reduction in headline corporate income tax rates (from 26.3% to 22%, effective 1 January 2013), with a corresponding limit on the tax deductibility of interest payments which will cover roughly half the cost of that rate reduction. On 12 June 2014 the Swedish Committee on Corporate Taxation (the Committee) presented a report to the Government, proposing a further set of major corporate tax changes regarding, among other things, the deduction of interest expenses impacted in the 2012 changes.

The report of the Committee to the Government represents the first step in the legislative process and the proposals will need to be presented to Parliament by way of Government bills before the changes can be enacted on 1 January 2016 as suggested. A main proposal was delivered, as was an alternative proposal for the Government to consider.

Under the main proposal, the net of financial costs and financial income would not be deductible. Moreover, the Committee suggests a “financing allowance” amounting to 25% of the taxable income, which would in practice mean a reduction of the corporate income tax rate to 16.5%.

Further, the Committee proposes a new definition of financial costs for tax purposes which is very similar to the definition used in accounting. The term “financial cost” is proposed to include, inter alia:

- Interest and other, direct or indirect, costs for credits
- Loss on disposal and impairment of financial instruments
- Deductible dividends

The definition of “financial instrument” is intended to correspond to the definition used for accounting purposes. The term “financial cost” would comprise interest that is included in rental charges. Thus, the interest element would have to be separated from ordinary rental charges and not only from disbursements under financial leasing agreements, for example. Certain exceptions from the main rule are also proposed:

- In respect of real property rental payments, the interest element would only need to be separated in case of inter-company payments or sale and lease-back transactions.
- A simplification rule is proposed, under which the interest element of the leasing agreement would not need to be separated if the rental period does not exceed eight months, or if the total rental cost does not exceed SEK 300,000 on a group level. The simplified rule would not be applicable in relation to inter-company agreements or, in some cases, rental of real property.
- It is further proposed, as a result of the limitations, that the acquisition cost of assets that are depreciated under the Income Tax Act should not include capitalized financial costs.
- Net financial income and expenses would be able to be offset among affiliated companies which can exchange group contributions.
- Finally, the existing interest limitation rules relating to inter-company debt would be abolished.

**The impacts**

This main proposal aims to treat debt and equity in the same way by denying deductions for both dividends and net financial costs. However, it should be further analyzed to what extent this could imply a lack of neutrality in other ways as the proposal will in some cases favor equity-financed investments over debt-financed investments.

Moreover, the proposed limitation applies not only to interest, but to all financial costs. The reasoning set forth by the Committee is that this route would go further to prevent aggressive tax planning by way of conversion of interest expenses into other types of expenditures.

In practice, the financing allowance provides a reduction of the corporate income tax rate to 16.5%. Credit institutions will not, however, benefit from this rate due to a proposed imputed income computed as 0.24% of total liabilities, and referred to as a new Bank Tax in the media.

**Alternative proposal**

The Committee has also provided an alternative proposal which has many similarities to the main proposal. Under the alternative proposal, however, net financial costs would be deductible with an amount equivalent to 20% of EBIT. This alternative proposal does not include a “financing allowance.” Instead, a reduction of the corporate income tax rate to 18.5% is proposed. In contrast to the main proposal, it would (to some extent) be possible to carry-forward net financial costs. This alternative proposal would also mean that the current interest deduction limitation rules, which have been highly criticized for their complexity, would remain. The Committee's report also contains a range of other proposals impacting business significantly:

- It is proposed that 50% of the existing tax loss carry-forward would be removed. This is a remarkable suggestion and should be further analyzed to determine whether the proposal is at all appropriate in view of the prohibition against retroactive legislation.
- As mentioned above, some financial companies (credit institutions and foreign credit institutions under the Banking and Financing Business Act) would report a taxable imputed income which is intended to neutralize the effects of the financing allowance. Furthermore, it is proposed that interest on subordinated debt should no longer be deductible.
- Non-life insurance companies will be subject to tax on an imputed income, which would be calculated as yield on allocations to contingency reserves.
- Companies would be able to exchange group contributions until the corporate income tax return is filed.

**Next steps and final comments**

Prior to becoming a law, the proposed changes will be sent for consultation to certain organizations, companies and authorities, who may provide input to the Ministry of Finance no later than 24 October 2014. After potential adjustments, a proposal will be referred to the Council on Legislation for consideration (Sw. “Lagrådsremiss”). Depending on the outcome, the Government will present a Bill to Parliament for adoption into law.

Elections will be held later this autumn which in theory could have an impact on the chances of adoption by Parliament, although the largest opposition party seems to have endorsed the proposal. It would, however, not be surprising if we see some amendments to the proposal anyway, since the wide definition of “interest” presumably could cause uncertainties and increased risk for dispute between taxpayers and the Tax Agency. Finally, the removal of 50% of the existing tax loss carry-forward remains under intense debate.
UK heading towards new criminal sanctions for offshore tax evasion

On 19 August 2014, Her Majesty’s Revenue and Customs (HMRC) published a consultation paper regarding its plans to introduce a new “strict-liability” (i.e., no need to prove intent) criminal offense of failing to declare taxable offshore income and gains. The removal of the need to show an intention to evade tax opens up the possibility that individuals could inadvertently fall foul of the new rules and find themselves facing harsh sanctions.

HMRC is seeking views by 31 October 2014 on the design of the new offence, which will be limited to individuals’ conduct in relation to their personal tax affairs. The consultation follows the publication in April 2014 of No Safe Havens, HMRC’s strategy for tackling offshore tax evasion.

A parallel consultation, also launched on 19 August, looks at extending the scope of offshore civil penalties and other sanctions to increase the deterrent against offshore non-compliance. It examines three options: extending the scope of the existing penalty regime for offshore non-compliance; deterring taxpayers from deliberately moving offshore assets to continue evading tax; and updating the existing offshore penalties regime to reflect the new global standard in tax information exchange.
A strict-liability criminal offense

In its consultation “Tackling Offshore Tax Evasion: A New Criminal Offence,” HMRC notes the progress made on international tax transparency. It points to the fact that, since the end of June, financial institutions in the Isle of Man, Guernsey, Jersey, and all the UK’s Overseas Territories with financial centers have been collecting information on UK residents’ offshore accounts to share with HMRC. It also highlights that financial institutions in a further 33 jurisdictions will do the same under the new Common Reporting Standard.

HMRC suggests that if taxpayers do not come forward to clear up their past non-compliance (possibly under time-limited disclosure facilities), or if they continue to fail to comply with their obligations, then they must expect tough consequences. One of these consequences should be the realistic threat of a criminal conviction.

The use of a strict-liability offense means that the prosecution would need only to demonstrate that a person failed to correctly declare the income or gains, and not that they did so with the intention of defrauding the Exchequer. The new offense would carry less serious sanctions than existing criminal offenses, albeit more serious than a civil penalty. HMRC would continue to investigate cases of fraud using existing powers, with a view to ensuring the most serious cases receive the most serious punishment.

The consultation sets out the proposals for a new criminal offense in more detail and asks a number of questions about: the scope of the offense; measures to ensure the proportionality of the offense, including a de minimis threshold; the level of sanction which should be attached to the offense and the need for legal and operational safeguards and defenses.

Strengthening deterents

HMRC believes that criminal investigation and sanctions will play an increasingly prominent role in its response to offshore tax evasion. However it recognizes that the majority of cases are still likely to be investigated and settled through the civil processes.

This includes cases not covered by the scope of the new criminal offense – for example, because the revenue lost is below the qualifying threshold – and cases which, under its published criminal investigation policy, HMRC decides are not appropriate for criminal investigation. HMRC therefore sees the necessity for the civil penalties framework to provide a consistent, coherent and tough deterrent against offshore tax non-compliance.

The current offshore penalties regime has applied to liabilities arising from 6 April 2011. The level of penalty is based on the type of behavior that leads to the understatement of tax, and is linked to the tax transparency of the territory in which the income or gain arises. The 2013 Autumn Statement announced that HMRC would consult on extending the scope of offshore penalties and other civil sanctions to increase the deterrent against offshore non-compliance.

Accordingly HMRC is now seeking views on six options, across a broad range of issues:

- Extending the scope of the existing penalty regime for offshore non-compliance. This would involve extending the principle of increased penalties for offshore matters to include inheritance tax and undeclared income and gains arising in the UK but hidden offshore. HMRC cites inheritance tax as one of the most significant tax regimes avoided through the use of offshore territories and complex structures.
- Deterring taxpayers from deliberately moving offshore assets to continue evading tax. New measures are proposed which are intended to remove the benefit of moving funds to less tax transparent jurisdictions and to strengthen sanctions against this kind of behaviour. The options being considered are a new offshore surcharge (in addition to late-payment interest), an extension of the 20-year assessment time limit and an increase in penalties to reflect the number of times assets are moved. These measures should only apply where the assets are the proceeds of deliberate non-compliance and the movement is in response to the increased tax transparency of the jurisdiction in which the assets were located with the intention of continuing to hide them.
- Updating the existing offshore penalties regime to reflect the new global standard in tax information exchange. Individuals who hold or place the proceeds of tax evasion in a jurisdiction which has not adopted the new standard, with the hope of escaping scrutiny, should face tougher consequences. Although the proposed measures are targeted at tax evasion, the breadth of the proposals means that a range of taxpayers may be impacted by the proposals if they are brought in. While it may be that the Government is willing to consult on the scope of the new penalties, it seems clear that it thinks a strengthening of the penalty environment is needed in some form.

Individuals who consider that they could be impacted by any new rules that are introduced should consider the following questions:

- In terms of any past tax to be paid, do I understand the potential settlement options available and have I fully considered these?
- In terms of possible future tax exposures, do I have a clear understanding of my offshore assets and a record of any advice obtained as to the tax position of those assets?

EY’s Tax Controversy & Risk Management team will be involved throughout the consultation process for these measures.

This represents the latest in the ongoing increase in focus by HMRC on ensuring that it has the powers and sanctions to reinforce the already strong compliance record of the UK. We can expect more of the same in the future.
IRS Large Business & International (LB&I) group issues Competent Authority statistics

On 30 April 2014, the US Internal Revenue Service (IRS) released the *Large Business & International (LB&I) Division Competent Authority Statistics* for the period covering 1 October 2012 through 31 December 2013.¹ These statistics provide an update of the 2012 Mutual Agreement Procedure (MAP) results under the Advance Pricing and Mutual Agreement Program (APMA),² including information on requests received and pending and resolved cases.³

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MAP background

A US citizen or resident can request assistance from the US Competent Authority and its treaty partner when the actions of one or both of the contracting states result or will result in taxation that is contrary to the provisions of the tax treaty. The competent authority process is a remedy to avoid the denial of treaty benefits and to avoid double taxation. Although resolution of an issue through the competent authority procedures may result in full relief from double taxation, the full range of outcomes includes:

- Full relief of double taxation when:
  - correlative relief is granted for the entire amount of the agreed adjustment;
  - competent authorities agree on an amount less than the originally proposed adjustment; or
  - the full adjustment is withdrawn by the taxing authority who originally proposed the adjustment.
- Partial relief of double taxation when the adjustment is not fully agreed on by both countries
- No relief of double taxation when competent authority assistance is denied or a resolution is not achieved

¹. Note that data for prior years was presented on a fiscal year basis but in 2013 the IRS moved to calendar year format. As a result, 2013, being the transition year, covers a 15-month period rather than 12 months as in prior Competent Authority annual reports.
². As of February 2012, the IRS’s Competent Authority and Advance Pricing Agreement (APA) programs were merged into the newly created APMA.
³. APA information is reported separately in the APA statutory report.
The US Competent Authority cannot consider requests involving countries with which the US does not have an applicable tax treaty.

2013 MAP case closings
While the 2013 MAP statistics cover a period three months longer than reported for prior years, the number of cases resolved nevertheless reflects a significant increase relative to past years. In fact, the 2013 figures (159) surpassed the all-time high number achieved in 2010 (146 cases). Interestingly enough, while US-initiated adjustments constituted 17% of the total combined number of cases resolved in 2012, this number jumped to 25% in 2013. This percentage is more in line with the 2009 and 2010 statistics than with the past two years.

Increased US-based adjustments
In 2013, the US Competent Authority received a total of 266 allocation (transfer pricing) cases. Of this total, 218 (82%) of the cases were due to foreign-initiated transfer pricing audit adjustments and 48 (18%) of the cases were due to US-initiated transfer pricing audit adjustments. Foreign-initiated transfer pricing case adjustments were 72% of total cases filed in fiscal 2012. This increase in the percentage of foreign-initiated transfer pricing cases is driven by a flat number of US-initiated cases combined with a steep increase in the number of foreign-initiated cases filed.

Inventory allocation: transfer pricing cases only

| Year         | US initiated adjustments received/ disposed | Foreign initiated adjustments received/ disposed | Year-end inventory
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2009 (12 months)</td>
<td>24/30</td>
<td>134/55</td>
<td>329</td>
</tr>
<tr>
<td>2010 (12 months)</td>
<td>23/31</td>
<td>77/115</td>
<td>283</td>
</tr>
<tr>
<td>2011 (12 months)</td>
<td>25/18</td>
<td>141/119</td>
<td>312</td>
</tr>
<tr>
<td>2012 (12 months)</td>
<td>51/16</td>
<td>130/74</td>
<td>403</td>
</tr>
<tr>
<td>2013 (15 months)</td>
<td>48/40</td>
<td>218/119</td>
<td>524</td>
</tr>
</tbody>
</table>

Greater elimination of double tax/reduced MAP processing time
In 2013, the MAP program eliminated double taxation in the majority of the cases reviewed, whereas only 20% of the case resolutions by adjustment amounts resulted in no-tax-relief for the taxpayer. During 2013, US-initiated competent authority cases were processed in 23.8 months on average, a slight increase from the 2012 processing time of 23.1 months on average. In addition, the average time to process foreign-initiated Competent Authority cases also slightly increased from 26.6 months in 2012 to 26.9 months in 2013.

Processing time on all closed transfer pricing cases (average months)

<table>
<thead>
<tr>
<th>Year</th>
<th>US initiated adjustments</th>
<th>Foreign initiated adjustments</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>29.4</td>
<td>24.3</td>
<td>26.1</td>
</tr>
<tr>
<td>2010</td>
<td>25.6</td>
<td>30.8</td>
<td>29.7</td>
</tr>
<tr>
<td>2011</td>
<td>28.2</td>
<td>27.8</td>
<td>27.9</td>
</tr>
<tr>
<td>2012</td>
<td>23.1</td>
<td>26.6</td>
<td>26.0</td>
</tr>
<tr>
<td>2013</td>
<td>23.8</td>
<td>26.9</td>
<td>26.1</td>
</tr>
</tbody>
</table>

Implications
The highlight of the most recent Competent Authority annual report is the significant increase in the number of MAP cases closed in 2013. Also noteworthy is the number of MAP requests received in 2013, probably influenced by APMA’s recent success in providing relief from double taxation and expediting the processing time for APAs, combined with an increase of foreign-initiated adjustments. The number of MAP requests has been steadily increasing since 2010.

The 2013 competent authority relief statistics reflect positive results in that double taxation was eliminated for 82% of the dollar amount of the total adjustments at issue. In addition, although the total inventory of transfer pricing cases has significantly increased, the average processing time has not increased, both for US- and for foreign-initiated cases.

These positive signs coming from the APMA program reinforce the previously released report indicating the IRS closed a record-high 145 APA cases in 2013, more than triple the number of cases closed in 2011. With the APA process greatly improved and increased efforts to resolve backlog MAP cases with India, continued improvement in MAP processing times and case closure rates are expected in fiscal 2014.
## Corporate income tax (CIT) rates

Table 1. Global CIT rates – largest 50 “economies” or “jurisdictions” by GDP, sorted by tax rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>GDP 2014 (US$ billions)</th>
<th>2014 CIT rate (national statutory rate only)</th>
<th>2014 CIT rate (national and subnational, average)</th>
<th>Worldwide vs. territorial taxation</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>15,653</td>
<td>35.00%</td>
<td>39.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>2,580</td>
<td></td>
<td>38.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>5,984</td>
<td></td>
<td>35.64%</td>
<td>Territorial</td>
<td>The Government has repealed the 10% special corporate reconstruction surtax a year early. The effective corporate tax rate (Tokyo area, including local taxes) will be reduced from 38.01% to 35.64% for taxable years beginning on or after 1 April 2014.</td>
</tr>
<tr>
<td>Argentina</td>
<td>475</td>
<td></td>
<td>35.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>231</td>
<td></td>
<td>35.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>2,425</td>
<td></td>
<td>34.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Venezuela</td>
<td>338</td>
<td></td>
<td>34.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>1,947</td>
<td></td>
<td>33.99%</td>
<td>Worldwide</td>
<td>Rate illustrated is applied to domestic companies, including surcharge and education CESS. Foreign companies pay tax of 43.26% including surcharge and education CESS.</td>
</tr>
<tr>
<td>Belgium</td>
<td>477</td>
<td></td>
<td>33.99%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>3,367</td>
<td></td>
<td>33.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>1,980</td>
<td></td>
<td>31.40%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>1,542</td>
<td></td>
<td>30.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>1,340</td>
<td></td>
<td>30.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>1,163</td>
<td></td>
<td>30.00%</td>
<td>Worldwide</td>
<td>An additional 10% CIT will be imposed on certain profits and dividends from 2014 onwards. Because the tax on dividends would be on the distributing company, there would be no tax treaty protection.</td>
</tr>
<tr>
<td>Nigeria</td>
<td>273</td>
<td></td>
<td>30.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>241</td>
<td></td>
<td>30.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>391</td>
<td></td>
<td>28.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Dominican Republic</td>
<td></td>
<td></td>
<td>28.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guatemala</td>
<td></td>
<td></td>
<td>28.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Norway</td>
<td>500</td>
<td></td>
<td>27.00%</td>
<td>Territorial</td>
<td>Corporate tax rate is reduced from 28% to 27% with effect from 1 January 2014.</td>
</tr>
<tr>
<td>Egypt</td>
<td>255</td>
<td></td>
<td>26.50%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Israel</td>
<td>247</td>
<td></td>
<td>26.50%</td>
<td>Territorial</td>
<td>Increase in the standard CIT rate from 25% to 26.5% effective 1 January 2014.</td>
</tr>
<tr>
<td>Canada</td>
<td>1,770</td>
<td>15.00%</td>
<td>26.23%</td>
<td>Territorial</td>
<td></td>
</tr>
</tbody>
</table>

1. IMF World Economic Outlook Database – September 2012.
<table>
<thead>
<tr>
<th>Country</th>
<th>Tax Rate</th>
<th>Tax Type</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>26.00%</td>
<td>Territorial</td>
<td>Income from business activity acquired by entrepreneurs, private businesses and partnerships (OE) or limited partnerships (EE) with single-entry accounting books is subject to taxation at 26% for income up to €50,000 and at 33% for the portion of income exceeding €50,000. New private businesses and entrepreneurs (business start-up as from 1 January 2013) with income up to €10,000 are taxed at 13% for the first three years of operation. Corporate tax rate for corporations (AE), limited liability companies (EPE) and permanent establishments is increased to 26% (previously 20%).</td>
</tr>
<tr>
<td>China</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Rate for the first €200,000 taxable basis is 20%.</td>
</tr>
<tr>
<td>Islamic Republic of Iran</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>25.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Colombia</td>
<td>25.00%</td>
<td>Worldwide</td>
<td>Reduction of the CIT rate from 33% to 25% except for foreign taxpayers without a branch office or permanent establishment in Colombia. Those taxpayers will continue to be subjected to a 33% tax rate on income and capital gains of Colombian source.</td>
</tr>
<tr>
<td>Malaysia</td>
<td>25.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Algeria</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>24.50%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>24.20%</td>
<td>Worldwide</td>
<td>24.2% top tax rate includes a 10% surcharge applicable to taxable income in excess of KRW20 billion (US$18 million). While headline tax rates are the same in 2013, large companies with taxable income exceeding KRW100 billion will see the minimum tax rate raised from the current 15.4% to 17.6%.</td>
</tr>
<tr>
<td>Thailand</td>
<td>23.00%</td>
<td>Territorial</td>
<td>Thailand recently enacted a two-phased corporate tax rate reduction. Phase one reduction is from 30% to 23% and is effective for accounting periods beginning on or after 1 January 2012. Phase two reduces it down to 20% for accounting periods beginning on or after 1 January 2013 and 1 January 2014.</td>
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<tr>
<td>Portugal</td>
<td>23.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>22.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Vietnam</td>
<td>22.00%</td>
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<tr>
<td>Slovak Republic</td>
<td>22.00%</td>
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<tr>
<td>Switzerland</td>
<td>21.17%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>21.00%</td>
<td>Territorial</td>
<td>Mainstream rate of corporation tax will be 20% from April 2015.</td>
</tr>
<tr>
<td>Russia</td>
<td>20.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>20.00%</td>
<td>Territorial</td>
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</tr>
<tr>
<td>Saudi Arabia</td>
<td>20.00%</td>
<td>Worldwide</td>
<td></td>
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<tr>
<td>Chile</td>
<td>20.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>20.00%</td>
<td>Territorial</td>
<td>Finland cut the rate by 4.5 percentage points as of 2014.</td>
</tr>
<tr>
<td>Poland</td>
<td>19.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Czech Republic</td>
<td>19.00%</td>
<td>Territorial</td>
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<tr>
<td>Taiwan</td>
<td>17.00%</td>
<td>Worldwide</td>
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<td>Singapore</td>
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<td>Hong Kong SAR</td>
<td>16.50%</td>
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<td>Romania</td>
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<tr>
<td>Ireland</td>
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<tr>
<td>United Arab Emirates</td>
<td>0.00%</td>
<td>N/A</td>
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</table>
2014 CIT rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

Figure 1. 2012 Headline CIT rates – largest 50 “economies” or “jurisdictions” by 2011 GDP

Figure 2. “Economies” or “jurisdictions” taxing worldwide income

Figure 3. “Economies” or “jurisdictions” taxing territorially
The trend toward a reduction of statutory CIT rates started with the tax reforms in the United Kingdom and the United States in the mid-1980s, which broadened the tax base (for example, by making depreciation allowances for tax purposes less generous) and cut statutory rates. CIT rates have continued to be cut in recent years, accompanied by various base broadening measures, including limitations in interest (and other business expenses) deductibility, more limited utilization of losses and continuing to restrict depreciation allowances.

The table below shows that statutory CIT rates in OECD member countries dropped on average by more than 7 percentage points between 2000 and 2014, from 32.6% to 25.2% (a further 0.3% decrease from 2012). This trend seems to be widespread, as rates have been reduced in more than 90 countries globally. Within the OECD area, the rate has stayed constant in the United States, as well as in non-OECD countries such as Brazil. Almost 95% of OECD countries have reduced their CIT rates since 2000; only Chile and Hungary have 2014 rates that are higher than their 2000 rate.

A number of countries around the world (Denmark, Dominican Republic, Japan, Finland, Portugal, Slovak Republic, United Kingdom and Vietnam for example) continue to reduce rates in 2014, while other countries (Australia, The Netherlands, among others) seem to have now stretched their tax bases as far as they believe to be competitively and/or politically prudent. In a recent EY study of 61 countries, the number of countries reducing their statutory CIT rates outpaced those increasing it by a factor of more than 3 to 1.

Figure 1. Statutory corporate income tax rates, 2000 and 2014
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## Global Leaders

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## Americas

### Jurisdiction Tax policy Tax controversy

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<th>Tax controversy leaders</th>
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<td>Michael Mundaca</td>
<td>Rob Hanson</td>
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<td>Brazil</td>
<td>Ariel Becher</td>
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<tr>
<td>Brazil</td>
<td>Julio Assis</td>
<td>Julio Assis</td>
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<td>Canada</td>
<td>Greg Boehmer</td>
<td>Gary Zed</td>
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<td>Chile</td>
<td>Carlos Martinez</td>
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<td>Rafael Sayagués</td>
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<tr>
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<td>Fernanda Checa</td>
<td>Fernanda Checa</td>
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<tr>
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<td>Alf Capito</td>
<td>Howard Adams</td>
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<tr>
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