Global Tax Policy and Controversy Briefing
“Get involved is the answer! There is lots of room for involvement. What I have told people about the process is that BIAC has agreed, regardless of membership, to try and gather as full a range of business views as we can do: from everybody who thinks there is absolutely no problem at all and why don’t the governments back off, to those who think actually the whole system is completely broken and we do need something completely new.”

Will Morris,
Director of Global Tax Policy at General Electric and chair of the BIAC Tax and Fiscal Policy Committee
See page 6
Themes and issues

12/ Authorized OECD Approach (AOA) to allocating profits to Permanent Establishments: dealing with national variances in treatment

18/ OECD holds the first Global Forum on VAT

22/ European Union update

32/ Forgotten entities and their cost: the case for corporate simplification

40/ Indirect tax in 2013: with change comes complexity

50/ OECD publishes report on Co-operative Compliance

Country updates

56/ Australia: Base erosion and profit shifting – heightened local activities under way

60/ Canada: The Canada Revenue Agency takes new Approach to Large Business Compliance

66/ India: India’s budget maintains the high pace and volume of change

72/ Russia: An emerging approach to tax administration – a glance into the future of the Russian Federal Tax Service

76/ Thailand: Thailand bets on future growth through bold, competitive moves

82/ United States: Understanding the sequester – what to expect now that the cuts are in effect

88/ Vietnam: Renaissance in Vietnam – how the Vietnamese government is enhancing its tax policies to attract investors

92/ Corporate income tax rates

Global Tax Policy and Controversy Briefing is published each quarter by EY.

Contributing editor
Rob Thomas
T: +1 202 327 6053
E: rob.thomas@ey.com

To access previous issues and to learn more about EY’s Tax Policy and Controversy global network, please go to www.ey.com/tpc or sign up to receive future editions via email by going to www.ey.com/emailmeTPC.

Connect with EY Tax in the following ways:
www.ey.com/tax
www.ernstyoung.mobi for mobile devices
www.twitter.com/eytax for breaking tax news
Without question, a key event since our last edition was the publication of the OECD’s report *Addressing Base Erosion and Profit Shifting* (BEPS) in February, which was followed shortly thereafter by a meeting between the Business and Industry Advisory Committee (BIAC) and the OECD. With the report now in place, the three key areas of focus of the BEPS project – transfer pricing, jurisdiction to tax and countering base erosion – are now clear, and eyes will be upon the July delivery of the OECD’s Action Plan.

Foreshadowed in our last edition and arriving not long after the December announcement of a set of related proposals from the European Commission, the long-awaited BEPS report reflects the view that some elements of the cross-border tax architecture may not have kept pace with changes in global business practices, in particular in the area of intangibles and the development of e-commerce.

The report identifies relevant work that has already been completed by the OECD and states that a holistic approach is necessary to properly address the issue of BEPS, reflecting similar calls in recent months from a number of stakeholders. This balanced, principled discussion is to be welcomed in the light of so much negative media coverage of corporate taxpayers in recent months.

OECD representatives have made it clear that the July document will not contain solutions or recommendations, but rather will lay out the particular technical areas under each of the three work clusters that the OECD intends to pursue over the next one to two years.

As important as the upcoming publication of the action plan is the opportunity for multinational companies to actively engage in the ongoing BEPS debate. ‘Get involved!’ is the answer according to Will Morris, Director of Global Tax Policy for General Electric, BIAC Tax and Fiscal Committee Chair and our interviewee in this edition. Will discusses with us the hopes of BIAC that countries won’t pursue unilateral action in the BEPS area, setting out that “…you can be absolutely certain that if countries start acting unilaterally because they feel that part of their tax base has been taken away, that’s part of a tax base that somebody else in another country will see and tax as well”.

While wholesale action at the national level has not yet occurred, there can be no denying that many countries around the world are continuing to both propose and enact related policy measures and heighten their approach to tax enforcement more generally. Companies we work with tell us that the last 12 months has seen a distinct uptick in the enforcement landscape, which would certainly seem to be borne out by some developments in the area of GAAR and proposals at both the national and supra-national levels for increased disclosure and tax transparency requirements.

Alongside active engagement in the BEPS debate, we now see companies forming their response to change in a number of ways; without doubt, the need for business to monitor and assess potential changes has significantly increased and is reflected by the amount of time we are spending with our clients discussing the unfolding developments and their impacts on business. Many companies are taking the opportunity to review current structures against the potential areas of change in the BEPS project. In fact, as Jo Stobbs and Tom Bottomlee share with us, legacy structures can lead not only to increased risk in this changing environment, but to inefficient use of resources, value erosion and unnecessary direct and indirect carrying costs.

Many companies are also taking a refreshed look at how they identify and manage tax risk and tax controversy in order to ensure that they have the right approach, supported by the right resources, processes and technology. We think this is a sensible approach. While the enforcement landscape continues to intensify, it is worth noting that many countries continue to make efforts to develop their “enhanced relationships” with large taxpayers. Fred O’Riordan of our Canadian practice shares insights of the CRA’s Approach to Large Business Compliance, while Jeffrey Owens brings news of a pilot of the “Horizontal Monitoring” approach to tax compliance in Russia.
Five years on from its introduction, the OECD’s Forum on Tax Administration is refreshing the enhanced relationship concept and has issued a report on its performance, as well as renaming it as “cooperative compliance” at its May meeting in Moscow.

Alongside the OECD, the European Commission has also been busy since our last edition; as Steve Bill reports, mid-February saw the release of a new set of proposals for the European Financial Transactions Tax (FTT). More recently, the FTT has seen an implementation delay. The FTT proposals have been followed by new draft proposals that require greater financial transparency from the banking sector as part of the Basel III package as well as the opening of a consultation on a European Taxpayer’s Code.

Tax, though, remains a national business at its heart, and the spate of recent budgets including those of India, Hong Kong, Singapore and the United Kingdom (where the government secured its long-held desire to reduce the headline rate of corporate income tax to 20%) show just how much change continues to occur. Interestingly, our review of the global tax policy outlook for 2013 confirms that the UK is not alone in focusing on CIT as a core plank of tax competition; of all the tax types, CIT was reported as being the most likely to decrease in terms of tax burden in the coming year, while VAT and GST were shown as the most likely to increase. Of course, business ignores the growing importance of indirect tax at its peril, and Philip Robinson, EY’s Global Indirect Tax leader, shares the results of a new survey, Indirect Tax in 2013.

All told, there has been no let-up in the pace and volume of change since our last edition. And with no doubt more to come as 2013 unfolds, we hope, as ever, that you find this edition of our publication insightful and useful.

News and views from the G8 Summit
As we went to press with this edition, the G8 Summit at Lough Erne was concluding. Read about the tax issues covered in the G8 Communique and Declaration at www.ey.com/G8Tax.
An interview with Will Morris, Director of Global Tax Policy at General Electric and chair of the Tax and Fiscal Policy Committee of the Business and Industry Advisory Committee to the OECD

With the OECD base erosion and profit shifting (BEPS) report now published and discussions under way on potential recommendations for change, we asked Will to share his views on the changing tax landscape and what companies can do to engage in this important debate.
Rob Thomas: Will, thank you very much for spending time with us. Perhaps you could start by sharing some background on BIAC – its objectives, when it was formed, its composition and the process via which it works with the OECD?

Will Morris: BIAC was formed around 50 years ago by the OECD to be the business voice to the OECD, so it has really a semi-official role in the OECD process. The way it is constructed very much mirrors the OECD itself, so there are groups or committees that mirror the committees inside the OECD – a competition group, an environmental group and a tax group, among others. BIAC draws its membership from national federations in the various member countries for example the Confederation of British Industry in the UK and, Mouvement des Entreprises de France (MEDEF) in France, and in some countries two membership organizations such as in India with the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Confederation of Indian Industry (CII). As you can tell from that last comment, in addition to groups from countries which are members of the OECD, BIAC also has members from countries which are not OECD members, and that’s currently very important.

The tax committee, which is the larger grouping, is somewhere between 50 and 60 people, and they meet twice a year in Paris to talk about OECD developments. In the interim it provides input to consultations through comment letters. Our smaller working group mirrors the OECD structure and is referred to as a bureau, which has about 12 members. Again, we try to get a geographical spread, although it is, as the OECD is, a little heavy towards Europe and the US. But we do have members from elsewhere as well, and we are always striving to make sure we get all views represented. We have regular meetings with the OECD secretariat to discuss up-and-coming projects and to try and feed in the business view.

We are also active in reaching out to non-member governments, and in some ways we’re in a better position to do that than the OECD because we have businesses in these countries. Even if we, as business have tax disputes with these countries, they are also interested in inbound investment and so we make sure we meet regularly with them. Over the past couple of years, we have met with the State Administration of Taxation (Chinese SAT), and we are in the process of trying to do something similar in India. We are organizing a meeting in Brazil later in the year in combination with Composite Leading Indicators (CNI), the Brazilian Employers’ Confederation, to meet with the government and to talk about some of these issues.

Chris Sanger: You mentioned that there are a number of observers to the OECD. Do you think that allows it to deliver recommendations that apply more widely than just to the OECD members?

Will Morris: I think it does – the OECD does have the potential to bring in the widest number of people. Jeffrey (Owens, former director of the OECD’s Centre for Tax Policy & Administration) started doing this and Pascal (Saint-Amans, current director of the OECD’s Centre for Tax Policy & Administration) has expanded it. There is outreach not just to the BRICS, but also to the less developed countries through the tax and development project as well as through the Global Transfer Pricing Forum, for example, and the forum on transparency. I was at the Global Transfer Pricing Forum where 120 countries were represented, a powerful, wide range of people. This is not just well beyond the OECD membership but well beyond large country membership as well. I think the OECD provides a unique forum for doing that and that the stereotyping of the OECD as being the rich man’s club, the rich man’s think tank, simply isn’t true.

OECD meets with BIAC on BEPS

On 26 March 2013, the Organisation for Economic Co-operation and Development (OECD) held a meeting with OECD’s Business and Industry Advisory Committee (BIAC) on the topic of base erosion and profit shifting (BEPS). The basis for the meeting was to explore BIAC’s thoughts on a range of issues contained within the OECD’s BEPS report. An alert from EY provides an overview of the key issues discussed at the meeting and the potential impact on topics such as entity and instrument characterization mismatches, transfer pricing, intangibles and the effectiveness of GAAR, CFC and thin capitalization measures.

For more information, visit: www.ey.com/BEPS.
Wouldn’t you rather do it working with the grain of what business does rather than against the grain? Governments are also interested in investment; they’re interested in growth; they’re interested in jobs. So wouldn’t you rather raise your money in a way that affects those things positively than negatively, or at least less negatively?

Chris Sanger: Picking up on stereotyping, what are your thoughts on the coverage we’ve seen in the press arguing that the OECD is too close to business?

Will Morris: I find some of the press coverage strange, from two points of view. The first is that it simply isn’t true. There are many inputs into the OECD process, of which business is but one. We have disagreements with OECD as well as agreements, so this is not about us going in and presenting our agenda and getting what we want. On some projects, we have to make clear our dissatisfaction and the fact that we don’t think that these are in the best interests of countries or business. There are other examples where cooperation has been useful and has improved the end product for all sides – but not every case by any measure.

But the second thing is it’s just bizarre to me that people would think that you are going to get a better result if you do not talk to the people that you are trying to tax. I mean, wouldn’t you want to understand the impact that your proposals are going to have on business before you go ahead with them? You may in the end say, “well, that’s my policy decision; that’s where I’ve decided I want to go.” But to do something without actually talking to the people who are going to be paying the tax, well, it just strikes me as odd.

Engaging with business

Chris Sanger: Clearly policymakers need to be able to understand what will be the impact of their proposals and can then conclude on whether the side effects are acceptable.

Will Morris: The way I put it is you may be going in a certain direction, and as policymakers that’s your prerogative, but wouldn’t you rather do it working with the grain of what business does rather than against the grain? Governments are also interested in investment; they’re interested in growth; they’re interested in jobs. So wouldn’t you rather raise your money in a way that affects those things positively than negatively, or at least less negatively?

Rob Thomas: I think it’s probably fair to say that we’ve seen erosion in the overall trust in institutions over the last couple of years. Do you think that applies to business as well? Do you think there’s a role for business in rebuilding public trust and, if there is, how can business address that?

Will Morris: Well, there clearly has been erosion in trust in public and private institutions and part of that is a very simple correlation to the financial crisis and to the austerity which has followed. Something that was seen to be working five years ago is now no longer perceived as working, and therefore, people want to know who’s to blame.

So, yes, public institutions, governments and international organizations have been criticized, in part for being too cozy with business, which is perceived as having created these problems. Business in turn is also perceived as having contributed, whether through riskiness in banks, or over-indebtedness, or not paying the appropriate level of taxes and contributing to the exchequer. This has led to a loss of trust in business, but the point that I keep on making is that actually one of the huge success stories of the past 15 years has been globalization and, in particular, the growth of web-based commerce. Nobody could have conceived the success of e-commerce 15 years ago, and it has changed the way business is done – not just negatively, but in some really quite positive ways. At the same time, however, it is equally clear that the international tax rules have not kept pace with everything that has gone on, and therefore, we need to look at those rules again. So I acknowledge that, and that for me is part of what the BEPS project is about. That should be what business should be about: not hanging on to every single benefit that it has but actually saying OK, let’s step back from this and see what sort of tax system do we want going forward.

So I think that’s part of it. But trust, however, is also partly an emotional thing, and to try to restore that we probably also have to look at some soft law aspects as well. That may, for example, involve codes of conduct or things along those lines, and again, I think business should be open to doing that. We don’t tell our own story very well, but need to determine how we can tell our story more openly in a way that builds some trust without necessarily divulging so much data that we actually end up confusing people.

Chris Sanger: That’s a really interesting area – the amount of data and disclosure and transparency. How do you see the transparency debate moving, and what would you like to see to assist business in getting its message across?

Will Morris: Well, I think business has to help itself in getting its message across. I think there are dangers in legislating on this issue, not least because, once that happens and it becomes part of the law, then it becomes part of the compliance process so every company has to set up a unit, and that becomes about measurement and box ticking. If that happens, then in a sense you are not achieving what you really want to achieve, which is a change in the way people actually think about these things.
In terms of transparency, I simply don’t think that business does a very good job of telling its own story. Part of the answer may be something along the lines of talking about the corporate tax contribution, for example. I do think a single corporate income tax number doesn’t necessarily tell a particularly useful story, so I would be careful about doing that.

It might be something about narrative reporting – it’s also about business groups like the CBI speaking out more clearly on this. I do think we can be more transparent. It is always going to be hard in an area like tax where I’m afraid it’s very complicated to come up with simple sound bites, but I do think we can begin to rebuild that trust by explaining parts of the tax system and why they’re complicated but also why they’re there and – hopefully in comprehensible language – how they work.

Tax competition

Rob Thomas: In terms of that complexity, we talked about globalization, the growth of e-commerce, communications, intangibles. It’s very, very complex. But there’s also this other driver which is countries each trying to be competitive from a tax standpoint. Doesn’t that really add in to the whole agenda as well?

Will Morris: One of the features of today’s world is that the abolition of capital controls, mostly in the 1980s, has changed the face of the world. Following that, capital has been free to flow around the world, and countries are therefore more able to seek to attract capital. I don’t think there’s any doubt that some of the ways in which they’ve done this doesn’t help global welfare. Incentives which encourage the moving of bare risk, without economic substance, for example, should be looked at hard. But I do also think that if countries are genuinely trying to attract economic activity, then they should be allowed to do that. I also think that if the international community, as is absolutely its prerogative, comes to the conclusion that some of this activity is not in the international interest, then they should try and stop it. But there is a significant point here – lecturing companies about taking up incentives which are genuinely offered isn’t going to help. So if the rules need changing, then change the rules.

Base erosion and profit shifting

Chris Sanger: You mentioned the OECD BEPS project. What’s BIAC’s position on the key areas identified by the project?

Will Morris: Again, in all three of the clusters of the BEPS project I think that we would acknowledge that there are areas which need looking at, and one of the advantages that I see of the BEPS project is that it does look across the whole range of issues. So it’s not simply about focusing in on e-commerce, for example, or on one specific treaty article. It’s actually about trying to look at the entire system holistically, and that I think raises the possibility of sensible, incremental changes here and there to bring the system back into balance rather than necessarily saying we just need to break this whole thing open and build a new structure. So I do see some positives from that.

In terms of the various areas in the report, I think it is probably a little premature to comment because the report itself actually isn’t terribly detailed in terms of potential direction. I think once we see the issues note that the OECD is working on, we will have a much better idea.

Chris Sanger: Given the timetable of the OECD and the BEPS project, do you see any risk of countries going it alone and putting in place national-level legislation, or do you think we’re going to see the OECD as able to take the lead on this?

Will Morris: I certainly hope we don’t see countries go it alone. There are a number of governments involved which are under severe political pressure already, and I think there is a real danger that if the BEPS project did not exist, some of those countries might already have done something. There is, equally, the danger that if the BEPS project doesn’t move forward in what they see as a timely manner, unilateral action may still happen. That, I think would be a disaster – in part for the countries involved, but also, again, generally for growth and for jobs. The key role of the OECD has always been to foster cross-border trade and investment. The way that it has mostly done that in tax over the years is to squeeze out distortions in the form of double taxation.

Now, we can argue about whether double non-taxation is strictly a distortion, but I think something which gives sectoral advantages or country advantages is a distortion, and therefore, looking at that as part of the BEPS project strikes me as being entirely appropriate. But you can be absolutely certain that if countries start acting unilaterally because they feel that part of their tax base has been taken away, that’s part of a tax base that somebody else in another country will see and tax as well. There is no guarantee – in fact there is almost certainly the opposite – that double taxation will be prevented.
Rob Thomas: Coming back to the role of BIAC, what opportunities are there for companies to engage in this debate?

Will Morris: “Get involved” is the answer! In the UK the comments are being funneled through the CBI. Many of your readers will be members of the CBI, but even if they’re not, the CBI is still happy to hear from them. The same goes for any of the membership organizations, but equally I hope that your clients will be happy to funnel input through EY. There is lots of room for involvement. What I have told people about the process is that BIAC has agreed, regardless of membership, to try and gather as full a range of business views as we can do: from everybody who thinks there is absolutely no problem at all and why don’t the governments back off, to those who think actually the whole system is completely broken and we do need something completely new.

I don’t expect us to produce a consensus document or a consensus view. What I do hope is that everybody who is talking, even if they disagree, will be talking in the same room so that there is the possibility of us all understanding what the other is saying. I think the danger comes – as with governments moving unilaterally – if business groups say, “well, we’re going to have to go with this on our own,” and then you get this set of dissonant voices and governments saying, “well, we don’t know who to listen to so we will just listen to ourselves.” That’s the danger, and so my aim is not, as I say, to produce a consensus, or necessarily for us all to meet somewhere in the middle, but to make sure we don’t shut anyone out and to try and pull as many people as possible into the process.

Rob Thomas: May I ask you to change hats and talk to us about your role at General Electric? Given the pace and complexity and just the sheer volume of tax change we see in the world, have you way that you monitor, assess and deal with policy change and also the way you communicate internally around these issues?

Will Morris: My job has slowly ramped up over the past five, six, seven years, and given everything that’s going on, yes, it’s an increasingly busy and engaged role. My colleagues around the world are much more frequently in touch with me now on tax developments which are going on, and obviously because of the BIAC job as well, there’s more reason to reach out. So in terms of assessing it, we have some outside input, and obviously I talk to a lot of people and try and get views. Equally my colleagues talk to a lot of people and try and feed those views back to me. I have some people who monitor newspapers and social media and all that, but it’s mostly about talking to other people who are involved in this area just to see what’s going on.

In terms of internal communication, yes, that is also very important and has become more important as the pace has picked up. But also to the point that you were talking about regarding public trust before, it’s also very important that my fellow employees who are not in the tax area know that we’re not doing something in the magician’s den – that actually what we’re doing has substance, that we’re fully compliant, that we are very careful about the law, and that we do think about the policy. So when a story comes out in a particular country about our tax planning, our first aim, the first thing we do, is to communicate back to our fellow employees about what we’ve done, why we did it, and to explain to them what they’ve heard, in part so they feel that they know what we’re doing and what we’re doing is appropriate, but also so that they can explain to other people (family, customers) who come to them and say “what’s going on?” We also spend a lot of time communicating with our senior management, again so that they understand the full picture. And, last but not least, we have to make sure internal communications inside the tax department remain incredibly good. So, yes, internal communication is enormously important.
As this publication went to press, the publication of the BEPS Action Plan in conjunction with the G20 Ministers meeting was awaited.

The OECD’s earlier February report, titled Addressing Base Erosion and Profit Shifting (the Report), provided an overview of global developments that have had an impact on corporate tax matters and focuses on the key principles that underlie the taxation of cross-border activities together with the BEPS opportunities these principles may create.

The Report reflected the view that current international tax standards may not have kept pace with changes in global business practices, in particular in the area of intangibles and the development of e-commerce. The Report identifies relevant work that has already been completed by the OECD, but states that a holistic approach is necessary to properly address the issue of BEPS, a message that was further echoed by the G8 Declaration which The February report also emphasizes the need for collaborative, rather than unilateral, action by countries given the cross-border and multijurisdictional nature of BEPS issues.

More recently, BEPS dominated the agenda at the annual OECD tax conference in Washington, DC, held on 3-4 June 2013. Participants on two BEPS-related panels included Pascal Saint-Amans and senior OECD delegates from Canada, Germany, the United Kingdom, and the United States, as well as business representatives.

EY has created a dedicated web page where materials relating to the BEPS project can be accessed; this page will be updated with information on the BEPS Comprehensive Action Plan as soon as it is available:

www.ey.com/BEPS

Readers are also invited to join our 23 July webcast where a panel of senior international tax professionals from France, Germany, the Netherlands, the UK and the US will discuss the OECD action plan and its implications for multinational businesses. Register at:

www.ey.com/BEPSWebcast
Authorized OECD Approach (AOA to allocating profits to permanent establishments: dealing with national variances in treatment

In 2008, recognizing a legacy of uneven treatment and uncertainty in results arising from diverging interpretations of Article 7 (“Business Profits”) of its Model Tax Convention, the Organisation for Economic Co-operation and Development (OECD) issued the Report on the Attribution of Profits to Permanent Establishments¹ (the 2008 Report), setting what is today called the Authorized OECD Approach (AOA) for the allocation of income to permanent establishments. The 2008 Report endeavored to eliminate a lot of uncertainty as to the proper application of Article 7, and established a framework for the analysis of how to attribute profits to permanent establishments.

According to the OECD, the goal of the 2008 Report was to “[formulate] the most preferable approach to attributing profits to a permanent establishment under Article 7 given modern-day multinational operations and trade.”

The 2010 report

Once the 2008 Report was issued, the OECD recognized the need to make amendments to the Commentary to Article 7 and harmonize the guidance issued in the 2008 Report with the interpretation of Article 7 contained in the Commentary. Therefore, in 2010, Article 7 itself was amended to reflect the principles contained in the 2008 Report. In addition, a report was issued in 2010 on the Attribution of Profits to Permanent Establishments² (the 2010 Report). The 2010 Report does not deviate from any of the principles espoused in the 2008 Report. Rather, it was produced to harmonize the language of the 2008 Report with that of the 2010 version of Article 7.³

³. Accordingly, for treaties containing language that reflects pre-2010 Article 7, the 2008 Report and the 2008 Commentary to Article 7 should be used for interpretational purposes. Similarly, for treaties containing language reflecting the 2010 version of Article 7, the 2010 Report should be used, along with the 2010 Commentary.
The Authorized OECD Approach (AOA)

The 2010 Report confirms the authorized OECD approach (AOA) set forth in the 2008 Report, establishing a single standard of analysis when dealing with allocating profits between a head office and a foreign permanent establishment.

The necessity to allocate profits originates from the conflict that in case of a permanent establishment, both the source country of the permanent establishment as well as the residence country of the headquarters company may claim the right of taxation for the profits realized by the permanent establishment, thus creating double taxation. Therefore, setting clear rules on how to allocate profits to a permanent establishment is a critical step to avoiding double taxation.4

For this purpose, the AOA treats head office and permanent establishment fictitiously as functionally separate entities and presents a two-step analysis to arrive at a profit allocation between head office and permanent establishment.

Step One

Based on the assumption that the permanent establishment is a functionally separate entity, an analysis of the functions, assets, risks and other unique facts associated with the permanent establishment is conducted, significantly driven by where the acting persons are located (“significant people functions”). Further, it is then determined where, in a deemed third-party situation, so-called dealings (assumed contractual relationships) between the permanent establishment and the head office would exist.5

Step Two

Where dealings can be recognized, subsequently, transfer pricing methods as set forth in the OECD Transfer Pricing Guidelines (OECD Guidelines) are applied to determine transfer prices for the dealings between head office and permanent establishment.6

---

4. 2010 Commentary on Article 7, OECD Model Tax Convention, at paragraph 18.
5. Id. at paragraph 16.
6. Id. at paragraph 42.
The risk of inconsistent versions and applications of Article 7

While the pre-2010 OECD Model Convention in its Article 7 based the allocation of profits to permanent establishments on assigning individual income and expense items to either permanent establishment or head office, and refrained from realizing profits between head office and permanent establishment, the 2010 Model Tax Convention in its AOA allows exactly that: that profits are realized between head office and permanent establishment on fictitious transactions. However, a new OECD report, a change in a model tax convention or the related Commentary does not change existing individual treaties or their domestic tax law interpretation.

Against this backdrop, almost all countries are faced with the reality that their network of bilateral double tax treaties most likely includes both pre- and post-2010 language, or that their tax treaty networks contain largely pre-2010 language, but domestic law incorporates post-2010 principles. The question then becomes, how are countries dealing with the variances in treatment?

The remainder of this article takes a brief look at several countries’ solutions to a vexing problem that only promises to compound itself as the OECD continues to undertake revisions of its prior guidance.

China – no formal position taken to date

As part of Chapter 10 in the United Nations Draft Transfer Price Practical Manual for Developing Countries (UN Manual), China’s State Administration of Taxation (SAT) released the report China Country Practices. In the report, China establishes its position that while the OECD Guidelines may be applicable to developing countries, the UN Manual offers more realistic and practicable solutions for the issues developing countries face. Accordingly, it is not surprising that the SAT has not formally taken a position on whether it endorses or will adopt the AOA.

With regard to attributing profits to permanent establishments, the SAT has provided limited guidance. It is, however, worth noting that while China has not adopted a formulary apportionment approach to cross-border transactions, under domestic rules, allocation of provisional tax among branches in different locations takes into account allocation keys, such as operating revenue, employee remuneration and total assets of the branches. Also, China is constantly exploring allocation concepts, such as location savings advantages, cost savings, market premiums or marketing intangibles.

Germany – delayed legislation, definitive treatment

Germany planned in its Annual Tax Act of 2013 to adopt the AOA into German domestic law. For reasons not related to the AOA, however, the legislative process failed and most likely will only be resumed in 2014. Despite this, the German example offers a valuable insight into a possible approach to addressing the uneven implementation of the post-2010 Article 7 across a country’s treaty network.

Firstly, the German draft legislation aligned closely to the two-step analysis set forth in both the 2008 and 2010 Reports. Secondly, in an effort to deal with the fact that the majority of Germany’s treaties still include pre-2010 Article 7 language, the domestic rule proposed to employ a reciprocal approach. It planned to stipulate that Germany would generally tax a permanent establishment’s profits under the AOA approach. If, however, the taxpayer could successfully establish that the other State that is a party to the double tax treaty does not apply the AOA, Germany would be willing to refrain from applying AOA and to apply pre-2010 principles as contained in the relevant treaty’s language. Thereby, reciprocity would be achieved, but the burden of proof for not applying the AOA would have been put onto the taxpayer, an approach at least susceptible to future controversy.

7. The OECD currently has ongoing projects addressing the revision of Article 5 (“Permanent Establishments”), the revision of its position on safe harbors and extensive work on the transfer pricing aspects of “intangibles.”
India – attribution approved if one of six prescribed methods has been utilized

The Indian Income Tax Act, 1961 (the Act) supports an attribution of profits to a PE on the basis of transfer pricing principles. Though the Act is not explicit in this regard, the appellate authorities have arrived at this position based on an interpretation of the Act’s provisions. Prior to the introduction of detailed transfer pricing rules, PE attribution was done in India on an ad-hoc basis, pursuant to Rule 10. Rule 10 only provides for the formulary apportionment of global profits where an actual amount of attribution is not definitely ascertainable. With the introduction of the transfer pricing regulations, Rule 10 has been relegated to a method of last resort. Under the Indian transfer pricing regulations, a PE is defined as an enterprise distinct from its head office, and transactions between the PE and head office have been brought within the ambit of transfer pricing.

Recent rulings have upheld the use of transfer pricing principles for attribution, provided the taxpayer has used one of the six prescribed methods for attribution. In the absence of a detailed transfer pricing analysis by the taxpayer, the courts may rely on Rule 10 for attribution. There are some deviations within the current jurisprudence. For example, in the case of profit attribution to an agency PE, a tribunal in India (Tax Court) held that the PE is required to be compensated over and above the payment to the Indian agent. However, the High Court in the same case held that the PE’S arm’s length compensation to the agent extinguished any India tax liability the PE might have had.

In light of the above, taxpayers are urged to review the functions and risks of all parties to the cross-border transaction. Taxpayers are advised to maintain robust transfer pricing documentation and follow a benchmarking process that takes into account the function and risk analysis of the foreign principal and the Indian entity to mitigate potential challenges posed by the tax authority’s approach.

United States – conforming provision in model tax treaty

The US has not adopted new legislation or regulations in response to the AOA. In addition, the current US Model Income Tax Treaty was issued in September of 2006 and has not been updated to reflect the AOA. Nevertheless, the US is a member of the OECD, and generally takes the position that its transfer pricing policies are fully consistent with OECD principles. Further, Article 7 of the US Model Income Tax Treaty is generally consistent with the AOA, and thus, US tax treaties are generally consistent with the AOA. However, in the event of a dispute involving the US and a treaty partner, the taxpayer will wish to consult the applicable tax treaty for the specific treatment. In the event there is no applicable tax treaty, the US rules on taxation of the income of what would be a taxable presence in the US may depart significantly from the AOA; taxpayers should consult their tax advisor for further information.
Conclusion

From the brief survey of the countries above, it is apparent that the adoption of the AOA to attributing profits to PEs has been met with varying responses, from no explicit adoption to real attempts to incorporate an approach that is in line with OECD principles into domestic law. One might reasonably conclude that when dealing with certain emerging economies like China or Brazil, rigid adherence to and citation of the official OECD stance on how to attribute profits to PEs will carry little to no weight by itself. However, China's repeated and emphatic articulation of the importance it places on its unique market identifiers makes clear that the SAT will likely continue to begin examinations with an exhaustive discussion on the impact concepts such as location savings, market-specific premiums and marketing intangibles have on the functions and risks of the Chinese operations. Such a discussion will likely involve a more nuanced analysis than a mechanical application of allocation keys or formulas to attribute profits to the PE. In that respect, whether the SAT’s official view has been articulated as such or not, it is indeed aligned with the OECD’s AOA, in that the attribution of profits to the PE will only be determined through a careful application of transfer pricing principles to arrive at an arm’s length amount of profit for the PE.

Similarly, whether taxpayers are dealing with a jurisdiction with competing judicial decisions on the proper approach, or with a jurisdiction that has simply remained silent but for an articulation of the belief that its transfer pricing rules are generally aligned with OECD principles, the general rules of audit defense and controversy preparedness still apply: preparing and maintaining robust transfer pricing documentation is the most assured means of establishing a well-reasoned and defensible transfer pricing policy. Whether that policy relates to the arm’s length amount of compensation for the usage of intangibles between related parties, or whether it relates to the attribution of profits to a PE, taxpayers should consistently prepare documentation as a way to “tell their story” and present solid evidence to tax authorities as to why their methodologies are defensible and should be respected. For large multinationals, documentation of intercompany transactions on a global basis is often the approach that makes the most sense.

Finally, taxpayers may consider concluding APAs in relevant jurisdictions to obtain certainty with respect to their method for attributing profits to PEs and avoid scrutiny for a certain number of years, provided the results obtained conform to those agreed upon in the APA. As an example, the revenue procedure governing the APA process9 in the US was amended in 2008 to widen the scope of matters that may be addressed in an APA to include any issues “for which transfer pricing matters may be relevant, such as attribution of profits to a permanent establishment under an income tax treaty.”10 Certainly other countries have either modified regulations or contemplated the inclusion of PE issues in the scope of APA coverage from the beginning and, where there is a treaty in place between the jurisdictions in which they conduct business, taxpayers should give serious thought to achieving prospective resolution of the arm’s length amount of profits to attribute to a PE in an APA.

---

China’s VAT system is one of the most complex in the world. Although companies generally assume that VAT in China is “neutral” in reality they are often net payers of VAT and can incur significant amount of VAT-related costs. Our report on China’s VAT system studies the regime in detail, shares input from more than 500 China professionals interested in VAT and provides practical guidance on how to effectively manage VAT risks and opportunities.

Download the report at:
www.ey.com/ChinaVAT
OECD holds the first Global Forum on VAT

There is a clear trend for governments to increasingly rely on indirect taxes such as value-added tax (VAT)/goods and services tax (GST) to reduce budget deficits and support tax reforms in other areas. The Organisation for Economic Co-operation and Development (OECD) also recognizes the growing importance of indirect taxes and the issues that are posed in an increasingly global economy. EY actively supports and contributes to the work of the OECD in finding common principles and guidelines to align the VAT systems around the world and to reduce the risks for businesses of double taxation. In this article, we report briefly on the OECD’s first Global Forum on VAT, held on 7 and 8 November 2012 in Paris, which offered a unique platform for a worldwide dialogue on the design and operation of VAT/GST, notably addressing issues of double taxation and unintended non-taxation.

Why an OECD forum?

A forum is a special form of government meeting used by the OECD to enable the association of non-OECD economies in particular areas of the organization’s work. The first Global Forum on VAT brought together more than 85 country delegations from all continents and international organizations and academics to explore key policy trends and their impact for tax administrations and businesses. A few business representatives, including EY, were also invited to take part. This is the largest VAT/GST meeting ever organized worldwide at the governmental level. The organization of this historic event illustrates the growing importance of VAT/GST and its recognition by governments worldwide.

The first Global Forum on VAT

The forum addressed the following topics:

- Implementation of VAT from a global perspective: the aim was to set the scene by providing an overview of current policy and administrative developments in the implementation of VAT in emerging and developed economies and by presenting the European Union (EU) experience of operating VAT in a regional trading bloc.
Applying VAT to international trade — the challenge of economic globalization: this session explored the challenges to the principle of “taxation at destination,” the standard for applying VAT in an international context where exports are zero-rated and imports are taxed in the importing country at the VAT rate applicable to domestic production. This principle creates particular challenges with the growing international trade in services and intangibles, as these items are not subject to border controls.

The OECD International VAT/GST Guidelines: panelists presented the ongoing work on the development of the OECD International VAT/GST Guidelines, intended to become the internationally agreed upon standard for a consistent VAT-treatment of cross-border trade. The presentation focused on VAT neutrality in an international context and the allocation of taxing rights on international trade in services and intangibles.

Designing efficient and equitable VAT systems: as VAT is a major source of government revenue, the design of VAT regimes can potentially have a significant impact on a country’s economic performance. In this context, the main drivers discussed were the tax base (revenue and economic effects of broadening VAT bases), the rate structure (single rate versus reduced rates), the determination of an appropriate registration threshold and, more generally, the distributional impact of VAT, while bearing in mind the political obstacles to eliminating reduced rates and exemptions.

Managing VAT administration and compliance: this session explored the possibility to measure VAT compliance costs (as VAT is regarded as the most burdensome of all taxes for businesses) and different approaches to tackling VAT fraud and avoidance. The key question addressed was whether it is possible to develop an effective strategy against VAT fraud and avoidance without imposing excessive administrative burden and compliance cost on businesses.
**Business representation**

Although the Global Forum on VAT is a meeting at the governmental level, businesses were given the opportunity to participate and to report on their concerns about having to deal with VAT. The business representatives who were invited to make a presentation clearly pointed out that their main concern in conducting cross-border trade is the neutrality of VAT (i.e., that it should not be a burden on businesses). They believe this neutrality can be achieved only through the widespread application of the destination principle and efficient VAT refund mechanisms. Businesses reported to governments that VAT has now become a major driver for investment decisions and that VAT can even turn out to be a showstopper to investing in some countries.

**Conclusion**

The Global Forum concluded that there is a strong need for internationally agreed upon principles on VAT. It decided its key objective should be to build the largest worldwide consensus on the OECD International VAT/GST Guidelines as the future international standard for applying VAT to cross-border trade with a goal of minimizing risks of double taxation and unintended non-taxation. The OECD International VAT/GST Guidelines should be completed by 2014 and will be presented for endorsement by the Global Forum on VAT at its next meeting, expected to be held in early 2014. We will continue to actively support and contribute to the work of the OECD in this important area of indirect tax policy, and we will report on progress and developments as they evolve.
The OECD (Organisation for Economic Co-operation and Development) issued a report on “Aggressive Tax Planning based on After-Tax Hedging” (the Report) on 14 March 2013. After tax hedging is an approach designed to ensure that the hedging arrangement achieves a neutral position once the effect of tax in respect of an arrangement is taken into account. In the report, the OECD acknowledges that after tax hedging is not of itself aggressive; it is recognized as a frequently used risk management technique to achieve a posttax effective hedge.

An example of where a taxpayer may look to use after tax hedging is where a company has a foreign investment in shares. Foreign exchange movements recognized in respect of the revaluation of that investment are not reflected for tax purposes, however foreign exchange movements recognized in respect of the hedging instrument (for example a loan liability or a short position under a derivative contract) may be reflected for tax purposes. By “grossing up” the foreign currency liability, the arrangement should remain a fully effective hedge even though only the foreign exchange difference on the liability is taxable.

The Report expresses concern regarding the significant volume of transactions that have been entered into by both financial institutions and other corporations where the foreign currency exposure is created as part of the transaction, rather than being a pre-existing exposure for the taxpayer.

The Report describes these transactions as enabling the taxpayer to make higher returns through effectively borrowing in lower coupon currencies and depositing in higher coupon currencies, while eliminating the relevant risk, for example foreign exchange, by transferring that risk to the tax authority.

The Report describes the strategies used by different tax authorities to detect and respond to these types of transactions and sets forth recommendations to tax authorities as to how to respond to the use of such arrangements. The OECD recognizes the difficulty in separating the transactions of concern from the use of what is a relatively commonplace risk management technique and therefore the Report recommends that tax authorities take care in designing a balanced response in this area.

European Union update

The last few months have seen some significant tax development announcements in quick succession within the European Union (EU). In December 2012 the EU Action Plan to Strengthen the Fight Against Tax Fraud and Tax Evasion was released, while a new set of proposals for the European Financial Transactions Tax (FTT) was released in February 2013. More recently new draft proposals were issued requiring greater financial transparency from the banking sector and the opening of a consultation on a European Taxpayer’s Code.

Action plan to strengthen fight against tax fraud and tax evasion

The Commission’s action plan, published on 6 December 2012, proposes 34 short- and medium-term measures in the area of direct and indirect taxation. Together with its action plan, the Commission suggested recommendations on aggressive tax planning and good governance in tax matters in third countries.

The plan comes in response to a March 2012 call from the European Council for improving the fight against tax evasion and tax fraud, including relations with third countries. The Commission had already presented a Communication in July 2012 on this issue and the Economic and Financial Affairs Council (ECOFIN Council) adopted conclusions at its November 2012 meeting. These conclusions stressed that “particular attention should be paid to the efficient and cost-effective implementation of already existing EU legislation and IT systems” and that “beyond legislative instruments the EU should consider pragmatic tax coordination at the level of the Council and support, where appropriate, coherent action in relation to third countries, while taking relevant work in international fora into account.” The Council also indicated that priority should be given to:

1. For more information, see EY tax alert: European Commission Action Plan to strengthen fight against tax fraud and tax evasion – 6 December 2012.
• Carrying forward work and discussions on the revision of the Savings Directive and quickly reaching an agreement on the negotiating directives for savings agreements with third countries;
• Exchanging information effectively between direct tax administrations;
• Exploring the possibility of deepening administrative co-operation in the area of direct taxation;
• Combating the considerable losses in the field of VAT inter alia by continued work with and analysis of possible measures to effectively combat tax evasion and
• Exchanging information effectively between indirect tax administrations and effectively using the existing computerized control systems for excise duties.

In other words, the Council recognizes that it has already adopted several measures that provide a comprehensive framework for administrative cooperation but which the Member States are not yet using effectively. Therefore the top priority is to support a full and effective implementation of these instruments that when applied properly will enable Member States to considerably enhance the exchange of information between themselves.

Simultaneously, the Commission sent Member States two specific recommendations that are included in the action plan’s proposals for new initiatives. These include tax havens (adoption of a “toolbox” of defensive measures) and aggressive tax planning (inclusion of a preventive clause in Member States’ Double Tax Conventions and adoption of a General Anti-Abuse Rule (GAAR) in Member States’ national legislation). The Commission recommends that Member States coordinate common actions to resolve so-called double deductions and double non-taxation cases. Double non-taxation in this sense is defined as a situation “where income is not taxed by any of the tax jurisdictions involved.” In order to resolve certain risks of double non-taxation:
• Member States are encouraged to ensure, in the context of their Double Tax Conventions, that income may only remain untaxed in a Contracting State when it is taxed in the other contracting state (which may be either another Member State or a third country). The recommendation includes a provision, which Member States are asked to include in their treaties to this effect.

Much may also depend however on how disruptive the non-participating States wish and are able to be. In this context, it should be noted that 4 States (the Czech Republic, Luxembourg, Malta and the United Kingdom) abstained in the vote on 22 January 2013 since they were concerned that the conditions laid down in the EU Treaty governing enhanced cooperation were not fulfilled.

- Member States that avoid double taxation by exempting foreign income through unilateral measures are called upon to adopt provisions preventing double non-taxation.
- Member States are asked to adopt a GAAR. A suggested provision regarding this was included in the recommendation.

Against this background, the Irish presidency has identified its second priority in the tax area: the negotiations on amending the Savings Directive and the associated negotiating mandates with third countries. The rest of the Commission’s action plan will be examined by technical experts in the relevant Council working group and it will be interesting to see which, if any, new actions the Member States consider should be pursued. Those aspects relating to third countries “not meeting minimum standards of good governance in tax matters” will no doubt be considered in the light of progress on tax matters by the G20 and OECD work referenced elsewhere in this publication.

**European Commission establishes Platform for Tax Good Governance**

On 23 April 2013, the European Commission (EC) established the “Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation” (the Platform). The Platform was one of the initiatives suggested by the Commission in its December 2012 Action Plan for addressing tax evasion and tax avoidance.

The Platform will monitor Member States’ progress on the two recommendations to the Member States calling for coordinated EU-action on third countries not meeting minimum standards of good governance in tax matters and on aggressive tax planning. Although not highlighted in the EC press release, additionally the Platform will discuss issues in the area of double taxation. Replies from the EC’s Public Consultation on factual examples and possible ways to tackle double non-taxation emphasized that double non-taxation and double taxation are linked and should thus not be dealt with separately.

The aim of the Platform is to ensure that real and effective coordinated action is taken by Member States to address the problems raised in the recommendations. The Platform will be comprised of representatives of the national tax authorities, the European Parliament, the businesses community, academics, NGOs (Non-governmental organizations), and other stakeholders. This should facilitate dialogue and exchange of expertise with a view to adopt appropriate policy responses. Non-governmental representatives will be appointed by the EC, on the basis of an open application process.

As noted, the Platform will follow in particular the progress being made on the two recommendations linked to the EU Action Plan.

**FTT**

Adopted by a qualified majority, on 22 January 2013, the Economic and Financial Affairs Council (ECOFIN) authorized 11 Member States\(^3\) to proceed with the introduction of an FTT through “enhanced cooperation.” The States concerned had written to the Commission in September and October 2012 requesting a proposal for enhanced cooperation once it had become clear that the Commission’s 2011 proposal aimed at introducing an FTT throughout the EU was not going to get the necessary unanimity. They requested that the scope and objective of the enhanced cooperation FTT be based on that of the 2011 proposal that involved a harmonized minimum 0.1% tax rate for transactions in all types of financial instruments except derivatives for which a 0.01% rate was proposed. The stated aim was for the financial industry to make a fair contribution to tax revenues, while also creating a disincentive for transactions that do not enhance the efficiency of financial markets.

On 14 February 2013 the European Commission (EC) released a revised proposal for an FTT to be introduced by the 11 (together with any additional States, which decide in the future whether they wish to join in the enhanced cooperation). This proposal will be discussed in the Council by all Member States but will have to be adopted by unanimous agreement of the participating Member States only.

The new Commission proposal, closely based on its initial proposal of September 2011, remains a very broad measure, taxing transactions in equities, bonds,
Other Systematically Important Financial Institutions (O-SIIs)) will be required to provide to the EC disclosures, on a country-by-country-basis, covering pre-tax profit or loss, taxes paid and subsidies received.

The Directive would affect nonfinancial sector businesses in two key ways as a result of:

- The broad definition of ‘financial institutions’ is likely to include treasury companies, pension funds and other nonfinancial sector companies with a significant average value of financial transactions. They will be subject to the tax for transactions with FTT zone parties or in transactions in financial instruments issued in the FTT zone.
- Financial institutions passing on the estimated €35 billion annual costs of the tax through higher borrowing and hedging costs, lower returns on pension and investment fund assets and higher energy and commodity costs to consumers, or as a result of joint and several liability provisions of the Directive.

This is only the third time that an enhanced cooperation procedure has been launched to allow a limited number of Member States to proceed with a particular measure, and the first time in the area of taxation. For this reason it is difficult to predict how quickly matters will evolve. However we can safely assume that the European Parliament will give its Opinion relatively quickly and certainly in time for the proposed 1 January 2014 implementation date. Otherwise, much will depend on how rapidly and efficiently the 11 participating States reaches an agreement upon what they want to implement.

Much depends on how disruptive the non-participating States are. It should be noted that four States (the Czech Republic, Luxembourg, Malta and the United Kingdom) abstained in the vote on 22 January 2013 because they were concerned that the conditions laid down in the EU Treaty governing enhanced cooperation were not fulfilled. These require that any such cooperation “shall not undermine the internal market or economic, social and territorial cohesion; shall not constitute a barrier to or discrimination in trade between Member States; nor distort competition between them. Any enhanced cooperation shall also respect the competences, rights and obligations of those Member States which do not participate in it and shall comply with Union law.”

Although we are a significant step nearer the introduction of an FTT by a group of Member States, there are still difficult negotiations ahead and the role of the presidency will be crucial in steering the process through uncharted waters. The Irish Presidency recognizes this, “progress on the financial transaction tax” as its third priority in the tax area.

The United Kingdom challenges the legality of proposed EU Financial Transaction Tax

These difficult negotiations are aptly illustrated by the announcement of 19 April 2013 that the UK has launched a legal challenge to the FTT. The UK Government has consistently opposed a European-only FTT with the breadth and design contained in the EU Commission’s current proposal. Moreover, concerns about the EU FTT from the City of London, the UK press and UK Parliamentary committees have been increasingly articulated in the last few weeks. A number of recent studies have also highlighted in some detail the potential negative impacts of the EU FTT for the UK and for the City of London.

The UK is challenging the decision of the Council of the European Union, of 22 January 2013, to establish enhanced cooperation with regard to a European financial transaction tax (2013/52/EU). In the preamble to the decision, it is noted that the 11 participating Member States requested that the scope and objectives of the enhanced cooperation should be based on the European Commission proposal for a Directive of 28 September 2011.

4. For more information, see EY Global Alert “UK challenges legality of proposed EU Financial Transaction Tax” – 23 April 2013.
At the time of such decision, the UK indicated that it did not believe the relevant conditions necessary for the establishment of enhanced cooperation were satisfied. It should be noted therefore, that the UK is, technically, challenging the establishment of enhanced cooperation in the area of the EU FTT rather than the substance of the proposal published by the European Commission on 14 February 2013 – although in practice not much appears to turn on this point. The UK’s challenge should be regarded as protective, as it was lodged just ahead of the deadline for challenging the Council decision authorizing enhanced cooperation. The UK may consider that, if it did not lodge such a claim then there is a risk that it would be precluded from challenging the enhanced cooperation procedure altogether.

**Tax transparency for the banking sector**

On 28 February 2013, the EU announced draft proposals for greater financial transparency specifically aimed at the banking sector, although the proposals appear to extend to some investment firms. This announcement was part of a package of additional measures announced by the EU, including a cap on bankers’ bonuses aimed at increasing financial transparency and strengthening the regulatory regime for financial institutions. These proposed requirements are an extension of the EU’s well publicized Capital Requirements Directive IV (CRD IV) which seeks to implement the requirements of Basel III into EU law.

Other Systemically Important Financial Institutions (O-SILs) will be required to provide to the EC disclosures, on a country-by-country-basis, covering pre-tax profit or loss, taxes paid and subsidies received.

From 1 January 2014 all financial institutions will be required to publish their number of employees and “Net banking income” by group member. In addition, European banks (Global Systematically Important Financial Institutions (G-SILs) and Other Systematically Important Financial Institutions (O-SILs)) will be required to provide to the EC disclosures, on a country-by-country-basis, covering pre-tax profit or loss, taxes paid and subsidies received. In 2014, the Commission will review the abovementioned disclosures provided by the banks and assess whether they should be made public. The draft proposals state that the Commission will consider any adverse implications arising from public disclosure of the information ahead of any such disclosure. Specifically, the Commission points out that prior to publication it will consider adverse implications of public disclosure on areas such as competitiveness, levels of investment, availability of credit, economic impact and broader financial stability implications.

**Sunset clause**

Following consideration of the submissions received, the Commission will report to the Council and the European Parliament its recommendations for the ongoing publication of this information. It is important to note, however, that unless specific changes to the Directive are enacted following their review, it will require public disclosure of the above information starting in 2015.

**Timetable for introduction**

The proposed introduction of these country by country disclosure requirements for banks from 1 January 2014 coincides with the expected implementation of the rest of the CRD IV. However, given that the EU legislative process is not yet complete, there is speculation that the commencement date could be delayed by up to six months.

**Significant uncertainty over scope and application**

The details of the proposed requirements have been very brief and we anticipate there will be many areas where the Commission will need to provide further clarity. It is not clear to what extent local interpretation of the rules will be permitted to deal with particular complexities of domestic tax systems. Some initial observations are set out below.

**Institutions in scope**

Clarification is required on the scope of the rules relating to employee and net banking income disclosures. Will they apply to all regulated investment firms within CRD IV (this appears to be the case) or just to banks? In addition, will “bankruptcy remote” special purpose entities or insurance sub-groups be considered in scope? Further, how will EU inbound institutions be treated within the rules?

**Format and frequency of reporting**

Both for information to be made public and for the information to be provided to the Commission, the frequency of disclosures, timeline and format will need clarification. The announcement does not refer to public disclosures being made in the financial statements.
This option may be attractive to the legislator, but many businesses have argued that the annual reports are already too long and complex and indeed infrequent, to be useful to investors. For this reason, publication as a separate report or as part of the group’s sustainability or corporate social responsibility (CSR) report may be preferable. Whichever format is chosen, institutions will need to make sure that the data provided publicly and to the Commission under these proposals reconciles with other regulatory filings and published reports.

Interpretation issues
The published proposals remain very high level. Considerable effort will need to be made to develop implementation guidance to make sure the data the Commission receive is comparable and clearly understood. There are many open questions such as:

- How are profits defined and at which level? (e.g., will movements through Other Comprehensive Income be included?)
- How will Net Banking Income be defined? Which GAAPs will be permitted for these disclosures?
- Which taxes need to be reported? How are taxes that are paid by banks on behalf of others (such as withholding taxes) to be treated?
- How would intra-group trading be treated under these rules?
- How will complex entities like branches, partnerships, joint venture and investment vehicles be reported on?

Clarity would be required regarding how the number of employees is determined, e.g., a bank is likely to have contractors, mobile employees, shared service centers and dual contractors. These are a just small selection of technical issues that require further clarification.

Verification of information
It is also currently unclear whether any information disclosed would be externally verified. Should verification be required, there are further questions surrounding the parties to be involved. Verification may be undertaken as part of external financial audit or through procedures carried out by the European Commission, European Banking Authority, local country regulator or a designate they appoint.

Previous experience of country by country reporting in other sectors
The CRD IV country by country disclosure proposals are not a new concept. For example, the extractive industries sector, such as, mining, has had such a framework under the Extractive Industries Transparency Initiative (EITI), since 2003.

The EITI provides guidance for reporting but is not mandatory. Information such as company payments (e.g. material tax payments) and government receipts are disclosed, however, individual countries determine what material tax payments comprise. (Taxes, such as VAT and employee taxes, are excluded from the framework.)

Although it is not clear at this stage, the Commission may decide to draw on the experience of frameworks such as the EITI when setting out the detailed rules. More detailed guidelines are currently being formulated by the Commission and are planned to be voted on by Member States and the European Parliament on 15–18 April 2013. What is amply clear, however, is that the trend towards heightened disclosure and transparency marches on.
Consultation for an EU taxpayer’s code

On 25 February, the EC published a consultation paper and related questionnaire regarding the EU’s Taxpayer’s Code (the Code). This Code is one of the measures that the EC has proposed in its Action Plan. An EU Taxpayer’s Code should clarify the rights and obligations of both taxpayers and tax authorities. In a press release, the EU-Commissioner for Taxation, Algirdas Semeta, commented that, “Most Member States have established taxpayer’s codes. ... However, these codes vary considerably ... This can make it extremely difficult for citizens and companies to understand their rights in different Member States and comply with their tax obligations in cross-border situations.”

The EC’s questionnaire identifies the subjects and specific questions on which the EC would like to receive comments. The questions are designed to assess the respondent’s knowledge and experience with the existing Member State taxpayer codes (e.g., the United Kingdom). It also sets out some general and procedural principles to be considered in the context of the development of a Code and asks what additional topics could be seen as a natural extension of the fundamental principles, rights and obligations of a Code. Stakeholders are invited to give their views by 17 May 2013.

The potential impact of the creation of a European Taxpayer’s Code should not be underestimated. The Code could contribute, for example, to the adoption of gentlemen’s agreements (soft law agreements) between Member States or to share leading practices. It should also be noted that this is connected to the current public debate on tax fraud and evasion. The questionnaire raises the issue of question of whether general principles on information on possible measures to combat tax avoidance and evasion should be included in the Code.

European Council calls for expanded disclosure requirements for non-financial and diversity information

Following its May 22 meeting, the European Council on May 23 issued a set of Conclusions on taxation which included a call for “rapid progress” on a number of issues including a statement that “the proposal amending the Directives on disclosure of non-financial and diversity information by large companies and groups will be examined notably with a view to ensuring country-by-country reporting by large companies and groups.”

In a speech the following day, the European Commissioner for internal market and services, Michel Barnier, said that the EU would expand the reporting obligations already adopted for banks (commonly known as Capital Requirements Directive, or “CRD” IV) to apply them to all large companies and groups. He is reported as saying that this will be put in place “as quickly as possible.” However, this concept of expanded requirements for public disclosure of tax information had not been discussed at the May 22 meeting, as Member State officials have clarified.

The CRD IV proposals provide that from 1 January 2014, European banks and other institutions regulated under CRD IV should publically disclose the following information as an annex to their financial statements, on a country by country basis:

- Names, nature of activities and geographical location
- Turnover
- Number of employees

In addition, from the same date, CRD IV regulated institutions must disclose the following country by country information to the European Commission:

- Pre-tax profit or loss
- Taxes paid
- Subsidies received

During 2014, the Commission will review these additional three disclosures provided by the banks and assess whether

---

such information should be required to be publicly disclosed from 2015. Specifically, the Commission will consider any adverse implications of public disclosure on the areas of competitiveness, levels of investment, availability of credit, economic impact and broader financial stability.

It is not at all clear that Commissioner Barnier’s comments regarding expansion of public disclosure by all large companies and groups to comply with rules based on the CRD IV provisions will be formally advanced by the Commission or would attract sufficient support to be enacted, as there is understood to be opposition to the idea in some Member States. However, the European Council conclusions regarding public disclosure of non-financial and diversity information set a political direction at the level of EU Heads of State and Government and the ongoing discussions at European level will likely mean that the issues of country-by-country reporting – including with respect to tax information – remain in the public eye.

What other developments may be expected?

A number of non-governmental organizations have been campaigning for country-by-county reporting, and many have prepared reports on the level of reporting currently undertaken by certain corporations in some jurisdictions.

The discussions at the EU level are separate from the OECD Base Erosion and Profit Shifting (BEPS) project. The tax transparency issues being discussed as part of the BEPS project are focused on enhanced reporting to tax authorities, including the concept of reporting on a company’s full supply chain to the tax authorities in a simplified manner. The objective of such reporting would be to provide tax authorities with a better understanding of the company’s activities in other countries for purposes of risk assessment.

It is noted that the Australian government tabled a measure on public disclosure of certain tax-related information on 29 May.7

How can companies be prepared?

Greater tax transparency – in the form of expanded reporting to tax authorities and potentially public disclosure of some tax-related information – will continue to be the subject of discussion in the European Commission, the OECD, and elsewhere. As a result, tax and finance executives may wish to consider the following actions:

- Close monitoring of legislative and regulatory developments in this area to understand the likelihood of increased tax reporting or disclosure requirements
- Regularly monitoring the level of public interest in their company’s tax profile, based on their industry, importance of public perception to brand value, and social advocacy related to enhanced tax transparency
- Communication and discussion of these trends at the management level to ensure a common strategic view of issues related to tax transparency
- Assess the readiness of their company’s systems and processes to support reporting of taxes paid
- Establishing a closer relationship between tax and accounting functions – especially related to finance transformation initiatives and ERP-related projects – to ensure changes to systems and processes take current and potential future tax reporting needs into account

Conclusion

All issues considered, it has been a busy start to the year for the EC on tax issues. Whether any or all of the proposed measures in the Action Plan will be pursued in 2013 (not to mention the CCCTB) depends on the outcomes of the OECD BEPS project, especially important considering if the EU Member States either chair or co-chair all three of the main BEPS workstreams.

---

How do you remain at the forefront of global tax?

A little application.

Now you can access EY Global Tax Guides on your tablet. With information on more than 150 jurisdictions, the world of tax is at your fingertips.

The high volume of tax changes in response to the global financial crisis continues to give way to more targeted, selective and nuanced tax policy making in many countries around the world in 2013, even as most developed economies continue to wrestle with high debts and austere budgets.

No matter how well- or ill-positioned countries are to effect structural change, we see near universal commitment to the stronger enforcement of existing tax laws, giving rise to more controversy and disputes around the world. And increasingly, many countries are urging new action on cross-border taxation by supra-national organizations such as the OECD. Who’s recent BEPS report noted that current standards of international taxation may be out of date and have failed to keep pace with the rapidly changing climate for international business.

See how these trends and more may play out in 2013 and beyond by downloading the report at: www.ey.com/taxpolicy2013
Forgotten entities and their cost: the case for corporate simplification

In the last decade, large multinationals have often unintentionally developed extensive legal structures in multiple territories as by-products of organic growth, acquisitions or changing regulations. In some cases, legacy structures remain that were set up to generate certain funding, tax efficiency or control benefits that may no longer exist, and balances may have been left outstanding or arrangements in place due to a lack of rigorous testing of existing legal structures on a periodic basis or the need to address other more pressing issues first. In an environment that is rapidly changing, many multinationals are now choosing to review existing structures in order to reduce risks and costs.

The existence of surplus or non-functional entities in a corporate structure potentially leads to excessive use of resources, added cost, value erosion, and inefficient and sometimes non-compliant corporate trees. Related costs become more pronounced during periods of economic stagnation or decline, and the complexities created in growth periods can easily become a hindrance. In addition to annual compliance costs, such legacy structures can result in additional questions during audits, more extensive audits by tax authorities, challenges to the transfer pricing of any intercompany positions and the perception that some form of abusive tax planning has been carried on within a group.

Corporate simplification (CS) exercises are designed to remove these complexities and take advantage of the opportunities presented when a multinational group is restructured and when unnecessary or dormant entities are liquidated or merged. The type of exercise may vary from pruning the group structure and removing dormant or low-value entities to centralizing activities into a single entity (with branches), which particularly in Europe may be achieved in a tax-neutral manner, yielding direct and indirect cost benefits.
This article outlines some CS exercises that can benefit groups in removing complexity and related costs from their structures, as well as reducing the risk of tax authority challenge and related controversy risk. It is written from a general tax perspective, and deeper analysis can (and should) be carried out from a direct tax, indirect tax, transfer pricing and also information systems perspective. We first set out some of the drivers for such exercises, the tax controversy benefits that may result and also the cost benefits, before going on to set out some of the implementation issues, which are an important consideration when planning for a future improved structure.

EY polled more than 900 tax decision-makers in 2012 on the subject of CS, with 45% of groups confirming that they were analyzing the benefits of such simplification, and 16% currently engaged in some form of simplification exercise. We will look into the reasons and types of exercises conducted later, but when almost half of a large group of international businesses is doing something proactive in an area, one may wonder why the other half is not.

The CS value proposition

Very broadly, there are multiple benefits that can be achieved from reducing the number of entities in a complex legal structure, and we outline some of these below. Some are more immediate in terms of cost reduction than others, but all are beneficial in achieving a leaner, more efficient business structure, both from a management perspective and from a presentation perspective:

**Simplification**
- Reducing hierarchy and bureaucracy
- Reducing number of transactions
- Aligning the corporate organization chart with the business in sectors or geographies

**Cost reduction**
- Compliance costs associated with running multiple legal entities
- Staffing costs associated with implementing multiple transactions
- Reduction in intercompany transactions
- Costs associated with implementing new IT and accounting systems for multiple entities

**Change management**
- Improving governance
- Promoting increased engagement and satisfaction from employees

**Branding as one company**
- Supporting the elimination of a local silo mentality
- Presenting one interface to customers and suppliers
The direct benefits above should, through a tidier legal structure with fewer intercompany transactions and more centralized business model, improve the picture presented to tax authorities of the group as a whole and the entity or entities in their jurisdiction. It may also help better position the company in case of future M&A.

CS is deliberately an umbrella term that describes a variety of exercises, the key common ground between these being that they all result from a reduced complexity. This may be in terms of the number of entities in the legal structure, the number of tiers, the number and complexity of intercompany transactions between group companies, the number of filings required on an annual basis and the complexity of the business that is presented to the market.

Addressing the substance debate

The recent focus on base erosion and profit shifting as well as press attention to group structures and their tax implications means that CFOs and tax teams increasingly need to be able to explain the purpose of complex multi-company structures and the tax policy that a group applies. The reduction of complexity in a group simplifies this analysis and allows a more straightforward picture of a company to be presented to its shareholders, business partners, the media and customers.

A more detailed split of the various operational and financial benefits of CS exercises, along with the areas in which we find our teams helping businesses, is summarized in the benefit wheel below.
The CS spectrum

As CS exercises typically result in a reduction in the number of entities in a group, they may also bring closure for past tax liabilities and streamline future audits. While the laws of some territories or governmental units, including the laws of many U.S. states, may treat a transferee of assets as “stepping in the shoes” of an eliminated entity for purposes of assessing liability for certain past taxes, it may be possible to reach agreements with local tax authorities, regulatory bodies or other interested parties with respect to the entity’s final liability for past taxes.

Such agreements may foreclose future inquiries from tax authorities regarding the eliminated entity’s past tax liabilities and thereby reduce the scope of a successor entity’s future tax audits and the resources needed to address such audits.

The chart below describes the CS spectrum as we see it, which varies from the eradication of extraneous entities on the left, through rationalization exercises in the center, to single-entity models on the right.

### Legal entity reduction
- Liquidation of dormant entities
- Wind down parts of business
- Simplify legal structure

### Legal entity rationalization
- Post-acquisition integration
- Aim for one company per country where possible
- Centralize IP, treasury, SSC
- Explore “Regional Hub” concept

### Single entity models
- Single European entity
- Single entity by function; for instance, a single regional sales company

### Potential benefits

<table>
<thead>
<tr>
<th>Legal entity reduction</th>
<th>Legal entity rationalization</th>
<th>Single entity models</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scenario description</strong></td>
<td><strong>Potential benefits</strong></td>
<td><strong>Potential benefits</strong></td>
</tr>
<tr>
<td>Liquidation of dormant entities</td>
<td>Reduced legal, audit and compliance cost of multiple entities</td>
<td>Central control and risk management</td>
</tr>
<tr>
<td>Wind down parts of business</td>
<td>Reduced intercompany transactions</td>
<td>Reduced local country silo mentality</td>
</tr>
<tr>
<td>Simplify legal structure</td>
<td>Standardization and simplification of business processes</td>
<td>Supply chain rationalization</td>
</tr>
<tr>
<td>Creation and preservation of tax attributes</td>
<td>Simplified, quicker decision-making</td>
<td>Aligned transfer pricing and operational model</td>
</tr>
<tr>
<td>Tax-efficient consolidation of businesses and distribution of assets</td>
<td>Economies of scale</td>
<td>Competitive position with lower cost base territories</td>
</tr>
</tbody>
</table>

### The positive impacts of CS on tax controversy

Setting aside other benefits of CS and the not-to-be underestimated hurdles to executing the projects (with accompanying tax audit risk, which we will come to later), the simplified controversy benefits of the above three types of CS exercises can be summarized as follows:

#### Legal entity reduction

- Reduction to the number of corporate tax returns filed, members of a fiscal unity subject to intercompany adjustment and potential entities to be subject to a tax audit or review

#### Legal entity rationalization

- Reduction to number of registrations and filings from an indirect tax compliance and review perspective

- Reduction to number of intercompany transactions that may require transfer pricing supporting documentation and may be subject to review or challenge in terms of methodology used

Depending on the jurisdiction and type of tax, it may be possible to:

- Confirm the tax position of entities on liquidation or striking off – the important benefit of this is the assurance that there should be no further tax queries into the affairs of these companies.
Centralization of treasury and finance functions in one rationalized entity demonstrates a clear financing strategy and reduces the complexity of intercompany financing on an ad hoc basis between entities with surplus cash and those with funding requirements.

- Agree tax history — where tax basis in investments is not 100% known, it may be possible to agree a position with the tax authorities, thereby removing years of uncertainty and having a better understanding of the group and its tax profile as a result.
- Utilize tax attributes that may not necessarily be used otherwise – this should be done in a way that is obvious and easy to articulate to tax authorities.

**Legal entity rationalization**

- These projects would achieve many of the controversy benefits outlined above on entity reduction exercises, such as reduction to number of entities, returns, registrations, and potential associated tax audits or reviews.
- There may also be reductions to the number of local municipal or state/local tax filings required where rationalization exercises centralize offices into one local area within countries with such taxes.
- Whilst the entity reduction exercises will involve liquidations and striking off of dormant, low value or low activity entities, these exercises will also include mergers both within countries and across borders. In certain countries, mergers are more immediate than liquidations.
- Centralization of intellectual property (IP) in a hub company may result in reduced intercompany payments for IP, and promote consistency in the terms of these payments. By centralizing the IP management activities in a hub territory, the hub company may better defend or discourage any treaty based challenges from the paying territories.
- Centralization of treasury and finance functions in one rationalized entity demonstrates a clear financing strategy and reduces the complexity of intercompany financing on an ad hoc basis between entities with surplus cash and those with funding requirements. It also reduces the potential risk perception that there are tax-driven intercompany funding amounts or instruments between entities and allows historical funding arrangements to be unwound.
- Centralization of sales into a direct sales principal with sales support branches in each key territory changes the structure presented to tax authorities. If this can be managed rigorously, with agreement with the tax authorities on the profit attribution to branches, the permanent establishment (PE) risk can be reduced. There is a PE of the principal in existence and the focus is shifted from PE challenge to correct profit attribution.

**Single-entity models**

- Single-entity models generally occur in Europe, resulting in a single European company with its headquarters in the territory of incorporation of the main business and branches in the operational territories.
- The branch structure means immediate repatriation of funds to the headquarters territory, without the requirement of board meetings to declare dividends, potential dividend blocks that need to be resolved, withholding tax claims that need to be made and the complexities of tax credit on dividends from other entities. The overall system of profit repatriation is more straightforward from a tax perspective and it is less likely that important factors may be overlooked in the overall process.
- Centralization of operations in a single hub entity in a jurisdiction reduces the number of indirect tax registrations required, as all will be held by the one central entity in Europe. All indirect tax processes can be aligned within this one company and management of multiple registrations and returns is less cumbersome.

- The branch model generally reduces the level of controlled foreign company (CFC) review necessary within the subsidiaries. There may be CFC equivalent rules for low tax branches, but these may be less challenging as company CFC reviews.
- With respect to a single European company that is controlled by US shareholders, the single entity model may avoid inter-European cash movements from being treated as “subpart F income.”
- Where there is one European Board that is clearly making decisions for the whole business, and management in operating territories is limited, this also reduces the risk of residence challenges from tax authorities, although it is equally important to make sure that the central company is the territory of real management.
- Where the single entity becomes a true pan-European entity, potentially as a Societas Europeae, the legal form allowed under European law, the question of national profitability and tax becomes less pronounced than where multiple entities exist in different territories.
- In terms of funding, where the right territory is chosen for the headquarters (i.e., one with a good treaty network), analysis may be significantly simplified from multiple territories to the funding entity.
- The final point above with respect to PE risk and profit attribution is equally important with respect to a single entity model. If this has factories or non-sales support functions in branches then the pricing between branches and principal is more complex, but nonetheless the focus of the tax authorities should shift from PE to attribution.
These are just some of the multiple potential controversy and tax audit benefits to be derived from each of the three types of exercise. Such benefits are not the driver for such an exercise, and more of a fringe benefit once the target structure has been achieved. The precise benefits of any given exercise will be different, but given the shifting landscape, it is worth considering this in advance as a future indirect cost part of a cost benefit analysis, which is explored in some more detail below.

Cost benefit analysis

CS exercises are more commonly driven by commercial factors. When asked what the rationale was for a CS exercise in their group, our 900-plus tax decision-makers responded in various ways, but the main objective was clear. Thirty-three percent of those polled said that the exercise was driven by pure cost reduction, followed by 25% targeting improved business efficiency from a leaner corporate structure and 13% wishing to eliminate certain entities. If we consider improved efficiency to be an indirect cost improvement, more than half of the businesses are targeting cost reduction in these exercises.

This is a sign of the economically challenging times. When these types of exercise first started to become popular, there was a greater focus on improving corporate governance and control, as well as those less readily quantifiable benefits such as presenting a single face to customers. These were down to 8% and 2% of respondents in our survey last year.

The difficulty arises when one tries to calculate the cost reductions, and carry out a sensible cost benefit analysis. These exercises can be very costly in the most complex cases, in terms of liquidation costs, unwinding complex legacy structures, advisory and tax costs and also legal implementation. The costs that are removed from the structures as a result of each entity that is liquidated or struck off are ongoing costs over a long period of time, however, but are not necessarily removed entirely and where assets, functions or risks are moved to a central entity, its costs will increase accordingly. For some businesses the reduction of potential future tax audits for a given number of entities may be a component to justify the reduction in entities. For others a more detailed analysis is necessary to understand the likely costs of the exercise, and weigh this against the various benefits.

A difficulty arises in calculating both of sides of this equation with real accuracy. On the cost side of the cost benefit calculation, in some cases it is evident from the reduction to direct costs that the exercise will pay for itself in a matter of a few years, and it’s seen as worthwhile on that basis. For others, there is a desire to calculate in more detail, and where there is large-scale SAP information available, there are tools available to extract the relevant data from the accounts of the companies in question. This needs to be adapted in the case of each exercise but for some is a valuable indicator in deciding whether to go ahead with a CS exercise. Some examples of cost-saving analysis in large-scale exercises on which we have worked are illustrated below.

Project A – global pharmaceuticals group

- Entities eliminated: 102
- Carrying cost per entity estimated by the client: $45,000
- Cost savings on 102 entities: $4.6 million annual

Project B – global investment bank

- Approximate SPE population across numerous business lines: 200
- Total external cost savings estimates over a payback period of 12 to 24 months: €7 million

Project C – FTSE 100 global telecommunications group

- Entities eliminated: 80
- Cost savings per annum: £2.8 million

Project D – global technology group

- Entities eliminated: 80
- Entities in phase 1 (of three-year program): 16
- Audit and compliance cost savings per annum: £286,000

While these case studies represent large-scale entity reduction and rationalization exercises, they are a useful illustration of the potential financial benefit of such simplification. As well as these there are more specific examples in which tax inefficiencies have been identified and eliminated as part of the restructuring, and in some cases these may pay for the entire exercise.

Tax benefits can therefore be a focus of the analysis at the feasibility and design stage, and although cost rather than tax is the initial driver, tax when seen as a cost may in itself derive direct and indirect cost benefits in this type of simplification.
The consolidation of businesses and offset profits and losses currently in separate entities possibly facilitated where currently not possible on an efficient basis.

The business driven transfer of assets or repositioning of legal entities that could otherwise be taxable may now be achieved in a tax neutral manner.

The evaluation of the tax attributes in the current structure achieved with associated tax risk analysis, which may inform the decision to either unwind or preserve tax positions.

The potential to upstream cash in a tax-neutral manner.

The establishment and implementation of treasury policies around entity debt equity ratios and management of these within the framework of local capitalization requirements.

The release of intercompany balances and reserves in a tax-neutral manner.

The mapping and profiling of entities possibly revealing new tax attributes.

Simplification of the supply chain and centralization of assets possibly leading to reduced customs duty compliance and costs.

A single European entity possibly being able to transfer head office location without tax cost.

So although tax is rarely the driver behind these projects, pricing these benefits prior to restructuring may be convincing in terms of the cost benefit analysis. A detailed analysis in terms of the tax risks and hurdles is also essential prior to restructurings. Although tax may not be a driver, it is deeply involved in these exercises at all stages, so a quality tax review is paramount.

### Tax controversy on restructuring

Corporate simplification may be executed in different ways, some of which may be more tax efficient than others. When eliminating an entity, care must be taken to identify the elimination technique and successor entity that best serves the business purpose while preserving valuable tax attributes. Because the redeployment of valuable tax attributes among group members may invite close scrutiny by tax authorities, it is important, to properly document the business reasons for the chosen elimination transaction. In addition to inquiries regarding business purpose, a large restructuring such as a CS project, and the disclosure of the tax treatment of such projects on tax returns, may lead to other detailed queries or tax audits. A brief summary of the key areas of such attention in CS projects is as follows:

- Final compliance and pre-liquidation or strike-off statutory or non-statutory clearances from tax authorities.
- Tax analysis of any share disposals on liquidation of intermediary holding companies, including qualification for tax exemptions.
- Controlled foreign companies analysis of the contemplated future state structure and the tax free or neutral steps to achieve this structure.
- Repatriation of assets and cash prior to elimination.
- Tax basis analysis and supporting information on disposal or distribution of assets.
- Tax-free or tax-neutral transfers of assets between companies.

Where tax authorities take a risk-based approach and require up-front communication of significant issues to maintain a low risk status (such as in Australia or the UK, or in The Netherlands under the horizontal monitoring regime), a well-structured plan and analysis presented to the tax inspector may go a long way to mitigating a significant part of this controversy. In any case a study of how the restructuring is disclosed on submission of clearances and returns is essential, alongside documentation of the business reasons for the restructuring and the desired outcome from a business perspective. Where these exercises are undertaken to reduce costs and operations may be downsized in some
countries, even where the transfer pricing methodology remains the same, local profits may be reduced. In such cases clear communication of the facts to the tax authorities at the outset may help them to understand that there is no overall exit.

**Conclusion**

In summary, the benefits of a well-managed, streamlined corporate structure are relatively logical and obvious. Whether some increased tax risk and controversy attention that is to be expected on complex restructuring is worth the benefits of the future steady state will depend on the group and all facts and circumstances. In many cases the tax benefits will be ancillary to the overall commercial rationale for a centralization or simplification exercise.

Today, tax is under more scrutiny than ever before, from the fiscal authorities in which companies operate, as well as the media, which ultimately impacts both customers and employees. A simplified group is easier to explain, and harder to interpret as somehow supporting tax abuse. In any case, a well prepared analysis, at the design and implementation stages will help to maximize the tax benefits, while managing tax risk on execution on an ongoing basis.
Indirect tax in 2013: with change comes complexity

The sheer number and variety of changes in indirect taxes in recent years and the challenge of implementing them into accounting and reporting systems can be overwhelming – making it hard to keep sight of the bigger, strategic picture. But what do all these changes add up to? Do common themes emerge? What changes can we expect in the future?

The “tax mix” is shifting toward taxes on consumption

It is probably unprecedented in the long history of taxes that a specific tax mechanism, such as value-added tax (VAT), has spread around the world in less than a half century. Limited to less than 10 countries in the late 1960s, VAT – or, in several countries, goods and services tax (GST) – is today an essential source of revenue in more than 150. Despite its importance, VAT/GST is not the only indirect tax. Taxes on specific goods and services – consisting primarily of excise taxes, customs duties and certain special taxes – form the other important leg of indirect taxes. The unweighted average of revenue from the five broad categories of taxes as a percentage of overall taxation in the Organisation for Economic Co-operation and Development (OECD) member countries indicates that the proportion of indirect taxes make up about one-third of the total (Figure 1).
We believe that the importance of indirect taxes will continue to grow. The economic crisis has caused many governments to find sustainable ways to rebalance their budgets and stimulate growth. This would imply government will continue the shift from direct to indirect taxes, which are less harmful for growth, look to improve the efficiency of indirect taxes and take action to combat tax fraud and avoidance.

Figure 1. Tax structures in the OECD area

Source: OECD Tax Database

1. Percentage share of major tax categories in total tax revenue.
What is driving this change?

We have identified five key trends in indirect taxation that we believe will be significant for international businesses in 2013 and beyond:

1. VAT/GST rates are increasing.
2. Excise duties are on the rise again.
3. Free trade is increasing but is meeting protectionist challenges.
4. Indirect tax systems are becoming more efficient.
5. Tax administrations are focusing on compliance and enforcement.

Let’s consider each of these trends in detail and look at which regions of the world are most affected by each.
Around the world, many countries are relying more and more on indirect taxes to finance their budgets. Coupled with the ongoing economic crisis, VAT/GST rates have increased impressively in recent years as a result; at the same time, the scope of VAT has broadened in many countries.

The trend in rising VAT rates has been particularly strong in Europe, especially in the European Union (EU), where, as a result of the consistent rises, between 2008 and 2012 the average EU standard VAT rate increased from around 19.5% to more than 21% (Figure 2, p10). The upward rate trend in Europe continues as Cyprus, the Czech Republic, France, Finland, Italy, Poland and Slovenia have already increased rates recently or have announced increases later in 2013 and 2014.

In Asia-Pacific, the upward VAT/GST rate trend is less explicit, but still noticeable. Japan, for example, which is struggling with massive budget deficits, decided in August 2012 to increase the current VAT rate from 5% to 8% effective 1 April 2014 and to 10% effective 1 October 2015. Thailand has also announced a rise in the VAT rate from 7% to 10%, to happen by October 2014.

By contrast, VAT/GST rates in the Americas remain relatively stable. In South America, where VAT systems are widespread and have been in use for some time, rates have not changed much in recent years. One exception is in the Dominican Republic, where the rate is set to increase from 16% to 18% this year and next year.

**Broader base**

The scope of VAT/GST is also widening in many countries. This is being achieved through the “reclassification” of certain goods or services to apply a different rate and by removing exemptions. Examples of countries where the scope of the zero-rate (0% rate) was reduced in 2013 include Croatia, Norway and Kenya; while in the Dominican Republic, Jamaica, and Zambia, exemptions have been removed, and in Iceland, Italy and Poland, the application of the standard rate has been widened to goods that were previously taxed at reduced rates.

**The impact on business**

The immediate significance of this trend for final consumers is clear: retail prices rise. But its impact on businesses is equally important: higher VAT/GST rates increase the compliance risk. Companies must ensure that all the increases are properly dealt with in their accounting and reporting systems, which often results in a range of IT and administrative costs. Errors frequently arise when rates change, resulting, for example, from incorrect product or tax codings or confusion about the correct rate for supplies that span the change. More generally, rate increases mean the amount of VAT/GST “under management” also increases, as do penalties for errors that are based on the amount of tax payable.
The percentage of government revenues received from excise duties has seen a constant decline over recent years (Figure 1). However, this development has now slowed down and we might see a turn in the opposite direction as excise rates are rising and new duties are being introduced.

In Europe, in particular, all three important groups of “classic” excise duties (alcohol, tobacco and mineral oils) have seen significant increases, with the only decrease in fuel excise duties implemented in Slovenia in 2012. This year, excise duties on tobacco and/or alcohol have increased or will soon increase in most EU countries, Guernsey, Moldova, Norway and Switzerland. This trend can also be seen in other parts of the world; in Africa higher excise duties are being imposed on these items, e.g., in Benin, Gambia and Zimbabwe. In the Americas, Aruba, Canada, Costa Rica and Mexico have also raised taxes on alcohol or tobacco, as have Fiji, New Zealand and the Philippines in Asia-Pacific.

Influencing consumers

While the main purpose for excise duty rate increases – and the original reason for the introduction of excise duties – is to raise revenue, these taxes are also increasingly being used to discourage consumption of certain products considered to be harmful, thus influencing consumer behavior in a number of areas.

A relatively new trend is the introduction of excise taxes on health-related products (other than alcoholic beverages and tobacco products) such as snack taxes on “unhealthy” food. For example, Benin, Costa Rica, Norway and the Philippines have all increased excise duties on soft drinks, Finland has introduced an excise...
Customs duties were once a primary source of revenue for most countries. But continuously growing global trade and the efforts of organizations such as the World Trade Organization (WTO) have led to a constant reduction in customs duties around the world. This trend continues around the world as countries continue to conclude a growing network of various kinds of trade agreements.

The WTO currently has 158 members (the most recent, Laos joined at the start of February 2013) and it reports 546 active and pending reciprocal regional trade agreements among its members. This number does not include unilateral preference programs, that is, trade preferences granted to products imported from identified countries without reciprocal benefit, such as the Generalized System of Preferences (GSP) in the EU and the US, which provide duty-free treatment to many products from developing nations.

Environmental issues have played an increasing role in determining the nature and application of taxes. Over the last decade, environmental issues have also played an increasing role in determining the nature and application of taxes, e.g., on road fuel, motor vehicles and CO2 emissions. This type of measure includes tackling issues such as waste disposal, water pollution and air emissions. With support from the OECD, whose analysis seems to confirm the advantages of environmental taxes, many countries are introducing or increasing such taxes. For example, Germany has introduced a tax on nuclear fuel, Austria and Germany have introduced a duty on airline tickets for airplanes leaving from domestic airports, Iceland has introduced a tax on CO2 emissions and South Africa is currently working on a framework for a carbon tax for which legislation is expected in the latter half of 2013.

Free trade increases but is meeting protectionist challenges

Taxing financial transactions

Finally, there is a noticeable trend toward increasing the tax burden on financial transactions. Although there seems to be a common and widespread belief among countries that the financial sector should contribute its fair share in remedying the damage arising from the financial crisis, there is no common approach as to how this should be achieved. Some countries have increased supervision of the industry and tightened regulations. However, in Europe, in particular, the preferred approach has been to levy taxes on financial transactions. France introduced a financial transactions tax in August 2012, and on 1 January 2013, Hungary introduced a tax of 0.1% on the amount involved in any payment service. Italy will follow in March 2013 with a tax on the transfer of shares and derivatives and high-frequency trading. In addition, 11 EU member states have agreed to introduce a common transaction tax on the exchange of shares and bonds and on derivative contracts, which could be introduced as early as 2014.

Applying higher rates is just one way to increase indirect tax revenues; others include broadening the tax base of an existing VAT/GST system, increasing the efficiency of the tax system or improving compliance and enforcement.

Changing law and practice

Many countries are currently in the process of refining their indirect tax systems. In developed markets, long-standing VAT systems need to adapt to the demands of a 21st century digital economy. In emerging markets, which are experiencing economic developments at a fast pace, indirect tax systems need to adapt to keep pace. In India, for example, a new nationwide GST is ready to be implemented and only awaits agreement between the central and state governments. The new Indian system is intended to replace almost all existing

A number of new free trade agreements (FTAs) are expected to enter into force in 2013, thus further reducing the amount of customs duties imposed on global trade; examples include the agreement involving the EU and Peru and Colombia, Montenegro and the European Free Trade Association, and Hong Kong with the European Free Trade Association, and Indonesia and Pakistan. Nearing completion are, among others, the trade agreements between Costa Rica and Peru and between Canada and India, and negotiations are in various stages of completion for a range of others.

Duties still a significant source of revenue and cost

However, the situation is not always that straightforward. Although customs duty rates are generally reducing for international trade, these taxes still play a very significant role in meeting countries’ budgetary needs. In many cases, duty rates on many goods and materials remain high.

Unlike VAT/GST, duties charged at one stage in the supply chain are not offset against taxes due at later stages, so duties form part of the cost base of affected goods. In addition, customs clearance procedures can add to the time and related costs of moving goods cross-border. And even where FTAs exist, many businesses are not actually obtaining the potential benefits offered because they cannot or do not meet the qualifying conditions.

Protectionism

More generally, global trade may be hampered by the current economic climate, which is encouraging protectionist tendencies, as evidenced by the current difficulties encountered in the Doha Rounds. Non-tariff barriers have grown substantially in recent years, many in the form of health, safety or environmental requirements. The WTO reported 184 new trade-restrictive measures enacted between October 2010 and April 2011 and 182 between October 2011 and May 2012.

In addition, where countries are not bound by FTAs, import duties are still a common and often-used means to steer trade and production. For example, to boost the development of sugar cane production toward meeting the raw sugar needs of domestic sugar refining companies, effective 1 January 2013 Nigeria now applies a 0% import duty on machinery for local sugar manufacturing industries, but it has increased the total tariff on imported refined sugar to 80% from 35%, and raw sugar tariffs increased from 5% to 60%.

Non-tariff barriers have grown substantially in recent years.
indirect taxes levied at the state and national levels, minimize exemptions and do away with the current multiplicity of taxes. Similarly, China is in the process of replacing its current business tax on services with a broader-based VAT through a series of VAT pilots. In the end, it is intended to amalgamate all forms of China’s turnover taxes into the VAT.

In the EU, the European Commission has launched a comprehensive reform of the existing VAT system. The Commission has identified no fewer than 26 priority areas for further action in the coming years. The aim is to move to a more modern VAT system, which should be simpler, more efficient and more robust. Significant changes can be expected in the near future, such as the adoption of a one-stop-shop registration for all taxpayers’ duties or a standardized EU VAT return.

The US is still far from implementing a federal VAT. Currently, states apply their own consumption taxes, most of which are single-stage taxes on the sale of goods. But, even in the US, a trend can be seen toward states extending the scope of their current sales taxes. While sales taxes, by definition, only apply to purchases of physical goods, it is the market in electronically supplied services (such as digital music distribution, internet downloads or telecom services), which is growing fastest. An increasing number of states are, therefore, trying to expand their current sales tax to cover electronic goods and services or are trying to create a “nexus” for out-of-state vendors to constrain sellers to collect sales taxes on remote sales.

With more than 150 countries now operating a VAT/GST system and international trade still growing, it is becoming more important than ever to provide a global framework for a consistent interaction of all these different systems. For a number of years, the OECD has been working on developing international VAT/GST guidelines, which could provide the basis for such a framework. This initiative gained momentum following the OECD’s Global Forum on VAT, held in November 2012. The forum brought together more than 85 country delegations from all continents together with international organizations, academics and businesses to explore key policy trends and their impact for tax administrations and businesses.

**Improving tax administration**

Finally, governments have discovered that also on the administrative side, the efficiency of VAT/GST systems can be drastically improved – which increases tax revenues. There are many approaches taken by governments, but an important one is to create common interfaces and reduce gaps in the system. This is (among others) one reason why many governments are enforcing the use of electronic data transmission and filing.

**Figure 3. Electronic filing of VAT/GST returns**

In December 2012, we conducted a survey of EY Indirect Tax professionals in 39 countries and asked them about indirect tax compliance requirements.3

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mandatory</td>
<td>35%</td>
</tr>
<tr>
<td>Optional</td>
<td>8%</td>
</tr>
<tr>
<td>Not available</td>
<td>57%</td>
</tr>
</tbody>
</table>

In December 2012, we conducted a survey of EY Indirect Tax professionals in 39 countries and asked them about indirect tax compliance requirements.3 Twenty-five of the 39 countries surveyed require VAT/GST returns to be filed electronically on a mandatory basis, 12 states have an optional electronic filing (e-filing) facility and just two countries do not offer or require e-filing (Figure 3).

3. The survey included the following countries: Australia, Austria, Belarus, Brazil, Canada, Chile, China, Cyprus, Czech Republic, Denmark, Egypt, Finland, Germany, Greece, India, Indonesia, Italy, Kazakhstan, Latvia, Malta, Moldova, Morocco, New Zealand, Norway, Pakistan, Peru, Portugal, Romania, Russia, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Tunisia, Turkey, Ukraine.
The growing importance of indirect taxes to governments places more pressure on tax administrations to enforce compliance. This focus is leading to greater scrutiny of taxpayers’ affairs through more frequent and more effective tax audits and greater consequences for errors.

**Audit and exchange of information**

In Europe, where VAT rates are highest, high-profile cases of missing trader or carousel fraud, involving organized criminal gangs exploiting how VAT applies to cross-border trade, have shown that VAT systems are vulnerable to such attacks and they have alerted governments to the need for vigilance.

As a consequence, tax administrations in all parts of the world are putting a greater focus on indirect tax compliance and enforcement.

Our recent survey of Indirect Tax professionals in 39 countries indicates that, in the large majority of countries, the number of tax audits has increased in recent years and is likely to increase further in the future (Figure 4). Only six countries reported that audits had decreased; even then, in some cases, while the number of audits carried out was said to be lower, the amount of additional tax levied due to tax audits is still increasing. This finding seems contradictory, but it can perhaps be explained by tax administrations carrying out more targeted audits; 24 out of the 39 countries already use specialized IT tools such as audit software to detect irregularities or suspicious patterns in taxpayers’ tax returns.

In our survey 16 countries indicated that the tax administration exchange information about taxpayers’ VAT affairs with other countries. These countries are mainly found in the EU, where the common VAT system requires an extensive information exchange. On a global scale, the multilateral Convention on Mutual Administrative Assistance in Tax Matters, which is open to all interested countries, facilitates exchange.
of information on all compulsory payments to the general government except for customs duties. In the last two years, more than 50 countries have either become signatories to the convention or have stated their intention to do so. This will lead, without doubt, to increased international cooperation. But, even if countries do not (yet) share information, they increasingly exchange information internally, between different authorities and departments (e.g., with customs or social security authorities). Only four out of the 39 countries we surveyed do not share any information at all.

Targeting fraud but hitting “honest” taxpayers too?

There is nothing to be said against stricter compliance enforcement if it actually helps to fight fraud. Fraudulent behavior damages the overall economy and tax compliant businesses, which suffer competitive disadvantages. The other side of the coin, however, is that tax administrations have generally become more wary toward all taxpayers; they are less open to entering into discussion, and it is more difficult to reach mutual agreement on specific issues. Tax administrations increasingly apply a strictly formal approach not considering specific economic and business issues. This is bad news for all honest businesses, which want to be compliant, even more so as our survey shows that formal mistakes (e.g., missing information on invoices) are still by far the most frequent reason for indirect tax adjustments, be it an additional tax charge or the denial of input tax recovery (Figure 5). In addition, we observe a tendency for tax administrations to pay out input tax surpluses with increasing delay – if at all – or to reject an input tax claim based on bad faith, stating that the claimant should have known that his supplier did not correctly handle the tax.

At the same time, many countries are applying stricter penalty regimes in the case of non-compliance and mistakes. In our survey, 27 of the 39 countries reported that penalties are increasing, and only three saw a decrease (Figure 6). Fines are generally imposed faster and sooner and the fines are higher than in the past. Increasingly, fines are enforced for timing issues, such as late payment, where in the past tax administrations were more lenient on these issues (for example, Austria, Germany, Pakistan and New Zealand).

OECD publishes report on Co-operative Compliance


The report, issued at the conclusion of the 8th Annual FTA meeting held in Moscow, is designed to explore past and current experiences in relation to the concept of enhanced relationships between taxpayers and taxing authorities and sets out how such a concept may be developed and improved in the future. The enhanced relationship model can be defined as a relationship between revenue body and taxpayer based upon mutual transparency, cooperation and collaboration. As such, they can be characterized as a form of voluntary disclosure: the taxpayer promises actively to notify the tax authorities of any facts and circumstances regarding the issues without hesitation or reservation. In return for full disclosure, the tax authority endeavors to provide timely advice on significant positions, taking into account real commercial deadlines when doing so. That approach to service provides the taxpayer with increased timeliness and certainty.2

A significant part of the OECD report is dedicated to providing support to revenue bodies in demonstrating the value of the approach. It should be noted that the report was issued in “preliminary” form, indicating that future amendments are likely. Before looking at the development of the enhanced relationship concept, the report states that “National revenue bodies face a varied environment within which to administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance.” The report advises readers to bear this fact in mind when reading the document.

The preface to the report also points out the strong linkage calls upon tax administrators to undertake a number of steps to improve overall levels of tax compliance. As well as improving compliance levels, the preface sets out the belief that co-operative compliance can “...restore trust and confidence in the relationship between business and tax administrations.”

An overview of the report

The executive summary to the report sets out how, in 2008, the OECD’s FTA published the “Study into the Role of Tax Intermediaries" which analyzed the tripartite relationship between revenue authorities, large taxpayers and their tax advisors. The 2008 report concluded that taxpayers and revenue bodies should be encouraged to engage in a relationship based on co-operation and trust, with a core objective of reducing inappropriate aggressive tax planning or abusive tax avoidance transactions. The study described a conceptual framework for an enhanced relationship and recommended that revenue authorities should be encouraged to establish a working environment, processes and protocols within which a working relationship based upon mutual trust, transparency and cooperation can be achieved with large corporate taxpayers and tax advisors.
The report concludes that the value of a co-operative compliance relationship has now been established, and is further validated by how many countries have adopted such an approach since its inception in 2008. The report does note, however, that a number of lessons have been learned in the past five years, all of which are set out in the new co-operative compliance framework which is discussed throughout the report.

The report also points out that some questions have been posed on the choice of the name “Enhanced Relationships”, asking whether such a name may give rise to connotations of inequality in tax treatment. While the report points out that the underlying principles on which the approach is based remain sound, there was some concern that the name has given rise to misunderstandings (and in some cases suspicion) that the concept may violate important principles of fairness and equality. In this regard, the report confirms that the name for the framework will now be known as “Co-operative Compliance,” which comports more closely with the underlying purpose of improving compliance.

While the five pillars of co-operative compliance that were set out in the 2008 report have been maintained, the report sets out how the new framework for co-operative compliance will now incorporate a more systematic approach to tax risk, based upon the important concept of a Tax Control Framework that is followed by each business taxpayer. The OECD believes that the presence of such a tax control framework will allow more objective and justified criteria to be applied as part of the relationship between taxpayer and tax authority.

Finally, the report discusses the basic building blocks in its development, setting out how a project team sponsored by the Netherlands Tax and Customs Administration worked closely with the OECD Centre for Tax Policy and Tax Administration and members of the FTA Large Business Network, along with input from BIAC and representatives of the tax intermediary community.

### Implications for business

Much has occurred in the five years since the publication of the OECD’s 2008 report on the enhanced relationship. As the new preliminary report sets out, there is a strong linkage between the OECD BEPS project and co-operative compliance as a method for tax administrators to employ in order to improve overall levels of compliance. While traditionally employed only by those more mature jurisdictions, the OECD’s survey demonstrates that more and more countries are now adopting some form of cooperative compliance model.

The OECD’s preliminary report makes it clear that the existence of an effective, well-maintained Tax Control Framework sits high on their list of requirements when assessing an MNE’s suitability for entry into such a program. From the potential of the MNE, an effective TCF not only allows tax risks to be identified, assessed and corrected as early as possible, but also allows other opportunities to be realized, assisting the company in achieving its overall strategic objectives.

With mandatory disclosure and transparency requirements growing at a steady pace, and with many MNEs now assessing how to prepare for future transparency requirements, the existence of a strong TCF is paramount for effective tax risk and controversy management.

---

3. Commercial awareness, impartiality, proportionality, openness through disclosure and transparency and responsiveness.
GAAR rising – mapping tax enforcement’s evolution is the first comprehensive, global analysis of general anti-avoidance rules (GAAR).

While many governments say they will use GAAR only as a last resort, many clients tell us they are concerned it will be wielded too quickly in cases where tax is just one small step in a complicated business deal. And while governments see GAAR as necessary, businesses say they need certainty and clear guidance about when and how it will apply. A hastily designed or implemented GAAR can add to uncertainty for businesses and could be prone to scope creep that targets common business transactions.

Our report gives an overview of how GAAR has grown as a global phenomenon, describes the different characteristics of a GAAR, provides practical guidance for companies to consider and shares analysis of GAAR rules in 24 jurisdictions.

Download the report at:
www.ey.com/gaarrising
Recent and upcoming developments in more than 100 countries include:

- VAT/GST rate and other rate changes
- Excise and other indirect taxes
- Customs duty and international trade developments

Additional resource — Worldwide VAT, GST and sales tax guide:

What should taxpayers do?

The indirect tax trends identified in this article are not new. But it is precisely their continuing existence that indicates that they are important and long-term developments. All of these trends, be it higher rates, changes in the VAT/GST system or improvements in the way authorities administer the taxes, have a direct impact on businesses, which need to keep abreast of these changes.

Indirect taxes are not easy to manage. For example, excise duties, such as carbon taxes, change quickly and represent a high compliance risk because they typically operate differently in each country. Taxpayers who collect VAT/GST from final consumers on behalf of the state run increased risks of carrying the tax burden and eventual penalties themselves if they do not correctly manage the tax.

With tax administrations assessing taxes more thoroughly and using powerful and efficient tools, the chance that mistakes will be found has risen considerably and will remain high. Also, as indirect tax rates increase, the consequences of mistakes become more severe. This is particularly true for businesses that do not recover VAT/GST in full (e.g., because of VAT exempt activity) such as banks and insurance companies. But higher rates also have an increased cost or cash flow impact on companies that incur VAT/GST in foreign jurisdictions, which is not refunded quickly or, which they do not or cannot recover (e.g., because of an absence of refund schemes for non-residents or because of complicated refund procedures).

As indirect tax administrations are turning increased attention to enforcement — including joint audits with other taxes and even other countries — these activities may disrupt business activity. Large assessments for underpaid tax or penalties for late filings not only have an impact on profitability, they may draw unwanted adverse publicity, even for compliant businesses.

More than ever, it pays to proactively manage indirect taxes. Establishing a clear indirect tax strategy aligned to your overall business strategy will help you keep your business up to date with the rapidly changing tax environment and avoid additional costs and risks of poor compliance or missed opportunities.
Indirect tax management – more crucial than ever

- Consider how indirect taxes align to your corporate strategy
- Formulate and establish indirect tax management and reporting structures
- Assign high-level responsibility for indirect taxes (e.g., by appointing a VAT Director)
- Clearly allocate responsibilities between tax, finance, IT, logistics and the business units
- Map all business flows and analyze their indirect tax impact
- Analyze the impact on VAT/GST, excise and customs costs and reporting before entering new markets
- Use advanced technology (ERP systems, automated diagnostic tools)
- Streamline reporting and accounting systems used within the company
- Assure proper documentation and archiving of all relevant transactions
- Proactively identify potential issues and seek clarification
- Adopt appropriate key performance indicators to monitor compliance and performance
- Keep up to date with developments, especially in key countries
Australia

Base erosion and profit shifting – heightened local activities under way

Australia is not only considering the issues of international businesses’ tax adequacy and “fairness” parallel to the OECD base erosion and profit shifting (BEPS) project; recent law changes have also been presented as being relevant to BEPS.

Alf Capito
Asia-Pacific and Australia Tax Policy Leader
T: +61 2 8295 6473
E: alf.capito@au.ey.com

Howard Adams
Asia-Pacific and Australia Tax Controversy Leader
T: +61 2 9248 5144
E: howard.adams@au.ey.com
Readers who actively monitor tax policy and legislative developments around the world will be aware of the pace and volume of change being experienced in Australia. Recent months have delivered new disclosure and transparency requirements, a strengthening of the existing GAAR regime and significant new transfer pricing legislation. Several measures in May 2013 Federal Budget, packaged as “addressing aggressive tax structures that seek to shift profits by artificially loading debt in Australia”, affect conventional tax structuring and financing, not just aggressive structuring.

Public consultation relating to multilateral BEPS discussions

On 22 November 2012, the Assistant Treasurer highlighted the international tax debate concerning the perceived adequacy of taxes paid by multinational businesses, particularly companies involved in the ‘digital economy’ and asked Treasury to produce a scoping paper on the sustainability of Australia’s corporate tax base, including sourcing input from a specialist reference panel.

The key focus of the Treasury paper will be “to build community understanding of the nature of the challenges we face.”

Media comment has highlighted that Australia should develop its approaches volumes which bear little tax in the countries to which the exports are transported.

Disclosure of taxes paid by large companies

On 4 February 2013 the Assistant Treasurer announced a proposal that large businesses and multinational companies report taxes paid in Australia, in order to “encourage enterprise to pay their fair share of tax and discourage aggressive tax minimization practices.” and “allow the public to better understand the business tax system and engage in debates about tax policy.” Concerns were raised during the very short consultation phase but the government introduced a tax B4 with the proposals largely unaltered: This Bill expected to be passed by Parliament in June 2013.

Larger companies will need to consider not only the impact of the disclosure but also the need to prepare for potential queries from the public and media in relation to their tax payable. For example, companies with low taxes due to tax concessions arising from large capital expenditure will need to prepare for any public disclosure regime to ensure that their low tax levels are not misunderstood.

Significant new transfer pricing law and changed General Anti-Avoidance Rule (GAAR)

The significantly-named Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 is expected to be passed by Parliament during the last sitting week in June 2013 will:

• Replace the Transfer Pricing regime and
• Amend the general anti avoidance rule. known as Part IVA.

The transfer pricing rules replace existing transfer pricing rules as modified by interim 2012 changes. The rules will have effect from the first income year commencing on or after 1 July 2013. Major changes to the transfer pricing rules include:

• Introduction of a self-assessment regime, effectively requiring public officers to sign-off on the appropriateness of their transfer pricing.

• Penalty regime linked to documentation: preparing transfer pricing documentation is not compulsory; however failure to prepare documentation results in an entity not being able to establish a reasonably arguable position and may lead to larger penalties in the event of an ATO audit.

• Extensive reconstruction provisions require taxpayers to go beyond the transactions in assessing their transfer pricing and provide the ATO with extensive powers to substitute transactions that the ATO believes better reflects arm’s length behavior.

Provisions that effectively require a double test, where taxpayers have to assess the overall commerciality of their arrangements as well as the pricing of individual transactions. The new transfer pricing rules are designed to bring the Australian domestic regime in line with international practice through a link with the OECD Guidelines. However, there are several areas where the rules diverge from these guidelines, established international practices and historically accepted practice by the ATO.

Businesses will need to review their existing transfer pricing arrangements for conformity with the new rules, specifically around the adequacy of documentation. For some businesses there will need to be significant additional work to align existing arrangements. Documentation to meet the minimum requirements must:

• Be prepared contemporaneously (i.e., before an entity lodges its income tax return).

• Explain how actual conditions are consistent with arm’s length conditions.

• Explain how the selection and application of transfer pricing method best achieves consistency, with the OECD guidelines (and OECD Model Tax Convention for Permanent Establishments).

Australia’s General Anti Avoidance Rule (GAAR) amended

Australia also introduced in the abovementioned Bill the long-awaited amendment to Australia’s general anti avoidance tax rule, known as Part IVA. Part IVA requires identification of a tax benefit from a scheme. The amendments are intended to prevent courts deciding that a taxpayer would, but for the relevant scheme, have done nothing and so Part IVA would not apply in those circumstances.

From a practical perspective, taxpayers will need to rely more heavily on establishing that they have not entered into transactions with a dominant purpose of obtaining a tax benefit. The definition of tax benefit has been potentially broadened. This analysis will therefore need to be undertaken more frequently and in relation to transactions that would generally be considered as “normal commercial activities.” The amendments will apply to transactions that commenced to be carried out on or after 16 November 2012.

The amendments seek to:

• Confirm that questions whether Part IVA applies to a scheme start with consideration of whether any person participated in the scheme for the sole or dominant purpose of securing a tax benefit.

• Establish two different tests for determining whether a tax benefit exists: one for schemes involving tax consequences that “would have” resulted if the scheme had not occurred and the second for schemes involving tax consequences that “might reasonably be expected to have” resulted if the scheme had not occurred.

There is no guidance in the Bill as to when a scheme falls within the “would have” or “might” categories; this needs to be resolved. Further, from a practical perspective it is unclear how the dominant purpose test can be applied without first determining the tax benefit, given that the dominant purpose test is applied by reference to what occurred and the tax benefit in question.

Financing tasks for multinational businesses – 2013 Australian Budget impact

Several measures in the May 2013 Federal Budget, packaged under the title “addressing aggressive tax structures that seek to shift profits by artificially loading debt in Australia” affect tax structuring and financing by Australian businesses, impacting:

7. For more information, please see GAAR rising: mapping tax enforcement’s evolution: www.ey.com/gaarrising.
• Tax deductions incurred by multinational groups in Australia for funding activities by altering the thin capitalization rules
• Deductibility of interest incurred on debt used to finance overseas investment
• The structuring of foreign subsidiaries and investments

The intended start date is for income years starting on or after 1 July 2014. That is a very short time for policy development. The changers must be considered immediately when for new financing or refinancing strategies.

Multinational businesses, both Australian owned and foreign owned, need to identify the risks and promptly consider the impact on their:

• Australian debt facilities and financing
• Refinancing of existing financing arrangements
• Foreign subsidiaries’ existing capital structures
• New funding of foreign operations

Immediate actions might involve considering restructuring of the financing and capitalization of foreign subsidiaries, and lobbying to ensure the adjusted law deals with practical issues and challenges in the new tests. Listed businesses might also need to consider the obligations under the continuous disclosure rules.

Prepare for a more active ATO scrutiny of multinational businesses

Many of the initiatives proposed in the OECD BEPS report are already familiar to Australian taxpayers; the ATO has been a leader in the Forum for Tax Administration (the international organization for tax authorities) encouraging multinational tax authorities to increase their scrutiny of multinationals, to exchange information, and to better understand cross border tax planning. For example the UK Inland Revenue has appointed Jennie Granger as Director General Enforcement & Compliance: she was previously Second Commissioner Law at the Australian Tax Office, tracking the interface between the legislation and tax compliance activities.

Australia’s new (since 1 January 2013) Commissioner of Taxation Chris Jordan confirmed the tax administration’s commitment to supporting the government’s anti-base erosion efforts. “Is it legitimate for international businesses to be left alone to adopt very aggressive structures?” asked Mr. Jordan in a recent speech. “Part of my role is to ensure businesses operate within the law. I want business to clearly know, if they choose questionable or very aggressive practices there will be consequences. The ATO has compliance tools to discourage inappropriate practices and I’ll direct my officers to continue to make full use of the toolkit.”

At the May 2013 meeting of the Forum for Tax Administration, Mr Jordan accepted leadership of the FTA initiative to develop a multilateral approach by tax authorities to multinational enterprises. Therefore, multinational businesses operating in Australia must consider as immediate priorities:

• Preparing for likely increased attention from global revenue authorities in relation to their taxes payable, pursuant to the OECD BEPS project
• Ensuring that they are prepared for the likely increased public interest in tax payment adequacy by multinational enterprises, which is likely to grow through the 2013 reporting and Annual General Meeting season
• Assess any reputational risk issues which might arise from the heightened public attention
• Consider the extent to which they will participate in the tax policy debate relating to multinational corporations, which will go into high gear in 2013 and 2014

---

In an interview that we published in our February 2011 issue, then-Canada Revenue Agency (CRA) Commissioner and CEO Linda Lizotte-MacPherson announced that the CRA would begin phasing in its new risk-based Approach to Large Business Compliance (ALBC) over the next five years.¹ The CRA is now well under way in rolling out this new audit approach across the country, beginning with a pilot project of 50 large businesses from 2011 to 2012. The new approach is of interest and relevance far beyond Canada because it shares a number of characteristics of new audit approaches being used by other tax authorities, particularly in other Organisation of Economic Co-operation and Development (OECD) countries.

To date, taxpayers’ reaction to the new approach in Canada has been mixed, but it generally can be characterized as cautiously optimistic. Therefore, this is an opportune time to more closely examine the approach and experiences to date, set out the likely implications for large taxpayers with operations in Canada, and provide some advice and suggestions on what steps they should consider taking in response.

A good place to begin is by explaining which taxpayers are affected, what approach the CRA had used previously to enforce large business compliance, why it changed its approach and what it is doing differently under the new approach.

**Which taxpayers are affected?**

The CRA uses an administrative definition of “large business” for purposes of corporate tax audit selection and coverage. Any business with C$250 million or more in annual gross revenues is considered to be a large business for audit purposes. At present, this large taxpayer audit population comprises about 1,100 businesses in Canada.

**An evolution in CRA’s Approach to Large Business Compliance (ALBC)**

Traditionally, the CRA maintained more or less continual audit activity and presence in virtually all 1,100 large businesses with wall-to-wall field audits conducted by separate teams of auditors with different specializations, including international tax, transfer pricing and tax avoidance.

However, that audit approach started to evolve as a result of several developments. The first was significantly increased supplemental funding for the CRA in the 2005 and 2007 federal budgets that was aimed at combating a perceived increase in international aggressive tax planning.

At the same time, the CRA implemented an organizational realignment as a result of undertaking a “functional activity review” that was designed to achieve greater synergy in the deployment of audit resources in high-risk areas. In the Compliance Programs Branch at CRA headquarters, the previously separate Tax Avoidance Division and International Tax Directorate were combined with the Large Business Division to form the new International and Large Business Directorate (ILBD). These previously separate programs were also integrated operationally in the field.

With the additional funding, the CRA also created 11 Centres of Expertise for international tax across the country. These allowed auditors with specialized knowledge and experience to work together on industry- and issue-specific areas of research and provide guidance in the conduct of audits in the area of aggressive international tax planning.

The CRA also designated certain local tax services offices across the country as Industry Coordinating Offices for audits of the pharmaceutical, financial institutions, oil and gas, and automotive industry segments.

**Global trends in large business tax compliance: the "enhanced relationship"**

The CRA did not undertake these developments in isolation of changes that were occurring in other tax administrations internationally. Just as large businesses have recognized they have to operate globally to expand and remain competitive, tax authorities have realized the need to work together on a worldwide basis and have responded to globalization with increased international cooperation and collaboration.

2. Subsection 225.1(8) of the *Income Tax Act* defines a “large corporation” as any corporation whose taxable capital employed in Canada, plus the taxable capital of any related corporation, exceed $10 million. However, this legal definition applies for specified legislative purposes including tax remittance, collection of reassessed tax, objections and appeals and failure to file penalties, not for audit selection or other administrative purposes.


They have accomplished this in part by gathering and sharing information on a bilateral basis, using a rapidly growing network of tax treaties and tax information exchange agreements (TIEAs). Canada, for example, currently has a network of 90 bilateral tax treaties and 16 TIEAs in force (3 TIEAs are signed but not yet in force, and another 11 are under negotiation).5

Perhaps more significantly, though, collaboration has been facilitated by membership in an expanding number of multilateral forums designed for that purpose. One example is the Joint International Tax Shelter Information Centre (JITSIC) created in 2004, whose original purpose was to:

- Share expertise, best practices and experiences to identify and better understand abusive tax transactions and emerging schemes, as well as those who promote them
- Exchange information about specific abusive transactions and their promoters and investors
- Carry out individual abusive transaction enforcement activities more effectively and efficiently.6

In terms of leadership and guidance concerning approaches to large business compliance, the most influential forum has arguably been the Forum on Tax Administration (FTA), which the OECD established in 2002 to develop effective responses to tax administration issues in a collaborative fashion.

At the third meeting of the FTA, in Seoul, South Korea, in September 2006, tax commissioners from 35 OECD and non-OECD countries met to discuss how to improve the relationship between revenue bodies, large corporate taxpayers and tax intermediaries. This idea of an “enhanced relationship,” as it was subsequently coined, was formalized into a conceptual model in a Study into the Role of Tax Intermediaries report released by the FTA in January 2008.8

The report recommended that tax authorities place greater reliance on tax management techniques as an essential tool to stratify large business taxpayers into different risk categories and then allocate audit resources accordingly. It underlined the need for revenue bodies to obtain information to effectively carry out these risk assessments through statutory obligations, mentioning advance disclosure regimes already in place in certain jurisdictions, such as Canada in particular. The report also encouraged taxpayers to provide information voluntarily, while noting at the same time the fact that important sources of information on large corporate taxpayers are those that are publicly available through accounting requirements – such as the FASB Interpretation 48 (FIN48) rules that were in place in the US by then and Australia’s Reportable Tax Positions (RTP) program, both of which require the disclosure of uncertain tax positions.

The report went on to state that “a more collaborative, trust-based relationship can develop between revenue bodies and large corporate taxpayers who abide by the law and go beyond statutory obligations to work together co-operatively. This is the enhanced relationship. It is a relationship that favors collaboration over confrontation, and is anchored more on mutual trust than on enforceable obligations.”9

When it released its Study into the Role of Intermediaries at the conclusion of its fourth meeting in Cape Town, South Africa, which 45 countries attended, the FTA issued a communiqué reiterating the Study Team’s recommendations that FTA countries risk-assess large corporate taxpayers and develop appropriate compliance responses. At the same time, the FTA acknowledged that the relationship between tax administrations and taxpayers varies between countries in accordance with different administrative and legal frameworks.10

These recommendations were in turn followed by the release of the report Corporate Governance and Tax Risk Management in July 2009.11 The report noted that many large businesses have changed the way they approach corporate governance and tax compliance, reflecting an environment of heightened community sensitivity to social responsibility. It pointed out that leading practice corporate boards are mandating that tax risk must be managed like any other enterprise risk.

The FTA report contained case studies from three member countries describing different experiences in promoting good corporate governance and enhancing relationships with large business. One of these case studies was from Canada. It stated that:

“The Canada Revenue Agency (CRA) is revising its audit program to recognize the differences among large businesses with respect to the strength of their governance and their willingness to deal with CRA in an open and transparent manner. In brief, audits will be eliminated or targeted to specific issues where there is evidence of strong governance and a willingness to work with CRA on an open and transparent basis. Agency resources that are saved from this reduction in auditing will be re-focused to address taxpayers whose governance is weak, or purposely risk tolerant, as well as taxpayers who do not operate in an open and transparent manner. An important feature of this approach will be that CRA will advise the taxpayer of how the Agency perceives their governance, openness and transparency, along with other risk factors and accordingly, the compliance approach that will be utilized.”

Thus, although it was not launched until 2011, the foundation for the CRA’s new ALBC was actually being laid through international collaboration with other FTA countries from 2006 to 2009. This in turn highlights the long development cycle of such fundamentally different approaches. Therefore, one might also assume that similar approaches are being developed elsewhere.

CRA’s new ALBC

One of the cornerstones of the CRA’s new ALBC is an increased reliance on risk assessment tools and techniques to help ensure that the compliance approach to each taxpayer is commensurate with its own risk profile and, similarly, to allocate audit resources across broad groups of taxpayers in accordance with the risk of non-compliance that they represent.

Under this new approach, the CRA assesses the risk of non-compliance associated with each large taxpayer, beginning with internal information drawn largely from the tax returns filed by the taxpayer, including supplemental information from reporting requirements contained in the Income Tax Act. This internal information is largely quantitative and does not necessarily provide much insight into the company’s internal controls, corporate culture and appetite for tax risk. For this reason, it is supplemented by information that is more qualitative and behavioral in nature, which is obtained from the company’s answers to a questionnaire sent by the CRA and accompanied by a letter addressed to a senior executive of the company, sometimes the CEO.

The questionnaire focuses on the company’s tax risk management approach and corporate governance, the second cornerstone of the ALBC. Among other things, it asks whether the company has a formal framework for identifying and assessing major tax risks associated with its normal ongoing operations; how material risk is reported, managed and monitored; what steps are taken when material risk is identified; whether its tax strategy is consistent with its overall business strategy; and whether it has a risk management committee.

With the information it has assembled, the CRA assesses the risk for each large business using the National Risk Assessment Model (NRAM) to consider the following main risk factors:

- Audit history
- Corporate governance (tax and or audit committee, oversight)
- Corporate structure (e.g., controls)
- Openness and transparency (relationship with the CRA)
- Participation in aggressive tax planning schemes
- Unusual and/or complex transactions
- Major acquisitions or disposals
- Industry sector issues
- International transactions

Companies in a given industry are stratified into high-risk, medium-risk or low-risk categories, in a similar (but slightly different) model to that used by Australia’s ATO, where large companies are assigned to one of four “quadrants.”

The letter accompanying the questionnaire requests a follow-up meeting with company executives, sometimes requesting the attendance of one or more members of the C-suite, including the CEO, CFO or a member of the audit committee. During the meeting, the CRA provides a general overview of the new ALBC and then shares its initial risk rating with the company officials. The risk rating exercise and meeting is intended to be a recurring event with each large business and is designed to improve transparency and build a more collaborative, less adversarial relationship with the tax administration.

Consistent with this philosophy, over time the CRA has stated its intention to reallocate large business audit resources away from low-risk taxpayers to high-risk taxpayers. However, it has not yet articulated how or when this will happen. “The multiyear strategy to implement the ALBC is progressing well,” Lucie Bergevin, Director General of the International and Large Business Directorate at CRA, told EY. “The approach is based on risk assessment of every large business, using a wide range of risk factors, followed by the segmentation of the population into risk segments with corresponding tailored programs. Over time, we are actively advancing our efforts in exploring the potential for implementing some form of enhanced relationship initiative in Canada.”

Pathway to success

The success of this new approach ultimately hinges on the ability of both taxpayers and tax administrators to adapt appropriately. Resistance to the type of behavioral change required to make the ALBC a success is not limited to taxpayers. The new approach requires a change in traditional attitudes inside the tax administration as well. As former Commissioner Lizotte-MacPherson recognized, “Building an environment of mutual trust is not easy... and involves a degree of cultural change by all parties, including our own CRA managers and officers.”

Discussing the relationship between tax administrators and taxpayers in the context of the OECD’s enhanced relationship initiative, Jeffrey Owens, the former Director of the Centre for Tax Policy Administration at the OECD and now Senior Advisor to the Vice-Chair – Tax of EY, sets out this mutual challenge nicely in observing:

“There is also the shared risk that the change in attitudes will not go beyond the Commissioner office or the corporate boardroom and that neither side will devote the resources initially required to facilitate the necessary cultural change. The behavioral change also needs to extend down the chain of command to those that are engaged in audit activities, and this communication between executive and field office has long been a source of frustration for tax administrators and taxpayers alike.”

Peter van Dijk, Senior Vice President of Tax at Toronto Dominion Bank Group, fails into this group. “There are some significant challenges with the new approach to large business,” he says. “Among the most significant is the level of cultural change that is necessary both within the corporation as well as the tax authority. That said, I think that overall it’s an efficient way of focusing very limited tax authority resources on the most aggressive taxpayers and issues. For those taxpayers that have strong governance processes, don’t engage in aggressive tax behavior and maintain transparent, cooperative relationships with the CRA, one would expect a more limited and focused review of their tax position. That seems like a good use of time and resources.”

It would be unrealistic to expect the entire large business community to unreservedly embrace the new approach. Having said that, the most common taxpayer reaction has been cautious optimism. A majority believes that this new approach represents a significant improvement over the past that should result in a more commercial awareness by the tax authority and a more business-like approach to tax compliance. They believe it is possible to establish a more transparent and less adversarial relationship, which in turn should result in lower compliance costs, more audit currency and greater tax certainty for their company.

Peter van Dijk, Senior Vice President of Tax at Toronto Dominion Bank Group, falls into this group. “There are some significant challenges with the new approach to large business,” he says. “Among the most significant is the level of cultural change that is necessary both within the corporation as well as the tax authority. That said, I think that overall it’s an efficient way of focusing very limited tax authority resources on the most aggressive taxpayers and issues. For those taxpayers that have strong governance processes, don’t engage in aggressive tax behavior and maintain transparent, cooperative relationships with the CRA, one would expect a more limited and focused review of their tax position. That seems like a good use of time and resources.”

Conclusions and recommendations

While the ALBC is conceptually similar to the OECD’s enhanced relationship initiative, the CRA itself acknowledges that it has not yet implemented a full-featured enhanced relationship program covering all aspects of annual compliance obligations, such as the Compliance Assurance Process program in the US or the Horizontal Monitoring program in the Netherlands.

Unlike the ALBC, which is being applied universally across the entire large business audit population, participation in these two latter programs is voluntary on the part of the taxpayer. They also have entry requirements, promise immediate benefits and are based on a formal memorandum of understanding or compliance covenant between the two parties.

The CRA should reorient the ALBC in the direction of these programs, or initiate a smaller pilot program, in order to move more quickly to reward compliant taxpayers with tangible results in the form of more certainty, fewer and less intrusive audits, and lower compliance costs. At the same time, it should reallocate the audit resources that are freed up toward those taxpayers and areas of concern that represent higher risk.

EY’s periodic tax risk and controversy surveys of tax directors and corporate executives in large businesses have shown that corporate boards and their audit committees are spending more time on a wide range of tax concerns as global tax risks increase and have a higher profile and priority. Initiatives such as the CRA’s ALBC provide an additional incentive for them to increase this oversight.

Large businesses should respond by not only continuing but also accelerating this trend. They should also implement formal tax risk management frameworks with the capacity to identify and manage key tax risks across the tax life cycle, making sure that they become a standard part of tax governance. This is perhaps more important than ever given the current volume and complexity of global change.

Ultimately, success will be measured by whether tax risk is managed in a way that meets both the needs of business and the expectations of revenue authorities. The goal is to achieve a level of certainty about tax positions, tax reporting and tax planning that aligns with the principles of good corporate governance and satisfies the concerns of both parties.

Before joining EY in 2010, Fred O’Riordan was Assistant Commissioner of Appeals at the Canada Revenue Agency, where he had also formerly been the Director General of International and Large Business and the Senior Advisor to the Commissioner.

---


India’s budget maintains the high pace and volume of change

On 28 February 2013, India joined a growing list of countries unveiling their 2013 budgets. Maintaining the high pace and volume of change seen in the last few years, the budget included a deferral of the General Anti-Avoidance Rule (GAAR) provisions by two years, assessment of additional income tax on the buyback of shares of an unlisted company, an increase to 25% of the tax rate for royalty and fees for technical services income streams, and the assertion that the tax residency certificate (TRC) is necessary, but not sufficient, for claiming treaty benefits.
While perhaps not capturing the media headlines after the budget, an expected measure was a small increase from the existing 5% to 10% and 2% to 5% in the surcharge for the tax year 2013-14, imposed on domestic companies and foreign companies respectively having income in excess of INR100 million (approximately US$1.8 million). This has resulted in an effective tax rate (including surcharge and cess) of 33.99% in the case of domestic companies and 43.26% for foreign companies earning income in India.

GAAR deferral

GAAR was introduced in the Finance Bill 2012 and would have become effective 1 April 2013, except for a high number of strong representations made by various stakeholders against the introduction of the GAAR in the form it was proposed. The Expert Committee was therefore formed to review the GAAR provisions. The committee took into account the industry concerns and the immense challenges that the proposed GAAR provisions could bring up, and it made many positive suggestions. In a press release dated 14 January 2013, the Finance Minister announced the acceptance of the committee’s recommendations on the major aspects.

The following are some of the GAAR-related measures introduced in the 2013 budget:

- The GAAR is deferred by two years and will apply from tax year 2015-16 onward.
- The “main purpose” test to obtain a tax benefit is required to be satisfied as opposed to “one of the main purposes” test that was specified earlier.
- The period for which the arrangement was in existence, payment of taxes and availability of an exit route are considered relevant but are not sufficient to decide whether an arrangement lacks commercial substance. Further, an arrangement will be deemed to lack commercial substance if it does not have a significant effect on business risks or net cash flows other than the tax benefit effect.
- The Approving Panel will consist of a chairperson who is or has been a judge of a high court, a senior member from the Indian tax authorities, and a member who is an academic or a scholar with specialized knowledge.
- Both the taxpayer and the Indian tax authority will be bound by the directions of the approving panel.

Remaining issues for the GAAR

While the Government’s move to address the concerns of the taxpayers and legislate on aspects relating to the GAAR is welcome, for greater clarity and certainty to taxpayers, the following issues still need to be addressed:

- In a press release dated 14 January 2013, the Finance Minister announced that the investments as of 30 August 2010 (being the date of introduction of the Direct Tax Code) would be grandfathered. However, absence of this proposal in the Finance Bill 2013 has raised uncertainty.
- Statutory recognition is needed for the following decisions announced by the FM:
  - GAAR will not apply to foreign institutional investors (FIIs) who do not avail treaty benefits and to the nonresident investors in FIIs.
  - There will be a monetary threshold of INR30 million of tax benefit in a year for invocation of GAAR.
  - GAAR will only apply to that part of the arrangement that is impermissible and not to the whole arrangement.

1. A surcharge levied on tax, utilized by the Indian Government to fund education.
Most countries recognize that profit distributions will have already suffered a corporate tax in the hands of the company distributing dividends. There is, therefore, a case for a review of the proposal so that it only captures transactions that are entered into with an intent to avoid tax and do not apply to all transactions of buyback of unlisted shares.

- Investors are also looking forward to adoption of the following principles outlined by the Expert Committee in its report on GAAR:
  - As an overarching principle, GAAR should apply to only abusive or highly aggressive/contrived arrangements.
  - GAAR provisions should codify the substance over form doctrine.
  - GAAR should not cover tax mitigation by taking advantage of a fiscal incentive and after complying with conditions of the section.
  - The onus of proving each of the requirements of declaring the arrangement to be impermissible should be on the tax authority.
  - GAAR provisions should not override treaty provisions.
  - GAAR should not be invoked in a case where there is compliance with specific anti-avoidance rule (SAAR) and the subject matter is dealt with under SAAR.

**Taxation of buyback of shares of an unlisted company**

The budget proposes a levy of 20% tax (plus applicable surcharge and cess) to an Indian company when buying back its own shares. This tax is imposed on the difference between the consideration paid for buyback and the sum received at the time of the issuance of the shares by the Indian company. As in the case of a dividend distribution tax, this income would not be taxed to the shareholder when distributed. The tax is effective from 1 June 2013 and applies to shares that are not listed on any stock exchange.

This dividend tax is at odds with international practices, and it can be questioned whether this is an indirect way of denying treaty benefits, as the extension of the tax treatment of dividends to capital gains effectively amounts to overriding the treaty benefits for capital gains. This issue was examined by the Expert Committee in the context of GAAR, and it had explicitly recognized that dividends should not be subject to GAAR. However, the Finance Bill has accelerated the GAAR provisions and given them a broader scope.

Buyback arrangements are typically performed for valid commercial purposes and are not related to any motivation to circumvent dividend distribution tax. Most notably, the buyback as a substitute for dividend can only take place in the case of wholly owned subsidiaries. The non-wholly owned subsidiary situations cannot be viewed as transactions for avoidance of dividend distribution tax.

Most countries recognize that profit distributions will have already suffered a corporate tax in the hands of the company distributing dividends. Hence, to ease the burden on the shareholder (and also to avoid economic double taxation), it is not taxed again on either distribution in the hands of the distributing company or by way of a withholding tax on dividend payments on distributions to shareholders (e.g., in the United Kingdom and Brazil).

There is, therefore, a case for a review of the proposal so that it only captures transactions that are entered into with an intent to avoid tax and do not apply to all transactions of buyback of unlisted shares. Further, it is our view that the proposed tax rate should not exceed 10%.

**Tax Residence Certificate (TRC)**

The Budget incorporates a provision in the income tax law, to the effect that the submission of the TRC is necessary but not sufficient for claiming benefits under a treaty. This applies retroactively from the tax year 2012-13. The proposal sparked immediate concerns and uncertainty among the investors about the continuing applicability of Circular 789 in respect of Mauritius and the undue inquiries from the authorities. Further, there is apprehension that the nonresident taxpayer would be compelled to obtain a TRC before the stage of payment itself, without which Double Taxation Avoidance Agreement (DTAA) benefit may be denied.

Even the existing provision of obtaining TRC is a compliance burden for the nonresident taxpayers. There is no threshold limit beyond which a TRC is made compulsory, and the TRC needs to be obtained in the form and manner prescribed by the Indian income tax authorities, which may not be entertained by the foreign government.

Responding to the widespread concerns, the Finance Ministry issued a press statement on 1 March 2013 clarifying that TRC will be accepted as evidence of tax residency and that the tax authorities will not go further than the TRC to question the residential status. However, to provide reassurance to investors, a categorical clarification will be important. This can be done using a formal Circular by the tax authorities that reiterates the contents of Circular no. 789 to the effect that a TRC will be regarded as necessary and sufficient evidence for the purpose of evidencing residency and beneficial ownership.
Increase in tax rates on royalties and technical service fees

Presently, the domestic tax law provides for a tax rate of 10% (plus surcharge and cess) on the gross amount of royalties and fees for technical services (FTS) received by a nonresident person from an Indian concern. This Budget increases this tax rate to 25% (plus surcharge and cess). However, where a treaty provides for a lower tax rate, it will prevail over the domestic tax law rate if the recipient qualifies for benefits under the treaty. The new rate applies from tax year 2013-14 on all royalty and FTS payments.

The intention behind the increase in the tax rate is stated to be twofold. The Finance Minister observed that the majority of tax treaties allow India to levy tax on gross royalties at rates ranging from 10% to 25%. However, the 10% tax rate under the law has resulted in taxation at a lower rate of 10% even if the treaty allows the income to be taxed at a higher rate. Also, it was felt that the lower rate of 10% is being abused for distribution of profit by subsidiaries to a foreign parent company in the form of a royalty.

Given the broad coverage of FTS and royalty definitions under the Indian tax laws, the existing tax rate of 10% should be retained, in line with the rate provided in the majority of the tax treaties. Enhancing the current rate to the proposed 25% would adversely impact a wide range of cross-border transactions with India. The high rate of 25% may be restricted only to transactions with persons located in certain specified jurisdictions.

Unaddressed issues

Indirect Transfers

It was expected that to provide greater certainty on this long-pending issue, the Government would announce its final view on the taxation of indirect transfers and introduce relevant legislative amendments in the 2013 Finance Bill. Absence of provisions to address indirect transfer taxation ambiguities has, however, added to taxpayer uncertainty. Foreign investors may need to review the impact of the other proposals on their Indian ownership structures, their eligibility for protection under an applicable treaty, and on taxation of cross-border royalty and technical service fees.

It should be noted that a recent ruling of the Andhra Pradesh High Court in the case of Merieux Alliance, France (Merieux) and Groupe Industriel Marcel Dassault (Dassault) addressed the issue of taxability of an indirect transfer of shares in an Indian company. The shares of the Indian company were held by a French holding company (Fr Holdco). Fr Holdco held no other assets other than the shares in the Indian company. The taxpayers transferred the shares of Fr Holdco to Sanofi Pasteur Holding (Sanofi), a French resident third-party buyer. In a ruling that was rendered prior to the decision of the Supreme Court of India in the case of Vodafone International Holdings BV, as well as prior to the retroactive amendment to the Indian Tax Law (ITL) on the taxation of indirect transfers of Indian assets by Finance Act (FA), 2012, the Authority for Advance Rulings (AAR) had held the sale to be taxable in India under the ITL Indian Tax Law and under the India-France Double Taxation Avoidance Agreement (the Treaty).

2. For details, please refer to EY Global Tax Alert “India’s High Court rules on taxation of indirect transfer under India-France Treaty,” dated 19 February 2013.
The taxpayers filed a writ petition in the jurisdictional High Court against the advance ruling. Considering the facts of the case, the High Court held that the corporate veil of the French holding company cannot be pierced.

According to the High Court, the French holding company was an independent corporate entity that had commercial substance and business purpose and was not a device for avoiding Indian tax. As the taxpayers had transferred shares of a French resident company, taxation of the capital gains arising as a consequence of the transaction is allocated exclusively to France under the Treaty and, therefore, not taxable in India. The High Court also held that the retroactive amendments to the Indian Tax Law would not impact the allocation of taxing rights under an income tax treaty.

This ruling affirms the principle that the allocation of taxing rights under a treaty are unaffected by the Indian Tax Law amendment on indirect transfers. With a number of India’s treaties having similar provisions as those contained in the treaty with France, this ruling should serve as a useful precedent under other similarly worded treaties. While this ruling reinforces the importance of commercial substance and business purpose in tax planning, it also recognizes that making and holding investments can serve a useful business purpose for a holding company.

**Taxation of development centers**

Another area awaiting clarification is the taxation of development centers in India. The Expert Committee reviewing this issue has submitted its report, but a final decision by the Government is still pending. In a recent development, the Indian income tax authorities issued two explanatory Circulars (Circulars 2/2013 and 3/2013). The first pertains to the characterization of Indian Development Centres (IDCs) engaged in research and development (R&D) as contract R&D service providers with insignificant risks, while the second pertains to the application of the profit split method.

While these circulars were widely anticipated by taxpayers engaged in contract R&D activities and/or those being assessed with profit split adjustments, they have further fueled surrounding controversies as they have essentially held the positions already seen when the Indian Chapter to the UN’s draft *Practical Manual on Transfer Pricing for Developing Countries* was released last year. The conditions mentioned in Circular 3/2013 for a taxpayer to be characterized as a contract R&D center with insignificant risk are more prescriptive than the general guidance in this aspect. This could result in subjective application and unintended consequences where an R&D arrangement substantively complies with most, but not all, the prescribed conditions. For instance, the Circular requires that the economically significant functions should be performed by the Foreign Principal while the IDC should largely be engaged in economically insignificant activities. For IDCs to be characterized as contract R&D service providers with insignificant risk, the Circular also requires that the IDC would not use any other economically significant assets (including intangibles) in research or product development.

Most importantly, once an IDC is determined to be a contract R&D service provider with insignificant risks, the Circular is mute on the transfer pricing methodology that should be followed. This is an extremely important omission in
the current circular, as the tax authorities may continue to benchmark such contract R&D service providers with entrepreneurs bearing significant risks.

Regardless of whether the activities being performed by the IDCs are economically insignificant to the research/product life cycle, if all the other conditions are being met and the Foreign Principal controls and also performs the economically significant functions, then the IDC's level of activity should not be a deciding criterion. Similarly, where all the services and resulting products are still owned (both legally and economically) by the Foreign Principal and other conditions mentioned in Circular 3/2013 are satisfied, usage of economically significant assets including intangibles in R&D should not be a criterion for not characterizing the taxpayer as a contract R&D center with insignificant risks.

As currently worded, Circular 2/2013 presumes the application of the profit split method as the most appropriate and de facto method. This will be detrimental to the transfer pricing methodology as being tilted in favor of one method over the remaining with the tax officers having the responsibility of justifying why this method was not applied in a particular situation. As the Indian transfer pricing rules require selection of the most appropriate method, as opposed to using a hierarchy of methods, it may be inappropriate to prescribe the profit split method as the preferred method in the hierarchy.

At the time of writing this article, business is once again urging the Government to review the two Circulars.

Final thoughts

India's latest budget shows that the high pace of volume of tax change of the last few years shows no sign of abatement. While the deferral of GAAR was welcomed by the business community, the ongoing concern regarding its potential scope coupled with the additional tax burden and uncertainty with regard to taxation of foreign companies doing business in India shows that there is still some distance to travel in terms of presenting India as an attractive home for investments.

Two significant developments to look out for in the coming months would be the revised Direct Taxes Code and the safe harbor rules. The Finance Minister proposes to place a revised Direct Taxes Code bill in the Parliament before the end of this budget session. He has also assured that the Rules on Safe Harbor will be shortly issued after examining the Expert Committee reports on taxation of development centers and safe harbor rules, the last of which was expected by end of March 2013.

Find out more about the 2013 Budget. While this article provides some of the key features of the Union Budget, space considerations do not allow full and complete coverage. Readers are advised to review our full coverage at www.ey.com/2013unionbudget.
Russia
An emerging approach to tax administration: a glance into the future of the Russian Federal Tax Service

Jeffrey Owens
Senior policy advisor to the global vice-chair of tax services
T: +020 795 11401
E: jeffrey.owens@ey-avocats.com

While the growth of fully featured, real-time auditing agreements (such as the well-regarded Dutch Horizontal Monitoring regime) have seen a steady if unspectacular rate of adoption over the last few years, few businesses would have expected the Russian Federal Tax Service to be at the forefront of such developments. But with its recently launched enhanced relationship pilot now under way, Russia’s robust adoption of the approach may herald a new phase of collaborative compliance efforts by tax administrations globally.
Late in 2012, I wrote that “… when you are in the front line of tax compliance, whether as the head of a large business unit in a tax administration or the head of a tax department in a multinational company, it is sometimes difficult to separate out underlying trends in tax compliance from ‘bumps in the road.’ Today, we stand on the threshold of a change in the relationship between tax administration, taxpayers – especially large MNCs – which account for the bulk of corporate revenues – and tax advisors. The question is, can we pass over this threshold to move towards a relationship which is more open and characterized by trust and understanding?”

Clearly, the Russian Federal Tax Service believes this to be the case. In December 2012 it launched a 5-company, multi-industry pilot that offers participating businesses the opportunity, as part of an 18-month agreement, to receive the assurance that, in return for real-time openness and transparency on positions taken, the Federal Tax Service will not commence on-site tax audits for the period of the agreement. Although the agreement underpinning these changed relationship dynamics is legally binding upon both parties, it differs from the Dutch approach in that there are no specific (i.e., published) standards for each company’s internal tax controls to meet in order to enter the new relationship. If successful, it is highly likely that the pilot program will be widened, following in the footsteps of other countries that have already traveled this route.

S.A. Arakelov, Deputy Director of the Russian Federal Tax Service with immediate responsibility for the program, explained the change in philosophical approach: “Our teams at the Federal Tax Service endeavor to make the process of paying taxes as quick and convenient as possible for taxpayers. We realize that tax compliance is a burden for business taxpayers, and we want to do everything we can to make the process as smooth and as efficient as possible. As representatives of the government, we want certainty just as much as business does. We all have to deal with limited resources, and just like business, we would like to focus our resources on where they will deliver the highest level of value.”

How Russia is reforming its approach to tax administration

In alignment with tax administration trends, Russia has introduced electronic taxpayer services that enable individual taxpayers to identify their tax bill and pay their taxes over the internet. The online services also include features unavailable in other countries, such as scheduling meetings with a tax inspector and checking the status of an appeal. This new approach to taxpayer service has moved Russia up among the leaders of countries using new technologies to reduce compliance costs for taxpayers by easing the burden of paying taxes; indeed, Russia already has one of the most competitive tax systems of the G20 in terms of the rates applied to profits and income. It also recognizes that good tax compliance requires getting the right balance between good enforcement and good taxpayer service.

Reducing the incidence of tax disputes

Ten years ago, the majority of tax audits tended to end up in the courts, and in many cases the tax administration lost the case. An analysis of Russia’s tax dispute cases in 2012 shows a positive trend toward a decrease in the number of court cases involving tax authorities in the arbitration courts of the Russian Federation. The number of such cases fell by 19.6% compared with the equivalent period in 2011, and there was also a 21% drop in the volume of lawsuit claims filed by private entrepreneurs and legal entities. While this is indeed welcome news, Russian continues its differential focus on the pre-litigation settlement of tax disputes, understanding that for both businesses and the tax authority, litigation is a resource-intensive, time-consuming affair.

The Federal Tax Service received 49,000 appeals in 2012, about 10% less than in 2011, continuing the positive downward trend since 2009, when the Russian Tax Code made it compulsory for appellate appeals against decisions based on tax control findings to be lodged with a higher tax authority. By developing the practice of internal reviews of decisions made by tax authorities, the Federal Tax Service hopes that its pre-litigation audit system acts as a sort of filter through which only those decisions it feels have a significant chance of prevailing in court are upheld.

Horizontal Monitoring arrives in Russia

Russia has been a long-standing member of the OECD's Forum on Tax Administration (FTA), a group of 43 of the most advanced tax administrations around the world. In May, the Russian Federal Tax Service will host the FTA's next meeting in Moscow with a wide-ranging agenda ranging from how to improve taxpayer service to how to counter tax base erosion. As readers will no doubt recall, the FTA's 2008 Study into the Role of Tax Intermediaries,2 introduced the concept of the “enhanced relationship” with business taxpayers. Since then, the number of FTA countries that have established cooperative compliance programs aimed at large corporate taxpayers has grown, with countries as diverse as France and Korea introducing such programs. In fact, the enhanced relationship – which may have suffered as many countries were perhaps more focused on dealing with the global financial crisis in 2008 – will form a centerpiece of the Moscow FTA meeting. The Dutch tax authority (the champions of the “horizontal monitoring” process first introduced in 2005) will be presenting its findings regarding the effectiveness of enhanced relationships five years on.

Characteristics of the real-time audit process

Horizontal monitoring processes can be generally characterized as a form of voluntary disclosure: the taxpayer promises to notify the tax authorities of any issues with a possible or significant tax risk and to disclose all facts and circumstances regarding these issues without hesitation or reservation. In return for full disclosure of relevant issues, the tax authority provides timely advice on significant reporting positions, taking into account real commercial deadlines. Around the world, horizontal monitoring is generally perceived as an effective and successful process within the business community, but it requires significant change management to occur, on the part of both the participating company and the tax authority itself. This is a challenge that Russia is well aware of, and the country intends to learn from the experiences of others.

But of course – as EY described in an insightful white paper on the issue3 – it is important to understand that an enhanced relationship between taxpayer and taxing authority isn’t necessarily limited to comprehensive contemporaneous processes such as the US CAP process or the Netherlands’ horizontal monitoring. In fact, the basic concepts could apply to the pre-filing agreements for one issue or equally to post-filing audit resolution processes.

Guiding principles of the Russian approach

The key principles underlying the Russian approach to horizontal monitoring agreements are legality, confidentiality, transparency, voluntariness, coordination and trust. The principle of voluntariness acts as a filter because only taxpayers who are confident that their tax obligations are correctly calculated will want to enter into an agreement with a tax authority.

---

Under the agreements with the Federal Tax Service, each taxpayer makes available to the tax authority its financial and tax records, primary accounting documents and other documents relating to business and finance operations and transactions, and provides the tax authority with access to its internal control system for tax compliance. In return, each company is able to find out the tax authority’s position on specific transactions on a real-time basis. Although there is no guarantee that the tax authorities will decide in the taxpayer’s favor on a particular issue, the process is designed to become less stilted and more constructive.

**Reducing the compliance burden**

Today, most large public companies prepare a large variety of reports: accounting (Russian and international reporting standards), tax, statistical and so on. Those reports are checked not only by the tax authorities, but also by internal and external auditors (of which there may be several, e.g., for Russian and international reporting standards) and other supervisory authorities. It is not uncommon for the same piece of information to be requested and for companies to have to give the same explanations to different inspectors several times over. Under the horizontal monitoring systems used in international practice, tax authorities use the results of internal control and work done by inspectors (internal audit and review departments), external auditors and consultants to check tax reports. In theory, this should mean that companies have to spend fewer hours catering to internal and external inspections, and tax authorities gain access to work done by professional experts. Whether this transpires in practice is somewhat of an open question. Indeed, in both the Australian and US approach to this issue, some (but certainly not all) taxpayers have questioned the cost benefit of entering into such a robust agreement with the tax authorities. This fact will likely be addressed in the FTA’s report – and likely rebranding – of the enhanced relationships concept in Moscow come May.

Of course, horizontal monitoring is a new development for Russia. Moving the relationship toward a true partnership based on openness, mutual understanding and a willingness to engage in a constructive and frank dialogue is not easy, and very few countries have achieved this transformation. As Arakelov said, “We very much hope that the new horizontal monitoring approach will allow us to further establish a framework of cooperation and information exchange with business taxpayers, aimed at ensuring compliance with Russian tax law, increasing the predictability of tax regulation and to improve the quality of our tax administration.”

In today’s world, it is fair to say that nobody is suggesting that the relationship between taxpayers and tax administration will be entirely free of conflict and tension. But it should be possible to manage the tensions and to recognize that there are many areas of common ground. Finding this common ground is going to become more and more important as the world, business, technology and communications all develop and globalize. In that regard, May’s FTA report on the enhanced relationship will likely signal the intentions of leading tax administrations in this area, and in that regard, should be firmly on the reading list of the multinational tax director.

In today's world, it is fair to say that nobody is suggesting that the relationship between taxpayers and tax administration will be entirely free of conflict and tension. But it should be possible to manage the tensions and to recognize that there are many areas of common ground.
A shifting global economy, globalization and the increasing mobility of capital and people all put a premium on competitive tax systems, encompassing both tax policies and their effective administration. While falling corporate income tax (CIT) rates has been one global trend that continues to play out – albeit at a slightly slower pace than of the last few years – Thailand is one country that is betting a significantly reduced business tax burden will spur domestic growth and inbound investment. The country believes this will bring it back to a budget surplus position and leave it in a more competitive position among Association of Southeast Asian Nations (ASEAN) neighbors – an important factor given the move to a single ASEAN market and production base by 2015.
With sovereign debt projected to increase by almost 10 percentage points in the next decade (from 41.7% today to 51.4% in 2017, according to the International Monetary Fund1), and with Thailand’s annual deficit not projected to start contracting until 2015, recent CIT rate cuts from 30% to 23% in 2012 and then to 20% in 2013 generated much controversy. Despite (smaller) simultaneous cuts in marginal rates of personal income tax (PIT), the CIT rate cuts actually created a wider disparity between CIT rates and the highest level of PIT rates. While the government has cut PIT (from a highest marginal rate of 37% to 35%) and increased the number of income bands for taxpayers, the disparity between CIT and the top rate of PIT has grown to 12 percentage points as opposed to an earlier 7 percentage points. This is further compounded in 2013, when CIT rates fall, as planned, to 20%, increasing the disparity to 15 percentage points. This inconsistency has attracted some criticism, but in general the measures have been well received by the business community.

Courting political controversy

While public debt is indeed rising, Thai Government economists argue that it can and should be allowed to accommodate tax cuts. They hope these will bring Thailand into a more competitive position against nearby Southeast Asian neighbors.

Other economists, meanwhile, argue that the populist policies of the Government are increasing public debt levels too rapidly and are inflationary. While the long-term impact of the rate cut may not be known for some years to come, initial indications are that in fiscal 2012, the Thai Revenue Department reported collections that were 0.53% below its target of THB1.62 trillion, due in large part to the cut in corporate tax rates. While tax revenue in 2011 grew by some 19.9% over 2010 figures (no mean feat itself, given Thailand’s devastating floods of June 2011), the 2012 figures demonstrate just what an effect the corporate rate cut has had on Government revenue, fueling further criticism of the policy and spurring efforts by the Government to expand the tax base, largely through implementing electronic filing of tax returns and focusing more on the grey economy. The Government will have taken comfort which showed that Thailand’s economy grew a better-than-expected 3.6% in the fourth quarter of 2012.

It should be noted, however, that tax revenues contribute barely 20% of GDP in Thailand. In the majority of developed economies, it is often closer to 50%, indicating that the Government is holding much hope that lower rates will spur growth.

The cuts in CIT and PIT are important policy decisions for the Puea Thai Party, which leads the current Government and came into power in August 2011 after putting forward a very populist platform during its election campaign. The campaign included promises of a massive increase in the minimum wage, tax rebates for first-time car buyers and first-time home buyers, and guarantees of high rice prices for farmers. The policies were designed to close the income gap in the country and also to appeal to the largest number of potential voters for Puea Thai, with the economic explanation given by the Puea Thai finance team being that these measures will stimulate domestic demand by putting more money in the hands of consumers. As the world economy remains somewhat anemic and exports have failed to meet targets (the slowdown in Chinese growth rate was a significant shock) the rationale that boosting domestic demand through these measures will help compensate for slumping exports has been heard more and more frequently and seems more and more appropriate. Nevertheless, while domestic consumption has grown, few (if any) independent economists agree that the measures chosen are the most effective for achieving this objective.

1. International Monetary Fund, World Economic Outlook Database, October 2012.
Limited relief for SMEs reeling from minimum wage increases

The impact of the minimum wage increase that came into force across Thailand between 15 April last year and 1 January of this year depends much on location and industry, with increases of around 35% in Phuket and Bangkok and over 80% in some less-developed provinces, which generally have little industry other than agriculture. The textile, service and agricultural sectors are expected to be the most affected, and some producers have already moved production to neighboring countries where labor costs can be less than half those of Thailand. One survey of the textile and garment industries estimated that labor costs would rise from around 19.2% to 24.4% of total costs. With significant volumes of garment manufacturing moving south from China and into countries such as Indonesia, Vietnam and Cambodia, the Government looks rather ill-prepared for the consequences of this dramatic measure.

SMEs using unskilled labor are perhaps the most affected by the changes, particularly as most multinational companies (MNCs) and major domestic companies were already paying most of their staff at least the new minimum wage anyway. As a result, much criticism was heard from the SME business sector in regard to the measures. In response the Government has put forward a large number of relief measures to help SMEs adjust, including lending money to help improve production, seeking new marketing channels, lowering CITs and expanding the time frame for loan repayment. Later measures added in the face of criticism (and fearing the political impact of job losses) include a 150% deduction on the difference between wage expenses under the previous and new minimum wage rates, a CIT exemption on income from sales of machinery that is used to purchase replacement machinery, 100% depreciation on new machinery in the first year, a rise in the CIT exemption bracket from the first THB150,000 of net profit to the first THB300,000, and a reduction of withholding tax from 3% to 2%.

However, in sum the measures have not found favor among the SME sector, with many criticizing them as being reactive in nature.

Incentives

Aligning themselves to a second global trend related to competitiveness, Thailand’s Board of Investment (BoI) in early January 2013 announced its new investment strategy, designed to attract foreign investors to Thailand. While Thailand ranks highly as the 8th most popular destination in the world for foreign direct investment (according to a recent United Nations Conference on Trade and Development (UNCTAD) survey), the ranking masks the fact that while the nation’s competitors such as Malaysia and Vietnam have seen significant growth in foreign investments, Thailand has not capitalized on such opportunities to the same degree. This longer term slippage was compounded by the widespread floods in 2011, which severely impacted Thailand’s manufacturing base.

---

2. Example: Payao province minimum wage: THB159 (1 January 12) increased to THB222 (5 April 12) and THB300 (1 January 13) +88.7%. Source: Ministry of Labor, BOI.
The focus of the new incentives policies will be on 10 industry groups, representing (as is the case in many other countries) a closer targeting of business incentives onto the sectors and activities that support the Government’s growth strategy. The ten groups are primary infrastructure and logistics, primary industries, medical and science tools, alternative energy and environmental services, industrial promotion services, advanced technology, food and processed agricultural goods, hospitality and wellness, automotive and transportation, and electronic and electrical goods. Benefits will focus on corporate tax rate exemptions (i.e., a tax holiday) of 3, 5 and 8 years, depending on the specific activity.

Meanwhile, incentives would be withdrawn for 11 industries deemed to be unfavorable for the environment, either because they use much energy, rely on human labor or have low value addition. These include hydroponic vegetable cultivation, forestation, organic fertilizers, animal feed or animal-feed mix, baked-dry plants and silos, and deep-sea fishing. Light industries such as textiles and garments, carpets, shoes, bags and sporting goods (among many others) are also excluded.

Expanding the taxable base: promoting e-filing

With such a gap in tax revenues now in place, the Government clearly wishes to expand the tax base, with a key target being the gray economy. In this regard, the Revenue Department’s stated hope is that encouraging taxpayers to shift to online submissions for their tax returns will help improve collection efficiency, as well as reduce the compliance burden of taxpayer and tax administration. Currently, 40% of tax filings and 30% of tax payments are made online compared with a Revenue Department target of 80% for both categories. However, while the Revenue Department hopes to add 200,000 income earners in fiscal 2013, it is hard to see how online filing can help add more taxpayers to the taxable base, and this measure may be more a response to criticism of the previous cumbersome filing process. Despite efforts to have more people start paying PIT by pursuing the gray area of tax evaders, only around 10,000 taxpayers are added each year.

The Revenue Department also wants to recruit 2,300 tax collectors and invest THB2 billion in its IT system as part of the Finance Ministry’s search for more income to compensate for the corporate tax cut and other related policies. “If the proposal is approved, the Revenue Department assures that it could collect THB157 billion more tax revenue in the first year and then increase this to THB200 billion per year after 3 years of implementation,” said Deputy Finance Minister Tanusak Lek-uthai in an August 2012 interview.5


Global Tax Policy and Controversy Briefing 79
Today's tax policy can lead to tomorrow's tax controversy

While leveraging technology to streamline the tax collection process is a laudable objective, the fact remains that tax revenue in fiscal 2013 may shrink by an estimated THB80 billion due to the reduction in the CIT rate. To offset this, in the absence of other consolidating measures, increased diligence around tax collection is a core objective. The Revenue Department plans to improve the efficiency of tax collection, broaden the tax base and increase enforcement of tax laws and regulations.

It can therefore be expected that the overall stance of the department may harden, and taxpayers should take this knowledge into account. Thailand’s Revenue Department is generally perceived to be fairly aggressive in its dealings with large corporate taxpayers, especially in the recent past, and this trend seems likely to continue given current circumstances. Moreover, a mandatory e-tax filing scheme for corporate taxpayers is being scheduled as a way to increase the efficiency of tax collection, and large corporate taxpayers are likely to be included in a pilot program.

Leading tax enforcement focus areas in 2013 are likely to include transfer pricing, withholding tax and value-added tax (VAT) compliance, continuance of the nontax filer follow-up program and joint audits with the Office of the National Anti-Corruption Commission for procurement projects with governmental entities.

It is important to note that the Revenue Department has not yet adopted the OECD “enhanced relationships” approach, and that an advance ruling process has yet to be deployed more generally in Thailand.

The Revenue Department also wants to shift to electronic filing for VAT, as having both purchasers and buyers file online would help improve efficiency in tax auditing and reconciling transactions across different parties.

Conclusion

A review of the global tax landscape would seem to indicate that countries seemingly fall into one of four camps:

• Those that can actively pursue or achieve significant tax reform, largely without hindrance
• Those that can actively pursue or achieve significant tax reform but are seen to be taking a greater risk against a backdrop of fiscal deficit
• Those that wish to pursue or achieve significant tax reform but cannot, either as a result of their deficit and/or political situation
• Those with little desire to attract MNCs and therefore not actively pursuing significant tax reform

Without any doubt, Thailand falls into the second camp, betting that bold measures taken now will reap future benefits. With the next general election likely to take place in 2015, the Puea Thai Party will be hoping that the populist policies of recent months will bear enough fruit.
Managing indirect taxes in the supply chain

Join our panelists for this important discussion of the changing indirect tax landscape and the need to manage indirect taxes in the multinational supply chain, including:

- Insights based on in-depth interviews with in-house tax executives from global companies operating in more than 30 countries worldwide and EY Indirect Tax and Incentives professionals
- The seven common supply chain challenges facing global companies and lessons learned
- Leading practices to reduce risks and boost performance in VAT/GST, customs and international trade, excise duties and environmental taxes, export controls, and incentives

Access this webcast archive at www.ey.com/webcasts
United States

Understanding the sequester – what to expect now that the cuts are in effect

On 1 March, the President issued a sequester order to reduce federal budgetary resources by $85 billion in across-the-board spending cuts for fiscal year 2013. The mechanism was included in the 2011 agreement to raise the federal debt limit as a way to force Congress to agree to more comprehensive long-term solutions to reduce the federal deficit.
Despite heated rhetoric about the implications of letting these automatic spending cuts take effect, competing proposals to replace or delay the sequester failed in Congress. The continuing resolution (CR) to fund the government that President Obama signed on 26 March did not replace the sequester cuts, but the legislative package did include five appropriations bills that reallocated funds for select programs to mitigate the impact of the sequester cuts. As the 1 March sequestration deadline neared, media reports highlighted potential furloughs for federal employees, longer wait times at airports and delays for other services provided by the federal government. Rather than focus on how much specific government programs will be cut under the sequester in 2013, this Alert aims to put the sequester in context by discussing the role of the sequester as part of the Budget Control Act of 2011 (BCA) and explaining the mechanics of the sequestration process for FY 2013, including the timing and distribution of the spending cuts.

The basis for the sequester in 2013

The spending cuts through sequestration were included in the BCA as part of an automatic enforcement mechanism to ensure that at least $2.1 trillion in deficit reduction is achieved over 10 years. The law reduces the deficit by $917 billion over 10 years through a combination of statutory caps on discretionary spending for fiscal years 2012-2021; lower mandatory spending through increased efforts to combat fraud, waste and abuse; and lower debt service payments. Because the so-called Super Committee in the fall of 2011 failed to reach an agreement to reduce the deficit by at least another $1.2 trillion, that amount in deficit reduction is now set to take effect through the automatic enforcement mechanism consisting of across-the-board spending cuts through sequestration and reductions in the discretionary spending caps set in the BCA. The automatic enforcement mechanism evenly divides cuts between defense and non-defense spending over nine years (FY 2013 through 2022).

Importantly, FY 2013 is the only year affected by the BCA in which the automatic enforcement mechanism will rely on sequestration cuts exclusively. Starting in FY 2014, discretionary savings required under the BCA’s automatic enforcement mechanism will be achieved by reducing the discretionary spending caps below levels set in the BCA. Lowering the discretionary spending caps provides Congress with flexibility to decide how to apply these spending reductions to particular programs. Reductions in mandatory spending required under the BCA will continue to be achieved through the sequestration process.
Two-month delay. The automatic spending cuts originally were slated to begin on 2 January 2013, but the American Taxpayer Relief Act of 2012 (ATRA) delayed the cuts by two months. The law paid for the cost of the delay with approximately equal spending cuts ($12 billion in further reductions in discretionary spending caps for fiscal years 2013 and 2014) and revenue increases ($12 billion from a provision dealing with conversions to Roth individual retirement accounts). The total sequester for FY 2013 is now $85.4 billion, half of which ($42.7 billion) will be applied to defense spending and half to non-defense spending. The White House Office of Management and Budget (OMB) generally calculated the sequester off of the annualized spending levels contained in the CR in place on 1 March 2013. The effect of the sequester on budgetary resources provided in the five appropriations bills may be unclear until OMB provides further guidance.

The table below presents the CBO estimates of automatic spending reductions for 2013, reflecting ATRA’s two-month delay.

<table>
<thead>
<tr>
<th>Estimates of automatic spending reductions for 2013</th>
<th>Reduction in budgetary resources (billions of dollars)</th>
<th>Percentage reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Defense:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretionary</td>
<td>42.7</td>
<td>7.9</td>
</tr>
<tr>
<td>Mandatory</td>
<td>*</td>
<td>7.8</td>
</tr>
<tr>
<td>Total</td>
<td>42.7</td>
<td>7.9</td>
</tr>
<tr>
<td><strong>Non-defense:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretionary</td>
<td>28.7</td>
<td>5.3</td>
</tr>
<tr>
<td>Mandatory</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medicare spending subject to 2% limit a</td>
<td>9.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Other</td>
<td>4.0</td>
<td>5.8</td>
</tr>
<tr>
<td>Total</td>
<td>42.7</td>
<td>4.6</td>
</tr>
</tbody>
</table>

Source: “The Budget and Economic Outlook: Fiscal Years 2013 to 2022,” Congressional Budget Office, February 2013. Note: Numbers are provided by the CBO and presumably do not add due to rounding.

Notes: Budgetary resources subject to sequestration include new budget authority, unobligated balances for defense programs and direct spending authority.

These estimates use CBO’s baseline projections for 2013 as a basis for allocating the reductions among categories. However, the Office of Management and Budget will make the official calculations, using its own numbers. As a result, the actual percentage reductions could differ from those shown here by a few tenths of a percentage point in either direction.

a. The sequester cannot exceed 2% for payments made for individual services covered under Medicare Part A (Hospital Insurance) and Part B (Medical Insurance) and monthly contractual payments for Part C (Medicare Advantage) and Part D (prescription drug benefit plans). According to the rules for sequestration, reductions in Medicare will begin in the month after the sequester order is issued, thereby delaying some of the effect on outlays until the following fiscal year (although total outlay savings will be attributed to the sequestration target for the previous fiscal year).

The confines of the process

Under the Balanced Budget and Emergency Deficit Control Act of 1985 (aka, Gramm-Rudman-Hollings, the law that first established sequestration), the President has little flexibility to decide how to apply the sequester. The statute provides that the “same percentage sequestration shall apply to all programs, projects and activities within a budget account” as delineated in an appropriation act or accompanying report. On 1 March, OMB released a report to Congress on the sequester, which set forth the amounts and percentages by which budgetary resources will be reduced in various federal programs as required by the BCA. OMB and federal agencies are expected to provide further guidance on how the cuts will be applied within specific programs. In addition, some federal agencies held back on spending earlier in the fiscal year to mitigate the potential effects of sequestration.

This lack of flexibility proved troublesome to lawmakers. The Congress in late March approved a CR to fund the government for the remainder of the fiscal year (through 30 September 2013), and President Obama signed it on 26 March. The CR did not replace the sequester cuts, but the package did include appropriations bills for Defense; Military Construction and Veterans Affairs; Agriculture; Commerce, Justice and Science; and Homeland Security that reallocated funds for select programs to mitigate the impact of the sequester cuts.

Special rules and exemptions. Although the BCA offers little flexibility in the application of the sequester, there are special rules for a number of programs, including student loans, Medicare, unemployment compensation, the Commodity Credit Corporation, community health centers and Indian Health Services, and federal pay. For example, special rules for Medicare limit the sequester to 2% of payments to providers and plans and exempt Part D low-income and catastrophic subsidies and payments to states for the Qualified Individual (QI) premiums.

The rules applied under the BCA also fully exempt certain programs and activities from sequestration, including refundable individual income tax credits, Social Security, Medicaid, and other programs for low-income people and economic recovery.

Implementing the sequester

Sequestration is governed by a complicated process and to some extent is unprecedented. A more detailed explanation of the sequestration process for FY 2013 is provided below.

The 1 March deadline. Under the BCA as modified by ATRA, President Obama issued a sequester order on 1 March. The White House Office of Management and Budget (OMB) is charged with calculating the sequester for each non-exempt account. For FY 2013, the sequester order issued on 1 March was effective upon issuance.
Within 120 days of the March sequester order, agencies must take administrative action to implement sequestration.

Sequestration process for FY 2013

1 March: President issues a sequester order that is effective upon issuance.

1 April: Medicare sequester takes effect.

Within 120 days of the 1 March sequester order, agencies must take administrative action to implement sequestration.

In addition, the Medicare sequester was required to be implemented the first full month after the sequestration order was issued. It went into effect 1 April and is to be carried out over the next 12 months (through March 2014). A subsequent sequestration order may not start until the prior one has ended. Therefore, there is no risk of a “double sequestration” in certain months because of the sequestration delay authorized in ATRA.

Within 120 days of a sequester order, agencies must take administrative action to implement the order. Although this may imply some flexibility in the timeframe for carrying out a sequester, there is a separate rule under the statute that requires any reductions in budgetary resources under sequestration to occur in the fiscal year in which the sequester is ordered. As a result, greater percentage cuts to remaining resources will be needed to cut the requisite amount within the fiscal year if an agency delays implementing a sequester order. However, it is important to note that the sequester applies to budgetary resources (including budget authority) and that the spend out rate reflecting reduced outlays from those budgetary resources may occur in later years. The CBO projects that in FY 2013 discretionary outlays will drop by $35 billion because of the sequester, and mandatory spending will be reduced by $9 billion.

The graphic below illustrates the steps of the sequestration process for FY 2013.

Preview of future automatic enforcement. For fiscal years 2014 through 2021, OMB must submit a sequestration preview report with the President’s budget submission, expected 10 April of this year. In this preview report, OMB must revise downward the discretionary spending limits to conform with enforcement of the budget goal of achieving $1.2 trillion in deficit reduction. These new lower discretionary spending limits will guide the appropriations process for FY 2014. The preview report will also include a sequester order of non-exempt mandatory spending for the upcoming budget year (FY 2014).

Conclusion

Sequestration will remain a central issue in the deficit reduction debate in Washington, DC. Beyond the immediate effects of sequestration in 2013, members of Congress and the Administration will be challenged to find more than $1 trillion to replace the deficit reduction and associated debt service that the CBO attributes to the BCA’s automatic enforcement mechanisms through 2023 in order to turn off the enforcement mechanism completely without increasing the deficit. The near-term debates over raising the federal debt limit this summer and funding the federal government after 30 September could be pivotal in efforts to address the sequester.
Branches of the US federal government

The executive branch of the government is responsible for enforcing the laws of the land. The president, vice president, department heads (cabinet members), and heads of independent agencies carry out this mission.

Article I of the United States Constitution establishes the legislative or law-making branch of government. It has a two-branch Congress – the Senate and the House of Representatives – and agencies that support Congress.

Courts make up the judicial branch of government and decide arguments about the meaning of laws and how they are applied. They also decide if laws violate the Constitution – this is known as judicial review, and it is how federal courts provide checks and balances on the legislative and executive branches.

A bill's beginnings in Congress

A new bill can be introduced into either chamber; one exception to this is that bills for raising revenue must originate in the House of Representatives. To become law, a bill must be passed by both chambers and signed by the President.

Members of the House or Senate introduce a bill and become its sponsor. Bills that have been introduced can be referred to one or more committees or placed on the calendar for upcoming debate. The Congressional Record publishes a list of bills introduced the previous day. The Government Printing Office (GPO) will then print the bill text, including sponsors, committees to which the bill has been referred, and legislative language.

Once a bill is assigned to a committee, there is no requirement that the committee has to consider it. But if it does, hearings may be held, and then the bill is “marked up.” During a markup, committee members can amend the bill before voting on it and either send it to the floor for debate or reject it. Once the committee files its report on a bill with the House or Senate clerk, it can be considered by the full chamber. It is up to the House or Senate leadership to decide whether or when to bring a bill up for floor debate. If the committee does not approve the bill, it does not advance.

The path to enactment

The procedures for floor debate differ somewhat between the House and Senate.

In the House, the bill goes to the House Rules Committee, which reports out a resolution setting the parameters for debate. This “rule” sets out the time limit for floor debate and can place other limitations on floor consideration, including how many amendments can be offered.

The House can also vote to “suspend the rules and pass” legislation, a shortcut for passing a bill. Under this scenario, a two-thirds majority of those present is needed to pass the bill, and debate is limited to 40 minutes, equally divided between those in favor of and those against the measure. While amendments can be added to the bill as part of the motion to suspend, none can be added from the floor.

In the Senate, a bill reported out by a committee is put on the calendar for debate. A senator may request “unanimous consent” to set aside certain rules of procedure to expedite floor debate, but if only one senator objects, the request is rejected. A senator may also offer a “motion to table” pending legislation. There is no debate on such a motion, and agreement to it stops debate on whatever was being considered.

Unlike the House, members of the Senate can engage in unlimited debate. Once recognized to speak, a senator may talk for as long as he or she desires. Speaking for a long time to delay or block consideration of a piece of legislation is known as “filibustering.” The way to stop a filibuster is invoking “cloture.” Under the cloture rule, debate can be brought to a close with the affirmative vote of a supermajority, three-fifths, of the Senate. Given the composition of the Senate, 60 votes are required to invoke cloture.

If the President chooses to veto a bill, he returns it to the chamber in which it originated accompanied by an explanation of his objections. If the president does not sign the bill and Congress adjourns within 10 days, the bill does not become law. This is called a “pocket veto.”

If the President vetoes a bill, Congress can modify it in hopes of gaining the President’s signature, let the veto stand, or vote to override the veto, which requires 2/3 of each chamber (67 in the Senate, 290 in the House). If the chambers vote to override the veto and within 10 days the President does not sign the bill and Congress is still in session, it becomes law without his signature.

Opportunities to engage in the legislative process

Individuals and businesses have many opportunities to engage in the US legislative process.

In the development of legislation, businesses may bring ideas to the attention of a legislator to introduce as a bill. They may also provide technical expertise during committee hearings. Alongside individual engagement, businesses may join forces with others who may be similarly situated to alert Congress to issues and concerns.
Vietnam

Renaissance in Vietnam – how the Vietnamese government is enhancing its tax policies to attract investors

Vietnam has a basic tax policy that has traditionally followed international tax policy norms, but the country is now contending with a deficit projected to grow to 4.6% of GDP in 2013. With most of its past tax policy efforts focused on inbound investment, foreign investments were subject to very favorable incentives that successfully attracted capital. In an effort to recharge the economy, the Vietnamese government has recently launched a series of solutions designed to support growth. It also has continued its tax policy reform introduced in the 2011-20 taxation master plan.
As scheduled in the Master Plan on Tax Policy for the coming period, the government believes now is the time to narrow the targeting of business incentives to focus on those domestic sectors and activities that they feel will support the greatest future growth. While aligned to wider trends in the incentives landscape, the change has upset foreign investors who had intended to make new investments or expand existing operations. As a result, the government, the Ministry of Planning and Investment and the Ministry of Finance (MoF) are reconsidering revising the corporate income tax (CIT) law to provide some form of remedy on the issue.

A key issue at hand for Vietnam to tackle is that it appears to follow form-over-substance rather than the internationally accepted reverse. Depending on the interpretations of the Vietnam government and the MoF, the same tax policy can be interpreted differently during different circumstances. Thus, the implementation is often unclear and inconsistent. As such, investors should be wary of a common risk in the country’s interpretation of its tax policy.

Proposal for amendment of the law on corporate income tax

One of the key goals of tax policy reform is to reduce the CIT rate. The government is drafting a new amended CIT law, likely to be passed in 2013 and take effect from 1 January 2014, that will seek to reduce the CIT rate to 23% from the current rate of 25% and further lower it to 20% by 2020. Although Vietnam continues to struggle with an increasing annual deficit, the government clearly believes that a corporate tax rate reduction will be growth-friendly.

Incentives

In addition to the headline CIT rate, incentives are a key focus area in the amended law. The current CIT law has been criticized for being unreasonable and for having vague provisions on incentives for expanded investment projects. The amended law will grant CIT incentives to companies that are newly established specifically for an investment project. For example, a US software development company that wants to expand in Vietnam would have to submit a business proposal for a new company (Company A) and receive approval and licensing from the Vietnam government. Once it receives an investment certificate, Company A will be eligible for CIT incentives. Suppose that the same US parent company decides to invest in cell phone accessories and establishes another new company (Company B) to run that investment project. It would have to go through the same process of submitting a business proposal and receiving approval and licensing from the government. Company B would also enjoy CIT incentives. However, if Company A were to expand its business to include the new business of selling cell phone accessories, this would not be considered a new investment and therefore no new CIT incentives would be allocated to it.

Incentive/location vs. incentive/industry

There are two distinct types of incentives that the government grants to companies investing in Vietnam:

- **Incentive/location.** The government is allocating CIT incentives to any industry within a particular region – mostly remote areas to promote investment activities in those areas. Under this incentive program, industry is of no importance as long as the investment project is located in one of these remote areas. For example, if a foreign investor sets up a plastic bottle manufacturing plant in Hanoi, no CIT incentive is granted. However, the same investor can enjoy CIT incentives if its plastic bottle manufacturing plant is located in any district or town in Cao Bang Province, which is classified as an area with especially difficult socio-economic conditions.

- **Incentive/industry.** The government is also allocating CIT incentives to promote investment activities in certain industries where Vietnam is developing or is seeking know-how or technology from foreign countries for further development, such as software or high technology. For example, CIT incentives will be granted for any software or high-tech investment project no matter where the foreign investor sets up a software manufacturing plant in Vietnam.
Income from production expansion in incentive/industry and incentive/location will be subject to CIT incentives. Industry/location is granted CIT incentives under prevailing regulations. For example, incentive/industry for a company manufacturing software products would include a newly set up software manufacturing plant and would be entitled to 10% CIT for 15 years plus CIT exemption for 4 years. It will also be provided with a 50% CIT reduction for nine subsequent years. On the other hand, incentive/location would only receive incentives in areas that have especially difficult socio-economic conditions. These include remote areas such as Ha Giang, Lai Chau, Son La, Ca Mau and Soc Trang. The CIT exemption/reduction period would be the same as those for newly established companies within the same incentive industry/location.

When companies are granted CIT incentives, they enjoy a concessional CIT rate in addition to being exempted from the CIT payable. They also benefit from a 50% CIT reduction of the CIT payable for the relevant tax years. As in the previous example, a company entitled to nine years of CIT exemption benefits from the nine years of the 50% CIT reduction.

During the past four years, such provisions have failed to promote investment in promoted sectors because the current law does not allow CIT incentives for production and/or expansion from the effective year of 2009. However, after long discussions, these incentives are once again being offered under the new draft law. Therefore, it’s anticipated that foreign investors will more likely expand their investment activities as they will be treated fairly – much like new companies with similar projects.

CIT incentives are granted based on the location of the investment (i.e., in difficult or especially difficult social-economic locations, economic zones and high-tech zones) or regulated encouraged sectors (e.g., high-technology, scientific research and technology development, investment in development of especially important state infrastructure facilities, production of software products or operating in the field of socialization). Companies established from investment projects that satisfy one of the two above conditions may be subject to a CIT incentive rate of 10% for 15 years, 4 years of tax exemption and 9 years of 50% tax deduction.

Further, prevailing regulations on CIT also provides a CIT exemption for the following incomes:

- Income earned from performance of technical services directly serving agricultural production
- Income earned from performance of contracts for scientific research and technological development, from sale of products during their test production, and from products made from new technology applied for the first time in Vietnam (exemption applies to maximum of one year)
- Income earned from activities of production or business in goods or services by enterprises with an average number, in the year, of 30% or more employees who are disabled people, reformed drug addicts and/or people infected with HIV
- Income from occupational training activities specially reserved for ethnic minorities, disabled people and children living in particularly difficult conditions, criminals, detoxifying or detoxified people, and/or HIV/AIDS sufferers

To be eligible for tax exemption of the above income, however, the taxpayer has to satisfy certain conditions for each type of income mentioned above.

Since the draft of the proposals for the amended law opened for consultation, EY’s Vietnam member firm has provided input into the new policy formulation through a series of different channels, including forums and events organized by various business groupings of which we are a member, including the Vietnam Business Forum, Vietnam Tax Consultants’ Association and others. Our input focuses on two distinct areas:

1. **Tax incentives for new investment projects.** We believe that investors who have an existing investment project in specified sectors should be entitled to new CIT incentive packages. The investment project should be able to be implemented via either a newly established or an existing legal entity. Clear criteria for any and all new investment projects should be defined under the law or implementing regulations.

2. **Tax incentives for expansion investments.** Other than new investment projects, when companies upgrade their production line, adopt new technologies to improve the operation efficiency of existing production capacity, or open new retail stores or sale branches, they should continue to benefit from tax incentives on the income derived from the increased investment. Companies should not be required to determine income from expansion projects separately and apply different tax incentives as currently required.
**High-tech enterprises**

To attract the business community, Vietnam has regularly targeted developed industries that add value to its tech sectors. Although tax policy has been developed to support this target, even after many years of implementation we have failed to see many enterprises meet the eligibility requirements. That said, most manufacturing companies in Vietnam have been performing assembly activities; as such, this policy has not had the desired impact on the target sector and is another area that we feel would benefit from detailed government focus.

**Advance Pricing Agreement program**

Alongside the proposed policy measures, Vietnam also recently joined the growing number of countries offering Advance Pricing Agreements (APAs). Effective 1 July 2013, an APA may be secured on a unilateral, bilateral or multilateral basis between the Vietnamese tax authority, taxpayers and other tax authorities of countries or territories with which Vietnam has signed double taxation agreements.

The National Assembly passed this new tax administration amendment into law on 9 November 2012, and for the first time, the new law provides an APA definition as well as different forms of APA. While APAs may be very familiar to other countries, they remain a new concept in Vietnam, as is transfer pricing itself.

Readers should note that although Vietnam’s transfer pricing approach has been in line with Organisation for Economic Co-operation and Development (OECD) guidelines, in practice it does not always fully align, although the arm’s-length principle is subscribed to. The availability of APAs is a significant improvement in transfer pricing regulations, providing benefits to both taxpayers and the tax authority. For taxpayers, it will provide a more regulated business and tax planning procedure and allow them to predict tax treatments in transactions with related parties; for the tax authority, it should provide improved control of transfer pricing risks, supporting tax administration efficiency.

**Final thoughts**

Many tax professionals, professional organizations and enterprises support EY’s policy input as outlined above. We see the introduction of the APA program as welcome proof of the effort the Vietnam government is making toward improving its tax policy and administration. These changes should help foreign investors feel more secure in a more predictable and transparent investment environment.

The National Assembly is expected to further discuss this amended CIT law in the next working session, scheduled for June 2013. We hope that the MoF will consider and take our proposals into account when revising the draft law.
### Table 1. Global corporate tax rates — largest 50 “economies” or “jurisdictions” by GDP*

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>GDP 2012 ($US billions)</th>
<th>2013 Corporate income tax rate</th>
<th>Worldwide vs. territorial taxation</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>15,653</td>
<td>39.00%</td>
<td>Worldwide</td>
<td>Effective for years ending on or after 1 April 2012. Includes recent 4.5 percentage point rate cut and temporary (three-year) corporate income tax surtax of 10%. Effective headline corporate tax rate will decline to 35.64% in 2015.</td>
</tr>
<tr>
<td>Japan</td>
<td>5,984</td>
<td>38.01%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>2,580</td>
<td>36.10%</td>
<td>Territorial</td>
<td>The Finance Bill for 2013 extends the application of the 5% additional contribution to corporate income tax for fiscal years ending on or before 30 December 2015. This surtax applies to companies with annual turnover exceeding EUR250 million.</td>
</tr>
<tr>
<td>Argentina</td>
<td>475</td>
<td>35.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>231</td>
<td>35.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>2,425</td>
<td>34.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Venezuela</td>
<td>338</td>
<td>34.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>477</td>
<td>33.99%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>1,947</td>
<td>33.99%</td>
<td>Worldwide</td>
<td>Foreign companies 43.26%: Small increase from the existing 5% to 10% and 2% to 5% in the surcharge for the tax year 2013-14, imposed on domestic companies and foreign companies respectively having income in excess of INR 100 million (approximately US$1.8 million).</td>
</tr>
<tr>
<td>Germany</td>
<td>3,367</td>
<td>33.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>1,980</td>
<td>31.40%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>1,542</td>
<td>30.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>1,163</td>
<td>30.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Nigeria</td>
<td>273</td>
<td>30.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>241</td>
<td>30.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>1,340</td>
<td>30.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Norway</td>
<td>500</td>
<td>28.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>391</td>
<td>28.00%</td>
<td>Territorial</td>
<td></td>
</tr>
</tbody>
</table>

*Where a country imposes both national and state/provincial/regional taxes, the figure shown is an average for the country.

1. IMF World Economic Outlook Database – September 2012.
<table>
<thead>
<tr>
<th>Country</th>
<th>Income</th>
<th>Tax Rate</th>
<th>Scope</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>255</td>
<td>26.50%</td>
<td>Worldwide</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 EUR50,000 and at 33% for the portion of income exceeding EUR50,000. New private businesses and entrepreneurs (business start-up as from 1 January 2013) with income up to EUR10,000 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>Canada</td>
<td>1,770</td>
<td>26.23%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>255</td>
<td>26.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>309</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Lowering the standard corporate tax rate from the current 25% to 22% is currently under debate.</td>
</tr>
<tr>
<td>Indonesia</td>
<td>895</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Islamic Republic of Iran</td>
<td>484</td>
<td>25.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Israel</td>
<td>247</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Rate increased to 25% for corporate profits and capital gains in 2012.</td>
</tr>
<tr>
<td>Malaysia</td>
<td>770</td>
<td>25.00%</td>
<td>Territorial</td>
<td>Rate for the first 200,000 Euro taxable basis is 20%.</td>
</tr>
<tr>
<td>Netherlands</td>
<td>211</td>
<td>25.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>247</td>
<td>24.50%</td>
<td>Territorial</td>
<td>The Finnish government recently announced that the statutory CIT rate will be lowered to 20% as of 2014.</td>
</tr>
<tr>
<td>Korea</td>
<td>1,151</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 (USD18 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>United Kingdom</td>
<td>2,434</td>
<td>23.00%</td>
<td>Territorial</td>
<td>Mainstream rate of corporation tax will reduce to 21% in 2014 and be further reduced to 20% with effect from April 2015, the first time that the UK's main rate and small profits rate have coincided since 1973.</td>
</tr>
<tr>
<td>Thailand</td>
<td>377</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>
</tr>
<tr>
<td>Sweden</td>
<td>520</td>
<td>22.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>623</td>
<td>21.17%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>268</td>
<td>20.00%</td>
<td>Worldwide</td>
<td>Rate will be increased to 20% on 1 January 2013. Further increases will likely be part of the presidential campaign in 2013.</td>
</tr>
<tr>
<td>Russia</td>
<td>1,954</td>
<td>20.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>657</td>
<td>20.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>783</td>
<td>20.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Czech Republic</td>
<td>194</td>
<td>19.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>470</td>
<td>19.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>268</td>
<td>17.00%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>466</td>
<td>17.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Hong Kong SAR</td>
<td>258</td>
<td>16.50%</td>
<td>Territorial</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>171</td>
<td>16.00%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>205</td>
<td>12.50%</td>
<td>Worldwide</td>
<td></td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>362</td>
<td>0.00%</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>
2012 Corporate income tax rate
(The tax rate includes both national and local tax rates.)

Figure 1. 2012 Headline corporate income tax 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.

Figure 1 below shows that the statutory CIT rates in OECD member countries dropped on average by more than 7 percentage points between 2000 and 2012, from 32.6% to 25.5%. This trend seems to be widespread, as rates have been reduced in more than 90 countries. Within the OECD area, the rate has stayed constant in Norway and the United States, as well as in non-OECD countries such as Brazil. A number of countries around the world (Colombia, Dominican Republic, Thailand, United Kingdom, for example) continue to reduce rates in 2013 and beyond, while other countries (Australia, The Netherlands, among others) have stretched their tax bases as far as they believe to be competitively and/or politically prudent.

Figure 1. Statutory corporate income tax rates in OECD nations, 2000 and 2012
## EY contacts

### Global Leaders

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Tax policy leader Email/telephone</th>
<th>Tax controversy leader Email/telephone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>Ruben Malvitano <a href="mailto:ruben.malvitano@ar.ey.com">ruben.malvitano@ar.ey.com</a> +54 11 4318 1655</td>
<td>Ruben Malvitano <a href="mailto:ruben.malvitano@ar.ey.com">ruben.malvitano@ar.ey.com</a> +54 11 4318 1655</td>
</tr>
<tr>
<td></td>
<td>Alf Capito <a href="mailto:alf.capito@au.ey.com">alf.capito@au.ey.com</a> +61 2 8295 6473</td>
<td>Howard Adams <a href="mailto:howard.adams@au.ey.com">howard.adams@au.ey.com</a> +61 2 9248 5601</td>
</tr>
<tr>
<td>Austria</td>
<td>Andreas Stefaner <a href="mailto:andreas.stefaner@at.ey.com">andreas.stefaner@at.ey.com</a> +43 1 21170 1041</td>
<td>Martin Schwarzbartl <a href="mailto:martin.schwarzbartl@at.ey.com">martin.schwarzbartl@at.ey.com</a> +43 1 21170 1405</td>
</tr>
<tr>
<td>Belgium</td>
<td>Herwig Joosten <a href="mailto:herwig.joosten@be.ey.com">herwig.joosten@be.ey.com</a> +32 2 774 9349</td>
<td>Philippe Renier <a href="mailto:philippe.renier@hvglaw.be">philippe.renier@hvglaw.be</a> +32 2 774 9385</td>
</tr>
<tr>
<td>Brazil</td>
<td>Romero Tavares <a href="mailto:romero.tavares@br.ey.com">romero.tavares@br.ey.com</a> +55 1 12 112 5444</td>
<td>Julio Assis <a href="mailto:julio.assis@br.ey.com">julio.assis@br.ey.com</a> +55 1 12 112 5309</td>
</tr>
<tr>
<td>Canada</td>
<td>Greg Boehner <a href="mailto:greg.c.boehmer@ca.ey.com">greg.c.boehmer@ca.ey.com</a> +1 416 943 3463</td>
<td>Gary Zed <a href="mailto:gary.zed@ca.ey.com">gary.zed@ca.ey.com</a> +1 403 206 5052</td>
</tr>
<tr>
<td>Chile</td>
<td>Ricardo Escobar <a href="mailto:ricardo.escobar@cl.ey.com">ricardo.escobar@cl.ey.com</a> + 56 2 676 1439</td>
<td>Carlos Martinez <a href="mailto:carlos.martinez.c@cl.ey.com">carlos.martinez.c@cl.ey.com</a> + 56 2 267 61261</td>
</tr>
<tr>
<td>China</td>
<td>Becky Lai <a href="mailto:becky.lai@hk.ey.com">becky.lai@hk.ey.com</a> +86 10 5815 2830</td>
<td>Henry Chan <a href="mailto:henry.chan@cn.ey.com">henry.chan@cn.ey.com</a> +86 10 5815 3397</td>
</tr>
<tr>
<td>Colombia</td>
<td>Margarita Salas <a href="mailto:margarita.salas@co.ey.com">margarita.salas@co.ey.com</a> + 57 1 484 71 10</td>
<td>Margarita Salas <a href="mailto:margarita.salas@co.ey.com">margarita.salas@co.ey.com</a> + 57 1 484 71 10</td>
</tr>
<tr>
<td>Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua</td>
<td>Rafael Sayagues <a href="mailto:rafael.sayagues@cr.ey.com">rafael.sayagues@cr.ey.com</a> +506 2208 9880</td>
<td>Rafael Sayagues <a href="mailto:rafael.sayagues@cr.ey.com">rafael.sayagues@cr.ey.com</a> +506 2208 9880</td>
</tr>
<tr>
<td>Jurisdiction</td>
<td>Tax policy leader</td>
<td>Tax controversy leader</td>
</tr>
<tr>
<td>---------------------</td>
<td>-------------------------------------------</td>
<td>-----------------------------------------------</td>
</tr>
</tbody>
</table>
| Croatia             | Denes Szabo  
denes.szabo@hr.ey.com  
+385 2480 540       | Denes Szabo  
denes.szabo@hr.ey.com  
+385 2480 540       |
| Cyprus              | Philippos Raptopoulos  
philippos.raptopoulos@cy.ey.com  
+357 25 209 999     | Philippos Raptopoulos  
philippos.raptopoulos@cy.ey.com  
+357 25 209 999     |
| Czech Republic      | Libor Fryzek  
libor.fryzek@cz.ey.com  
+420 225 335 310    | Luice Rihova  
lucie.rihova@cz.ey.com  
+420 225 335 504    |
| Denmark             | Trine Bonde Jense  
trine.b.jensen@dk.ey.com  
+45 70 108 050      | Trine Bonde Jense  
trine.b.jensen@dk.ey.com  
+45 70 108 050      |
| Ecuador             | Fernanda Checa  
fernanda.checa@ec.ey.com  
+59 32 255 5553109  | Fernanda Checa  
fernanda.checa@ec.ey.com  
+59 32 255 5553109  |
| Estonia             | Ranno Tingas  
ranno.tingas@ee.ey.com  
+372 611 4578       | Ranno Tingas  
ranno.tingas@ee.ey.com  
+372 611 4578       |
| European Union      | Marnix van Rij  
marnix.van.rij@nl.ey.com  
+31 70 328 6742     | Klaus Von Brocke  
klaus.von.brocke@de.ey.com  
+49 89 14331 12287  |
| Finland             | Tomi Johannes Viitala  
tomi.viitala@fi.ey.com  
+358 207 280 190    | Jukka Lyijnen  
jukka.lyijnen@fi.ey.com  
+358 207 280 190    |
| France              | Charles Menard  
charles.menard@ey-avocats.com  
+33 (0)1 55 61 15 57 | Charles Menard  
charles.menard@ey-avocats.com  
+33 (0)1 55 61 15 57 |
| Germany             | Ute Witt  
ute.witt@de.ey.com  
+49 3025 471 21660  | Jürgen Schimmele  
juergen.schimmele@de.ey.com  
+49 211 9352 21937  |
Jurisdiction | Tax policy leader | Email/telephone | Tax controversy leader | Email/telephone
---|---|---|---|---
Greece | Stefanos Mitsios | stefanos.mitsios@gr.ey.com +30 21 0288 6363 | Tassos Anastassiadis | tassos.anastassiadis@gr.ey.com +30 21 0288 6592
Hong Kong SAR | Becky Lai | becky.lai@hk.ey.com +86 10 5815 2830 | Henry Chan | henry.chan@cn.ey.com +86 10 5815 3397
Hungary | Botond Rencz | botond.rencz@hu.ey.com +36 1 451 8602 | Botond Rencz | botond.rencz@hu.ey.com +36 1 451 8602
India | Ganesh Raj | ganesh.raj@in.ey.com +91 120 6717110 | Rajan Vora | rajan.vora@in.ey.com +91 22 619 20440
Indonesia | Rachmanto Surahmat | rachmanto.surahmat@id.ey.com +62 21 5289 5587 | Dodi Suryadarma | dodi.suryadarma@id.ey.com +62 21 5289 5236
Ireland | David Smyth | david.smyth@ie.ey.com +353 1 2212 439 | David Smyth | david.smyth@ie.ey.com +353 1 2212 439
Israel | Arie Pundak | arie.pundak@il.ey.com +972 3 568 7115 | Gilad Shoval | gilad.shoval@il.ey.com +972 3 623 2796
Italy | Giacomo Albano | giacomo.albano@it.ey.com +39 06 8556 7338 | Maria Antonietta Biscozzi | maria-antonietta.biscozzi@it.ey.com +39 02 8514 312
Japan | Koichi Sekiya | koichi.sekiya@jp.ey.com +81 3 3506 2411 | Koichi Sekiya | koichi.sekiya@jp.ey.com +81 3 3506 2411
Latvia | Ilona Butane | ilona.butane@lv.ey.com +371 6704 3836 | Ilona Butane | ilona.butane@lv.ey.com +371 6704 3836
Lithuania | Kestutis Lisauskas | kestutis.lisauskas@lt.ey.com +370 5 274 2252 | Kestutis Lisauskas | kestutis.lisauskas@lt.ey.com +370 5 274 2252
<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Tax policy leader Email/telephone</th>
<th>Tax controversy leader Email/telephone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>Marc Schmitz <a href="mailto:marc.schmitz@lu.ey.com">marc.schmitz@lu.ey.com</a> +352 42 124 7352</td>
<td>John Hames <a href="mailto:john.hames@lu.ey.com">john.hames@lu.ey.com</a> +352 42 124 7256</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Lim Kah Fan <a href="mailto:kah-fan.lim@my.ey.com">kah-fan.lim@my.ey.com</a> +60 3 7495 8218</td>
<td>Azhar Lee <a href="mailto:azhar.lee@my.ey.com">azhar.lee@my.ey.com</a> +60 3 7495 8452</td>
</tr>
<tr>
<td>Malta</td>
<td>Robert Attard <a href="mailto:robert.attard@mt.ey.com">robert.attard@mt.ey.com</a> +356 2134 2134</td>
<td>Robert Attard <a href="mailto:robert.attard@mt.ey.com">robert.attard@mt.ey.com</a> +356 2134 2134</td>
</tr>
<tr>
<td>Mexico</td>
<td>Jorge Libreros <a href="mailto:jorge.libreros@mx.ey.com">jorge.libreros@mx.ey.com</a> +52 55 5283 1300</td>
<td>Manuel Solano <a href="mailto:manuel.solano@mx.ey.com">manuel.solano@mx.ey.com</a> +52 55 5283 1300</td>
</tr>
<tr>
<td>Middle East</td>
<td>Mohammed Desin <a href="mailto:mohammed.desin@sa.ey.com">mohammed.desin@sa.ey.com</a> +966 2667 1040</td>
<td>Mohammed Desin <a href="mailto:mohammed.desin@sa.ey.com">mohammed.desin@sa.ey.com</a> +966 2667 1040</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Arjo van Eijsden <a href="mailto:arjo.van.eijsden@nl.ey.com">arjo.van.eijsden@nl.ey.com</a> +31 10 406 8506</td>
<td>Arjo van Eijsden <a href="mailto:arjo.van.eijsden@nl.ey.com">arjo.van.eijsden@nl.ey.com</a> +31 10 406 8506</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Aaron Quintal <a href="mailto:aaron.quintal@nz.ey.com">aaron.quintal@nz.ey.com</a> +64 9 300 7059</td>
<td>Kirsty Keating <a href="mailto:kirsty.keating@nz.ey.com">kirsty.keating@nz.ey.com</a> +61 8 9429 2208</td>
</tr>
<tr>
<td>Norway</td>
<td>Arild Vestengen <a href="mailto:arild.vestengen@no.ey.com">arild.vestengen@no.ey.com</a> +47 24 002 592</td>
<td>Arild Vestengen <a href="mailto:arild.vestengen@no.ey.com">arild.vestengen@no.ey.com</a> +47 24 002 592</td>
</tr>
<tr>
<td>Panama</td>
<td>Luis Ocando <a href="mailto:luis.ocando@pa.ey.com">luis.ocando@pa.ey.com</a> +507 208 0144</td>
<td>Luis Ocando <a href="mailto:luis.ocando@pa.ey.com">luis.ocando@pa.ey.com</a> +507 208 0144</td>
</tr>
<tr>
<td>Peru</td>
<td>David de la Torre <a href="mailto:david.de.la.torre@pe.ey.com">david.de.la.torre@pe.ey.com</a> +5114114471</td>
<td>David de la Torre <a href="mailto:david.de.la.torre@pe.ey.com">david.de.la.torre@pe.ey.com</a> +5114114471</td>
</tr>
<tr>
<td>Philippines</td>
<td>Emmanuel Castillo Alcantara <a href="mailto:emmanuel.c.alcantara@ph.ey.com">emmanuel.c.alcantara@ph.ey.com</a> +63 2 891 0307</td>
<td>Cirilo P. Noel <a href="mailto:cirilo.p.noel@ph.ey.com">cirilo.p.noel@ph.ey.com</a> +63 2 891 0307</td>
</tr>
<tr>
<td>Poland</td>
<td>Zbigniew Liptak <a href="mailto:zbigniew.liptak@pl.ey.com">zbigniew.liptak@pl.ey.com</a> +48 22 557 7025</td>
<td>Agnieszka Talasiewicz <a href="mailto:agnieszka.talasiewicz@pl.ey.com">agnieszka.talasiewicz@pl.ey.com</a> +48 22 557 7280</td>
</tr>
<tr>
<td>Jurisdiction</td>
<td>Tax policy leader</td>
<td>Tax controversy leader</td>
</tr>
<tr>
<td>----------------------</td>
<td>------------------------------------------------</td>
<td>------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>Email/telephone</td>
<td>Email/telephone</td>
</tr>
<tr>
<td>Portugal</td>
<td>Carlos Manuel Baptista Lobo</td>
<td>Paulo Mendonca</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:carlos.lobo@pt.ey.com">carlos.lobo@pt.ey.com</a></td>
<td><a href="mailto:paulo.mendonca@pt.ey.com">paulo.mendonca@pt.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+351 217 912 000</td>
<td>+351 21 791 2045</td>
</tr>
<tr>
<td></td>
<td>Teresita Fuentes</td>
<td>Teresita Fuentes</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:teresita.fuentes@ey.com">teresita.fuentes@ey.com</a></td>
<td><a href="mailto:teresita.fuentes@ey.com">teresita.fuentes@ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+1 787 772 7066</td>
<td>+1 787 772 7066</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>Alexander Milcev</td>
<td>Alexander Milcev</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:alexander.milcev@ro.ey.com">alexander.milcev@ro.ey.com</a></td>
<td><a href="mailto:alexander.milcev@ro.ey.com">alexander.milcev@ro.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+40 21 402 4000</td>
<td>+40 21 402 4000</td>
</tr>
<tr>
<td>Romania</td>
<td>Alexandra Lobova</td>
<td>Alexandra Lobova</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:alexandra.lobova@ru.ey.com">alexandra.lobova@ru.ey.com</a></td>
<td><a href="mailto:alexandra.lobova@ru.ey.com">alexandra.lobova@ru.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+7 495 705 9730</td>
<td>+7 495 705 9730</td>
</tr>
<tr>
<td>Romania</td>
<td>Teresita Fuentes</td>
<td>Teresita Fuentes</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:teresita.fuentes@ey.com">teresita.fuentes@ey.com</a></td>
<td><a href="mailto:teresita.fuentes@ey.com">teresita.fuentes@ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+1 787 772 7066</td>
<td>+1 787 772 7066</td>
</tr>
<tr>
<td>Russia</td>
<td>Alexander Milcev</td>
<td>Alexander Milcev</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:alexander.milcev@ro.ey.com">alexander.milcev@ro.ey.com</a></td>
<td><a href="mailto:alexander.milcev@ro.ey.com">alexander.milcev@ro.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+40 21 402 4000</td>
<td>+40 21 402 4000</td>
</tr>
<tr>
<td>Russia</td>
<td>Alexandra Lobova</td>
<td>Alexandra Lobova</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:alexandra.lobova@ru.ey.com">alexandra.lobova@ru.ey.com</a></td>
<td><a href="mailto:alexandra.lobova@ru.ey.com">alexandra.lobova@ru.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+7 495 705 9730</td>
<td>+7 495 705 9730</td>
</tr>
<tr>
<td>Singapore</td>
<td>Gek Khim Lim</td>
<td>Bee Tin Poh</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:gek-khim.lim@sg.ey.com">gek-khim.lim@sg.ey.com</a></td>
<td><a href="mailto:bee-tin.poh@sg.ey.com">bee-tin.poh@sg.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+65 6309 8452</td>
<td>+65 6309 8017</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Richard Panek</td>
<td>Peter Feiler</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:richard.panek@sk.ey.com">richard.panek@sk.ey.com</a></td>
<td><a href="mailto:peter.feiler@sk.ey.com">peter.feiler@sk.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+421 2 333 39109</td>
<td>+421 2 333 39155</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Lucijan Klemencic</td>
<td>Lucijan Klemencic</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:lucijan.klemencic@si.ey.com">lucijan.klemencic@si.ey.com</a></td>
<td><a href="mailto:lucijan.klemencic@si.ey.com">lucijan.klemencic@si.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+386 1 58 31721</td>
<td>+386 1 58 31721</td>
</tr>
<tr>
<td>South Africa</td>
<td>Christel Brits</td>
<td>Christel Brits</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:christel.brits@za.ey.com">christel.brits@za.ey.com</a></td>
<td><a href="mailto:christel.brits@za.ey.com">christel.brits@za.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+27 11 502 0100</td>
<td>+27 11 502 0100</td>
</tr>
<tr>
<td>South Korea</td>
<td>Jong Yeol Park</td>
<td>Dong Chul Kim</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:jong-yeol.park@kr.ey.com">jong-yeol.park@kr.ey.com</a></td>
<td><a href="mailto:dong-chul.kim@kr.ey.com">dong-chul.kim@kr.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+82 2 3770 0904</td>
<td>+82 2 3770 0903</td>
</tr>
<tr>
<td>Spain</td>
<td>Eduardo Verdun</td>
<td>Maximino Linares</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:eduardo.verdunfraile@es.ey.com">eduardo.verdunfraile@es.ey.com</a></td>
<td><a href="mailto:maximino.linaresGil@es.ey.com">maximino.linaresGil@es.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+34 91 572 74 21</td>
<td>+34 91 572 71 23</td>
</tr>
<tr>
<td>Sweden</td>
<td>Johan Hörberg</td>
<td>Johan Hörberg</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:johan.horberg@se.ey.com">johan.horberg@se.ey.com</a></td>
<td><a href="mailto:johan.horberg@se.ey.com">johan.horberg@se.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+46 8 5205 9465</td>
<td>+46 8 5205 9465</td>
</tr>
<tr>
<td>Jurisdiction</td>
<td>Tax policy leader</td>
<td>Tax controversy leader</td>
</tr>
<tr>
<td>--------------------</td>
<td>--------------------------------------------</td>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Claudio Fischer</td>
<td>Walo Staehlin</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:claudio.fischer@ch.ey.com">claudio.fischer@ch.ey.com</a></td>
<td><a href="mailto:walo.staehlin@ch.ey.com">walo.staehlin@ch.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+41 58 286 3433</td>
<td>+41 58 286 6491</td>
</tr>
<tr>
<td>Taiwan</td>
<td>Sophie Chou</td>
<td>Sophie Chou</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:sophie.chou@tw.ey.com">sophie.chou@tw.ey.com</a></td>
<td><a href="mailto:sophie.chou@tw.ey.com">sophie.chou@tw.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+886 2 2720 4000</td>
<td>+886 2 2720 4000</td>
</tr>
<tr>
<td>Thailand</td>
<td>Yupa Wichitkraisorn</td>
<td>Ruth Chaowanagawi</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:yupa.wichitkraisorn@th.ey.com">yupa.wichitkraisorn@th.ey.com</a></td>
<td><a href="mailto:ruth.chaowanagawi@th.ey.com">ruth.chaowanagawi@th.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+66 2 264 0777</td>
<td>+66 2 264 0777</td>
</tr>
<tr>
<td>Turkey</td>
<td>Yusuf Gokhan Penezoglu</td>
<td>Yusuf Gokhan Penezoglu</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:yusuf.penezoglu@tr.ey.com">yusuf.penezoglu@tr.ey.com</a></td>
<td><a href="mailto:yusuf.penezoglu@tr.ey.com">yusuf.penezoglu@tr.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+90 212 368 55 47</td>
<td>+90 212 368 55 47</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Jorge Intriago</td>
<td>Jorge Intriago</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:jorge.intriago@ua.ey.com">jorge.intriago@ua.ey.com</a></td>
<td><a href="mailto:jorge.intriago@ua.ey.com">jorge.intriago@ua.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+380 44 490 3003</td>
<td>+380 44 490 3003</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Chris Sanger</td>
<td>Chris Oates</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:csanger@uk.ey.com">csanger@uk.ey.com</a></td>
<td><a href="mailto:coates@uk.ey.com">coates@uk.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+44 (0)20 7951 0150</td>
<td>+44 (0)20 7951 3318</td>
</tr>
<tr>
<td>United States</td>
<td>Michael Dell</td>
<td>Debbie Nolan</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:michael.dell@ey.com">michael.dell@ey.com</a></td>
<td><a href="mailto:debbie.nolan@ey.com">debbie.nolan@ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+1 202 327 8788</td>
<td>+1 202 327 5932</td>
</tr>
<tr>
<td>Venezuela</td>
<td>Alaska Moscato</td>
<td>Alaska Moscato</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:alaska.moscato@ve.ey.com">alaska.moscato@ve.ey.com</a></td>
<td><a href="mailto:alaska.moscato@ve.ey.com">alaska.moscato@ve.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+582 1290 56672</td>
<td>+582 1290 56672</td>
</tr>
<tr>
<td>Vietnam</td>
<td>Huong Vu</td>
<td>Huong Vu</td>
</tr>
<tr>
<td></td>
<td><a href="mailto:huong.vu@vn.ey.com">huong.vu@vn.ey.com</a></td>
<td><a href="mailto:huong.vu@vn.ey.com">huong.vu@vn.ey.com</a></td>
</tr>
<tr>
<td></td>
<td>+84 903432791</td>
<td>+84 903432791</td>
</tr>
</tbody>
</table>
EY | Assurance | Tax | Transactions | Advisory

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.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EY’s Tax Policy and Controversy services
Our Business Tax services are designed to meet your business tax compliance and advisory needs. Our tax professionals draw on their diverse perspectives and skills to give you a seamless global service in planning, financial accounting, accounting and tax compliance and maintaining effective relationships with the tax authorities. Our talented people, consistent global methodologies and unwavering commitment to quality service give you all you need to build the strong compliance and reporting foundations and sustainable tax strategies that help your business succeed.

© 2013 EYGM Limited.
All Rights Reserved.

SCORE No. DL0817
ED 0114

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com

The opinions of third parties set out in this publication are not necessarily the opinions of the global EY organization or its member firms. Moreover, they should be viewed in the context of the time they were expressed.

Circular 230 Statement: Any US tax advice contained herein is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.