Spring 2022
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Taxing crypto assets

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ITR

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War and taxes

Josh White

Almost halfway through 2022 and the world seems like a more uncertain place despite COVID-19 being contained in many countries. As if COVID-19 was not bad enough, the world is still reeling from the shock of the Russian invasion of Ukraine.

Many Western governments have responded with tough sanctions to hit Russian businesses and isolate President Vladimir Putin. As the war continues to play out, so will the consequences for the global economy.

The sanctions on Russia have led to consequences with tax implications for businesses around the world, yet the Russia-Ukraine war continues more than two months on. Negotiations have not produced a ceasefire or a settlement, and the conflict shows no sign of ending soon.

Europe was already facing a gas crisis before the war started, and the conflict is only making this crisis more severe. Many governments have turned to cutting indirect taxes, particularly fuel duty and VAT on energy, to alleviate the cost-of-living crisis (page 13).

This is just one result of the conflict, but it is far from the only consequence. At the same time, *ITR* has not taken its eye off of wider trends in international tax. The OECD may have secured a deal on digital tax, but there remains plenty of other sources of uncertainty.

Tax waits for no one, and cryptocurrency is just one area where change seems inevitable (page 23). Meanwhile, every taxpayer should consider the mutual agreement procedure (MAP) toolbox for dispute management (pages 20).

ITR continues to cover the social aspects of tax policy because social issues have business implications. This Spring edition covers environmental tax initiatives (page 7) and the state of gender equality in the tax profession (page 5).

We're also changing with the times. We will be running special reports every month on market studies and surveys to provide you with in-depth analysis of tax and transfer pricing trends.

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MEET THE TEAM

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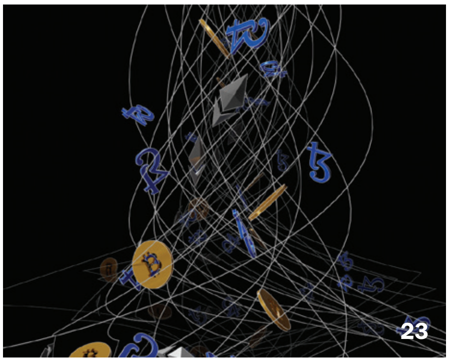

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Market insight

Cases & Lacamba boosts tax practice with partner

Andorran firm Cases & Lacamba announced the addition of a tax partner to its practice based in Les Escaldes.

Albert Hinojosa Besoli has more than 20 years' experience working for the Andorran government, most recently serving as the Director of the Department of Taxes and Borders for the past eight. He also served as the President of the Andorran State Agency for Banking Resolution for the past seven years.

That experience saw him working as the most senior figure involved in developing the principality's tax system, meaning he brings with him an unparalleled knowledge of its processes and procedures.

Molitor launches tax and estate planning practice group

Luxembourg law firm Molitor announced the expansion of its offering to include a tax and estate planning group.

The group is headed by senior counsel **Pierre-Jean Estagerie**, who is supported by **Emmanuel Rouil** and **Lena Hartmann**.

Estagerie joined the team from Deloitte, where he had served as a tax partner for its global employer services (personal tax) team for almost 10 years. Prior to that he worked for both law firm Loyens & Loeff and PwC. He holds individual Master's degrees in both tax law and accounting and has particular experience advising high net worth individuals, entrepreneurs, senior executives and HR directors.

Rouil also joined the team from Deloitte, also having spent almost 10 years there as a tax manager and tax director. Senior associate Hartmann has been with the firm since March 2019, having previously held roles in firms in both Germany and France.

Andersen continues global expansion

International tax network Andersen Global has brought several new names to its brand from locations on all continents.

In South Asia, it signed a collaboration agreement with full-service firm Varners in Sri Lanka. Led by managing partner **Mahinda Haradasa**, the Colombo-based firm has eight partners and more than 50 professionals. It also brought Sri Lankan tax-specialist firm Gajma & Co into its network. Founded in 1996, it includes four partners and more than 75 staff members.

Elsewhere in the region, in Bangladesh, the group joined forces with ACE Advisory. Founded and led by partners **Montakim Ahmed** and **Seezan Choudhury**, it includes more than 45 professionals and has been in operation since 2012. It also signed an agreement with AS & Associates, another Bangladeshi firm based in Dhaka that also has a branch office in Mymensingh.

In Africa, the network brought on board several new members, including a collaboration with Mali-based tax advisory firm Kanaga Consulting. Led by managing partner **Somine Dolo**, the Bamako-based company has been in operation since 2011. The network entered the Central African Republic market for the first time through a collaboration with Rigo Parse Avocat. Founded in 2006, the Bangui-based firm is led by managing partner **Rigo Beyah Parse**.

In the Middle East the network signed a collaboration agreement with Almoayed Chambers Consultancy in Bahrain. It also announced that network firm Chartered House from the United Arab Emirates was rebranding as Andersen.

In Croatia, the network announced the addition of a new member firm and a rebranding. BD Savjetovanje has rebranded as Andersen BD, and Zagreb-based firm Kallay & Partners has also joined the group.

In Chicago, the firm announced that **Rosa DeLuna-Frede** joined the team as a new managing director in its corporate tax practice. She joined from Kraft Foods, where she had served as a tax reporting manager for three years, having previously worked as a senior tax manager with Grant Thornton for almost 11 years. She has more than 20 years' experience advising on tax matters, with a particular focus on transactional tax.

The network strengthened its presence in the British Virgin Islands, signing a collaboration agreement with Chorus International Services (BVI). Founded in 2019, and trading as Chorus-Global, the firm is led by managing partner **Nicholas Lane**.

In Mexico, the network announced that SKATT, a collaborating firm since 2020, had fully signed-on as a member of the global organisation.

Finally, in Taiwan the network signed a collaboration agreement with Eiger. The firm was founded in 2003 in Taipei and has a second office in Shanghai.

RSM bolsters Northern England tax team

Global audit, tax and consulting firm RSM announced the addition of an associate director to its offering the north west of England.

Rob Adams is based in Liverpool and Chester and will work with clients from across the region. He joined the firm from Grant Thornton, where he had served for more than 20 years as an associate tax director. Prior to that, he spent more than 10 years with PwC.

Broseta opens Barcelona office

Iberian law firm Broseta announced the expansion of its offering with the addition of a new office in Barcelona.

This brings the firms presence to five offices: Madrid, Valencia, Barcelona, Lisbon and Zurich.

The new offices includes more than 50 professionals and is led by partners **Toni de Weest Prat**, **Álvaro Gámez** and **José María Rebollo**.

Broseta opens Barcelona office

Stibbe appoints tax counsel in Belgium

Benelux law firm Stibbe announced the appointment of a new counsel to its tax practice in its Brussels office.

Lizelotte De Maeyer was promoted to the role from senior associate, having been with the firm since 2018. Prior to joining Stibbe she had worked as an associate for Liedekerke Wolters Waelbroeck Kirkpatrick for more than six years.

Schoenherr appoints tax counsel in Austria

Austrian law firm Schoenherr announced the appointment of a new counsel to its tax practice in its Vienna office.

Marco Thorbauer was promoted to the role from associate, having been with the firm since 2016. Prior to joining Schoenherr he had worked as an associate for DLA Piper for more than two years, in both Austria and Germany.

Bomchil incorporates Teijeiro & Ballone in Argentina

Argentinian law firm Bomchil boosted its tax offering in Buenos Aires by merging with a boutique practice.

Guillermo Teijeiro and **Mariano Ballone** joined the firm, along with a team of associates, from legacy Teijeiro & Ballone Abogados.

Teijeiro had been a partner with the firm for almost 32 years, and has experience serving in a number of leading roles with global organisations, such as the International Fiscal Association.

Ballone had been a partner at the firm since 2012. Prior to that he served almost 18 years with Negri & Teijeiro Abogados as an associate and senior tax partner.

Bomchil takes over Buenos Aires tax practice

Willkie expands tax offering in Los Angeles office

US firm Willkie Farr & Gallagher announced the addition of a tax partner to its LA office, expanding the firms capabilities in Southern California.

Bryan Kelly joined the firm from the Los Angeles office of Withers, where he had been for almost three years as a partner. Previously he worked in various roles for Venable, EY and O'Melveny & Myers.

Kelly's practice is practice is focused on providing tax counsel companies and families with complex interests, including related tax considerations in cross-border matters.

Morgan Lewis announces local tax capabilities in Singapore for first time

International firm Morgan Lewis & Bockius announced the addition of a tax partner and associate to its Singapore office.

Lau Kai Lee and **Rajiv Rai** both joined the firm from the Inland Revenue Authority of Singapore (IRAS), Lau as a partner and Rai as an associate. The team represents the first time that the Singapore office of Morgan Lewis has boasted a local tax capability.

Lau had been with the IRAS for more than 12 years and brings with him more than 17 years of experience in tax law. He was the lead partner on a number of high-value and complex tax with IRAS, across a wide range of practice areas.

Walkers Ireland appoints experienced tax consultant

Offshore firm Walkers announced the addition of a tax consultant to its Dublin-based Irish practice.

Padhraic Mulpeter joined the firm from William Fry, where he had been for more than eight years, most recently serving as partner since September 2020. Prior to that he spent more than five years with KPMG in Ireland.

Mulpeter brings with him more than 13 years of experience in the Irish market, primarily working clients looking to invest in and through the country. His work covers a broad ranged of practice areas, and he brings with him particular experience covering the tax aspects of aviation and asset financing deals.

RSM welcomes experienced tax partner to London office

International audit, tax and consulting firm RSM announced the addition of an indirect tax partner to its London office.

Simon Atkins joined the firm's VAT team from Deloitte, where he had been for almost 23 years.

His work is primarily focused on indirect tax issues, including complex VAT rules around property, partial exemption and electronically supplied services.

Fieldfisher bolsters London practice with private client hire

International firm Fieldfisher announced the addition of a partner to its private client team based in London.

Elena Tzialli joined the team from Fletcher Day, where she had been for the past five years, serving most recently as partner since January 2018. Prior to that she had roles with Rooks Rider Solicitors, Forsters and RadcliffesLeBrasseur.

Tzialli specialises in working with high net worth individuals, celebrities and other types of private clients based in the UK. She has a particularly strong track record working with Greek Cypriot clients.

Deloitte Ghana appoints tax partner

Big Four consultancy group Deloitte announced the addition of an experienced tax partner to its team in Accra.

Gideon Ayi-Owoo joined the team from PwC, where he had been since 2005, most recently serving as an associate director and manager. In this role he also spent several years working in London.

Ayi-Owoo is a chartered accountant with extensive experience of Ghana's complex tax landscape. His work is largely focused on the energy, resources and industrials sectors with a particular emphasis on tax management consulting, transfer pricing and business tax.

Tax industry sees progress in gender equality, but barriers remain

Tax industry shows signs of improvement when it comes to gender equality, but female professionals still face significant barriers in their careers in comparison to their male peers, according to an ITR survey.

Leanna Reeves

Women tax practitioners claim the tax industry has improved in regards to gender equality, but there is still a long way to go. There are still obstacles for women tax professionals. As the world celebrates International Women's Day, *ITR* assesses how gender equality is still considered a significant issue in tax in the Women in Tax Leaders survey.

The survey conducted by the research team involves leading women tax practitioners from around the world that have agreed to share their views on the role of gender in tax. The data is based on the responses of 51 tax professionals from different backgrounds.

A top issue in the world of tax

Almost half of respondents agreed that gender equality could be considered one of the most important issues facing the tax industry.

"Many of the tax departments across law firms and the Big Four in my jurisdiction are male. The gap between genders is still a reality we need to face and fight against," said one of the respondents.

One tax leader recalls the divide between male and female tax professionals in the industry, in which gender can often split practices.

"There was a time when we could identify what was 'girl tax' and what was 'boy tax'. Girl tax – estates, trusts, employment. Boy tax – M&A, capital markets. I am really proud that I have practised 'boy tax' almost my entire career," she said.

The survey results also showed that half of respondents say gender equality has improved in the industry significantly in the last 20 years. However, female practitioners reiterated that progress is still lacking in certain parts of the industry, such as high-level management roles which are predominantly male.

While there are more women tax practitioners today, the number of male tax leaders still leads.

"Unfortunately, there is still a long way to go until we have an equality of gender. The solving of the issue is being masked by the promotion of women in lower levels, which increases averages. However, at higher levels it is still obvious that the management is led by men (around 90%), which shows a real lack of interest by the companies in this matter," said a respondent.

The tax industry's attempts to level the terrain across gender, sex, and sexual orientation, brought in mixed reviews from respondents. Over a third disagreed that the attempted playing field was adequate while 29% agreed that the industry was responding to the issue of gender equality.

One respondent noted that the industry failed to provide support, mentorship and sponsorship to improve women's path for gender equality in tax.

"There is a lack of interest to develop female practitioners in mid-sized tax companies. Female practitioners should actively seek challenges, professional recognition and promotion," said a tax professional.

Figure 1: Female tax practitioners face greater obstacles to reach the same level of success in their careers than men

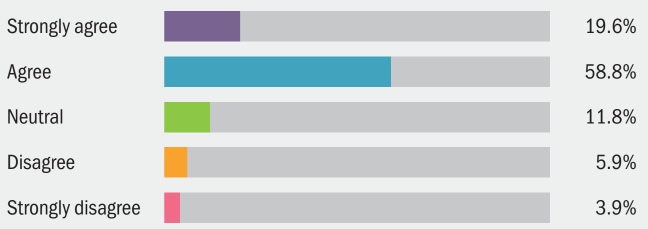
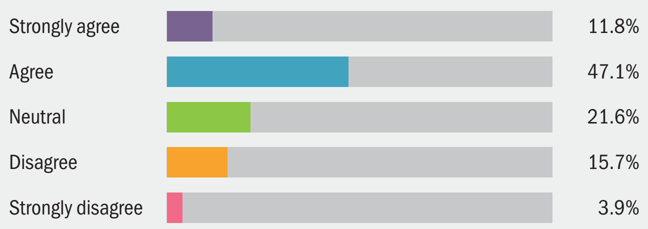


Figure 2: Female tax practitioners encounter different expectations of demeanor and personality (from clients, the industry or other professionals) than their male counterparts



While over half of female practitioners suggested that the tax industry considered the issue of gender equality seriously enough, almost 60% claimed to face greater obstacles to reach the same level of success in their careers than men (See Figure 1).

Some female tax leaders shared how they failed to be included in meetings with clients and how their name was not included in legal opinions that had been prepared. Others also shared that male colleagues were often favourited during nominations.

"The male partner was the outshining one," said a respondent.

"Later in my career and being a partner, co-head of the practice with another male, the males were the ones participating in the interviews with legal publications and also trying to stand out," added another practitioner.

Women in the tax industry highlighted again how top roles within certain firms were male dominant.

"It should be important that all the partners in a specific line-of-service can vote, and not just the leader. Men and women are equal so their work must be considered, and not the gender," said a respondent.

Personality expectations

Amongst key concerns on gender equality, women tax professionals shared how they face different expectations of demeanour and personality than their male counterparts, whether from clients, the industry itself, or other professionals.

Results from the survey show that 47% of respondents agreed to have encountered this issue (see Figure 2). Some women noted, in particular, how the industry often highlighted the dichotomy made between male and female personalities at work and how it could play in their disfavour.

Women in tax call for more gender equality

"The hardest part of becoming a female leader was being strong and decisive without causing offence, because I was held to a higher standard than my male colleagues. Men would say I was unprofessional, lacking executive presence, or unable to control my emotions," said a respondent.

"It is a business that for years has been dominated by men and opening opportunities has not been simple; because we as women, in addition to demonstrating technical mastery, have to impose our essence. Sometimes we are even asked to think like men, and that goes against our identity," added another respondent.

Some female tax professionals have yet learnt to use the different personalities in their favour. One practitioner explained that while working with large private clients and high-net-worth families, she felt "uniquely qualified" to advise those clients by being "better positioned and taking a different approach" than her male colleagues.

The work-life balance issue

Another key issue for women in the world of tax is the work-life balance. Many women consider maternity leave to be another crucial factor in the lack of gender equality.

Over a third of respondents suggest achieving a work-life balance is not an equal challenge for male and female tax practitioners.

"Young female tax practitioners will especially face pressure to keep up a work-life balance when returning from maternity leave, especially when they cannot find support from family or social resources for caring for new babies," said one woman tax professional.

"They tend to leave the industry during this special period to have a rest or take care of the family and child, but they'll then find themselves having difficulties to get back into the industry after those years," she explained.

Women tax leaders noted that there remained an expectation that a woman might come back after her maternity leave or that she could go on a second leave once back at work.

While the survey results disclose significant improvement in the tax industry, there are concerns over how top roles and nominations are led by men. The gender gap is still a reality in the tax profession and this must be tackled by firms across the world.

Hurdles to career development still exist, the personality divide remains, and maternity leave is a key work-life balance problem – all impending on women's leadership within the tax industry. The fight for gender equality continues.

Environmental tax policy is important in achieving Earth Day's objectives

Earth Day 2022 marks high government and in-house investment in tax policymaking globally to meet climate change targets. In addition, wider environmental tax policy through alternative carbon pricing is boosting climate protections.

Danish Mehboob

Corporate tax continues to be a powerful lever for environmental policy as more carbon pricing mechanisms, such as carbon taxes, are enacted following the UN Climate Change Conference (COP26) in October 2021. Additionally, the EU has a contentious proposal for a carbon border adjustment mechanism (CBAM), while more governments are turning to plastic taxes for extra revenues.

"As countries hold lofty sustainability targets, we need to be conscious of the distributional effects of any environmental measures taken including carbon taxes," said Muhammad Ashfaq Ahmed, chairman of the Federal Board of Revenue in Pakistan and member of the UN Tax Committee.

Environmental, social, and governance (ESG) policies are also big tax items for multinational enterprises (MNEs) to mitigate climate change alongside government investment in carbon pricing. ESG items influence investor portfolio management, MNE strategic decision making, and intergovernmental policymaking.

The ITR team compiled a list of the top business-focused environmental tax developments in 2022.

In-house ESG investments

Tax teams are collaborating with other departments in their companies more often to manage ESG responsibilities as global legislative changes in environmental tax policy ramp up following COP26.

"Environmental tax plays an increasingly important role in ESG transformations at companies," said Evi Geerts, director at PwC Netherlands.

Environmental tax and ESG legislation often straddle more than one discipline as carbon pricing could take the form of an emissions trading scheme (ETS) or a carbon tax. This means that colleagues from different teams within MNEs will need to work together to comply with several incoming rules.

"MNEs are less siloed and work more holistically with other teams as ESG legislation is getting more ambitious," said Karl Berlin vice president of tax at Ørsted.

ESG initiatives coming from either shareholder pressure or government pressure are helping C-suite leaders pivot away from aggressive tax planning and identify more sustainable in-house tax policy and cross-border tax structures. More companies including Ørsted are publishing their tax policies and preparing public annual tax reports that outline their contributions to direct and indirect taxes.

"As a result, we and our stakeholders have proof that we strive to pay tax on profits according to where value is created in the normal course of commercial activity," explained Berlin.

Tax directors are expecting a series of environmental tax and ESG legislation to follow in the next five years following discussions at climate change conferences in 2021. This will continue to have an impact on how MNEs structure their in-house tax teams.

Carbon pricing and plastic taxes

Carbon pricing is among the most important policy levers that governments can use to combat global warming. Many countries already have carbon pricing, but momentum is growing as more countries face pressures to tackle carbon emissions and meet targets under the Paris Agreement.

Indian Finance Minister Nirmala Sitharaman, alongside other finance ministers, again called for a coordinated approach to carbon pricing at the meeting of the G20 Emerging Market Economies in April 2022.

The World Bank reported that 45 countries have carbon pricing initiatives in one form or another, whether an emissions trading scheme (ETS) or carbon tax. That list is growing as Indonesia is among the latest countries to adopt a carbon tax in January 2022.

Additionally, plastic taxes are increasingly common around the world, driven by a combination of public pressure and political will. The EU introduced a tax on its member states of €0.80 ($0.86) per kilogramme on non-recycled plastic packaging waste, which produced reactionary local legislation in other countries including the UK. The plastic tax at £200 ($272) per tonne came into effect from April 2022.

Similar environmental measures are part of the 100-item-list of proposals in the European Green Deal.

The European Green Deal

A growing awareness of global climate change among EU policymakers led to the Green Deal, the proposal to revise EU climate legislation. All business departments from tax operations, supply chains, and marketing are impacted.

The EU intends to reach its net-zero energy target by 2050 with the Green Deal. The package seeks to reduce EU greenhouse gas emissions by 55% by 2030 and it is the first step to carbon neutrality by 2050. The package is composed of more than 100 initiatives, including a CBAM.

"State aid may be necessary to achieve our targets," said Benjamin Angel, tax director at the Taxation and Customs Union at the EU Commission.

Steelmaker ArcelorMittal and some other MNEs have advocated for the CBAM over the EU's emissions trading system (ETS) as the ETS leaves EU MNEs at a disadvantage compared to non-EU competitors.

"Proper monitoring of these taxes is key as they directly hit the profitability of companies," added Geerts.

However, less than half of the businesses in EU countries are prepared for the Green Deal, according to a PwC survey on environmental taxation. Many in-house teams have not yet quantified the cost of taxes in the Green Deal after legislation was revised in July 2021 to widen the legal framework.

> **"Many countries already have carbon pricing, but momentum is growing as more countries face pressures to tackle carbon emissions"**

Earth Day 2020 marks mixed environmental tax policy outcomes for the next five years

Environmental taxation after Russia's invasion in Ukraine

Russia's war in Ukraine shows countries are still dependent on fossil fuels as many introduced subsidies amid the struggle to shore up energy supplies when the world must slash the use of gas and coal.

For example, the Ukraine State Tax Service issued a zero-excise tax rate on April 11 on the production of liquefied gas and certain other greenhouse gas activities while under temporary martial law. Also, the US released more oil from national reserves in March and encouraged drilling to lower gas prices.

Meanwhile, the EU still intends to reach its net-zero energy target by 2050 under the European Green Deal. However, energy sanctions in Russia are slowing progressing as Germany and other EU countries add temporary subsidies including tax breaks on the local production of coal and gas to limit exposure to Russian energy, which provides 40% of the European energy supply.

Advisors suggest the war is only the most recent complication for carbon pricing alongside other international setbacks such as rapid inflation that governments must also manage to meet their climate targets.

While recent subsidies on fossil fuels amid the global energy transition is undermining climate change targets, some countries such as India have kept fossil fuel subsidies in place for years.

Earth Day is an event to raise awareness of the various environmental challenges facing our planet. While 2022 highlights certain setbacks to climate change targets amid Russia's war, it also marks the fastest pace of change in environmental tax policymaking at the corporate and government-levels. Carbon pricing is also likely to be the next global cooperative tax effort via the OECD/G20 Inclusive Framework on BEPS.

GERMANY

NERA Economic Consulting

Yves Hervé and Philip de Homont

Statistical approaches to TP adjustments for profit split systems

One key development in the OECD transfer pricing guidelines (OECD TP Guidelines) – and consequently in many national tax rules – has been the strengthening of the profit split method. In many cases, this will be the most reliable method to assess TP, especially between group entities, which each make unique and valuable contributions.

The application of the profit split method is not necessarily based on actuals. In many cases, the profit split analysis is conducted on an ex-ante basis and translated into specific prices or non-routine mark-up throughout the year.

In such cases, one challenge in the application of the profit split method is the missing guidance of the OECD on how ranges of acceptable outcomes can be established and how deviations between target profit allocations and actual outcomes should be handled. In the absence of such dedicated guidance, taxpayers should look to tested economic and statistical approaches as demonstrated herein.

In this article, the case of a multinational group with several manufacturing and several distribution companies is shown. Based on an ex-ante profit split analysis, transfer prices are set at the beginning of the financial year and normally kept constant throughout the year.

Ex-post adjustments in TP

In most business circumstances, ex-post actual outcomes at year-end will differ from ex-ante budgets. In TP, such deviations can be handled in different ways. The extremes would be to either make a full adjustment, (i.e., to make an ex-post determination of appropriate transfer prices and book a correction payment) or to make no adjustment at all (i.e., to simply rely on the transfer prices set ex-ante).

In practice, a frequently applied approach is a middle-ground solution: transfer prices are tested ex-post and, if they fall into a certain range, are accepted without further adjustment; only larger deviations are corrected. This corresponds to observed third-party behaviour, as independent parties rarely adjust prices ex-post, at least for 'normal' deviations.

This is also applied in our case example, in which the group would generally prefer to not conduct any adjustment payment due to administrative burdens and to not distort their management incentive structure. However, in order to decrease tax risks (which may more example may arise if an expected profit for one party turns into a loss while overall the business remains profitable overall), adjustment payments would be acceptable for 'large' deviations that fall outside of acceptable ranges.

The challenge of ranges in profit splits

For standard, plain-vanilla TNMM TP, the arm's-length range is usually determined by the interquartile range of benchmarked comparables' results. However, for profit split solutions, no such natural benchmarking method to compute ranges exists, since the complementary intangible contributions of the transacting parties are unique.

In principle, a range could be established by applying different allocation keys, but ultimately this runs the risk of having tax authorities pick and choose the allocation key they prefer. This would also be in conflict with traditional pricing thinking where in which taxpayers need to justify which key they consider most appropriate. Thus, in practice, a different approach is needed.

Comparison between of ex-post outcomes and ex-ante expectations

From an economic perspective, we propose differentiating between, on the one hand, developments that reflect commercial uncertainties as they ordinarily occur throughout a normal financial year and, on the other hand, developments that would be considered extraordinary such that they may trigger renegotiations between unrelated parties. For this purpose, the natural uncertainties in the budgeting process are evaluated by considering three variables:

1) The ex-ante target margin that is determined on budget profit split analysis. For a specific supply relationship, the overall expected profit might equate to 20% of manufacturing costs, which we assume is split 50/50. Thus, the profit split analysis might, for example, translate into a manufacturing mark-up of 10% that will be used for ex-ante price setting. We call this number the 'target TP budget'.
2) The ex-post target margin that is determined on actual profit split analysis. For a specific supply relationship, this might, in a simplified example, be equivalent to a mark-up of e.g. 15% (e.g., because the business turned out to be more profitable than expected). We call this number the 'target TP actual'.
3) The actually realised margin. Since all financials (distribution costs, productions costs, sales, etc.) are uncertain, this number can deviate from both target numbers (ex-post and ex-ante). In a simplified example, the realised mark-up might be 17%. We call this number the 'realised TP'.

> **"In certain business set-ups, it is possible to design a TP system based on the profit split method that identifies not just point value targets, but also allows for certain well-defined deviations"**

The comparison between target margins (budget and actual) shows the uncertainties inherent in TP. In our example, a deviation of five percentage points already occurred between the target TP budget (10%) and the target TP actual (15%). This could be an indication that the actual realised margin is not too far off the ex-post target. Indeed, the two percentage point difference (17%–15%) is smaller than the uncertainties due to the budgeting process.

Statistical analysis

On a pure bilateral transactional basis, gaps between ex-ante and ex-post profit margins for a single year provide no great insight regarding the uncertainties of related to the budgeting process. However, a statistical analysis is possible in the assumed set-up of multiple manufacturing and distribution entities. In such cases,

a distribution of the deviations of profit share outcomes from profit share targets considered during budgeting can be assessed statistically. If this procedure can be done, for example, for for e.g. 3–5 years and 10 intercompany supply relationships, this would generate 30–50 data points, which can then be subject to statistical analysis.

In particular, it is possible to identify typical deviations and deviations that can be considered as an outlier. Typical statistical metrics to apply to this data set would include either the interquartile range, or the standard deviation.

Deviations within the interquartile range or within the standard deviation from the target value would be considered related to acceptable normal business fluctuations, and would not require TP adjustments. Deviations out of this range would qualify to be related to exceptional business circumstances. Ex-post TP adjustments to the acceptable range would then be accepted.

Summary

As shown, in certain business set-ups, it is possible to design a TP system based on the profit split method that identifies not just point value targets, but also allows for certain well-defined deviations.

In our practical case, we could identify a threshold of 3.5 percentage points to a target mark-up derived from an ex-ante profit split analysis – if the realised transfer prices deviate by less than this amount from the target transfer price mark-up, no adjustment is booked. In practice, this solution allowed the client to implement a profit split solution with very few year-end adjustments, together with a consistent documentation of how and when adjustments are made.

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LUXEMBOURG

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Preliminary lessons learned from TP audits

In 2020, the Luxembourg tax authorities (LTA) launched a wave of tax audits with a focus on financial transactions. These audits are not yet closed but based on observations regarding how the audits are being conducted it is possible to describe some practical lessons learned that are relevant for taxpayers facing a tax audit in Luxembourg.

Some of these lessons may appear to be rather basic to readers that are located in jurisdictions where tax audits are a common and recurring practice, but it is important to understand that, until recently, this often was not the case in Luxembourg.

A Luxembourg tax audit starts with a long list of information that the taxpayer must submit to allow the LTA to carry out an extensive investigation of the taxpayer's tax position. This part of the process tests the taxpayer's ability to respond to such a request.

The pace at which the taxpayer is able to gather and submit the information and the completeness and quality of the information submitted, especially with

> **"In 2020, the Luxembourg tax authorities (LTA) launched a wave of tax audits with a focus on financial transactions"**

regards to the books and records of the company, provide an indication of the taxpayer's operational capabilities to run its financing or holding business under genuine business conditions.

Consistency between the profile of the taxpayer reflected in the transfer pricing (TP) documentation and the behaviour demonstrated through its board activities is a key initial test to pass when it comes to group financing operations under a tax audit in Luxembourg. As an example, the taxpayer may be requested to submit copies of the minutes of the board meetings that took place during the period under audit, which are expected to provide an indication of the level of management of the financing operations, with the focus on the risk of such business.

A company engaged in a genuine lending business would not be expected to fail to monitor the risk of the borrower defaulting on its obligation. In other words, if the TP documentation reflects a genuine lender taking risk on its funding operations and seeking risk-weighted remuneration, the minutes of the board meetings should cover risk-monitoring and risk-mitigating activities.

A further area of focus of the LTA is the completeness of the documentation with respect to the related party transactions under review. Lending transactions, even long-term ones, often evolve quickly.

New loans may be extended and existing loans refinanced or completely or partially repaid, which calls for prompt adjustments to maintain documentation sufficient to support each of the lending transactions.

Submitting documentation that covers only part of the operations or that is outdated could give the impression to the LTA of a lack of documentation capabilities with respect to related party operations. Depending on the facts and circumstances, the taxpayer could be in a better position by requesting a deadline extension from the LTA to allow it to close any such gaps, even if the request could be interpreted as a lack of preparedness.

The authorities generally seek direct contact with the taxpayer's representatives (even though, during the COVID-19 situation, a live meeting often was not possible). Even for an initial 'kick-off' meeting, a company should not hesitate to invite tax specialists, whether they are the group's tax director/manager or an external service provider.

The management of the company is not expected to be able to address any technical questions that the authorities may have in light of the documentation already received. The presence of external tax specialists should not be viewed as a lack of internal capabilities (which often is referred to as "substance" in the field of international tax), but rather as a sign that the taxpayer is willing to address any technical questions that may arise in the conversation.

Interactions with the authorities, including phone calls, should always be documented to ensure a common understanding of requests or of mutual positions expressed during calls and meetings. Correspondence still often occurs by mail, so a company should be proactive in ensuring that the post is being regularly collected.

We hope the discussion provided allows taxpayers to better navigate any future TP audits in Luxembourg. The learning curve on both sides (tax authorities and taxpayers) may make the process rather challenging, but an awareness of the basics described above should help avoid unnecessary escalations that are unlikely to favour the taxpayer.

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NORWAY

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Proposal on widening Norway's taxation right on the continental shelf

On February 21 2022, the Ministry of Finance proposed a change in the Norwegian Tax Act, widening Norway's taxation right on the Norwegian continental shelf. The proposed new rules have been circulated for public consultation.

Current legal position

Foreigners have limited tax liability to Norway. Currently, non-Norwegian tax residents, both individuals and companies, are liable to tax of wealth in, and income from, business activities which the foreigner is engaged in, and which take place in or are managed from Norway, including business activities in which foreign employees are made available to others in Norway cf. Article 2-3 (1) b) of the Norwegian Tax Act.

Norwegian territory at sea includes the territorial sea, extending to 12 nautical miles measured from the Norwegian baseline. Outside the territorial sea, including the Norwegian continental shelf, non-Norwegian tax residents are only subject to tax if the activity relates to petroleum cf. the Norwegian Petroleum Tax Act. The Norwegian government now proposes to widen its taxation rights by defining certain business activities on the continental shelf as taxable for non-Norwegian tax residents under the Norwegian Tax Act.

The proposed change

Under the proposed rules, there are three different types of business activities that will be considered taxable activities on the Norwegian continental shelf for non-Norwegian tax residents.

Firstly, mineral activities on the continental shelf, as defined under the Norwegian Seabed Minerals Act, are to be treated as taxable activities for non-Norwegian tax residents. For practical reasons this means that examination, such as searching and mapping, and exploitation of minerals on and beneath the seabed, will qualify as a taxable mineral activity. In addition, ancillary services (typically transportation and supply services) supporting the main activities, will qualify as taxable mineral activities, including also sub-contractors.

Secondly, activities on the continental shelf related to production of renewable energy resources, as defined under the Norwegian Act on Offshore Renewable Energy Production, is proposed to become taxable for non-Norwegian tax residents. Renewable energy resources are defined as production of electronic energy by means of renewable energy sources, typically including wind, waves, tides and solar energy. In the legislative proposal, the taxation right is not limited to certain renewable resources. By using a technology neutral term, it is instead sought to be dynamic and include energy resources that are not yet discovered. The taxation right is intended to include all steps of energy production, meaning both the searching stage, the examination stage and the exploitation of the renewable energy resource as such. In addition, ancillary services are suggested to fall within the scope. For practical matters this means that non-Norwegian tax residents preforming activities such as examining seabed conditions and installing windmills on the continental shelf will become subject to tax under the new rules.

> **"The immediate effect of the new rules, apart from widening Norway's taxing right, are compliance obligations"**

Lastly, the proposed rules make activities related to capture and storage of carbon dioxide taxable to Norway. This includes activities as defined in the Norwegian Regulation to Act on Petroleum Activities and Regulation on storage and transportation of CO_2 on the continental shelf. *Capture and storage of carbon dioxide* comprise of measures to redeploy carbon dioxide from a gas flow following permanent storage of the carbon dioxide in order to reduce the amount of carbon dioxide in the atmosphere. Capture and storage of carbon dioxide have three main elements: capture, transportation and permanent storage. These three elements, along with examination, exploration, exploitation and the like, fall within the scope of taxable activities under the new rules. Ancillary services are also included in the scope of taxable activities, whereby supply services may serve as an example.

Note that the proposed changes will not only include non-Norwegian tax resident companies working with or providing business activities as outlined above, but also non-Norwegian tax resident employees (individuals) working within the above-mentioned business activities, hereunder salary income.

Consequences

The deadline for providing comments to the legislative proposal is May 21 2022. The changes are expected to be passed and proposed to enter into force immediately after its adoption.

The immediate effect of the new rules, apart from widening Norway's taxing right, are compliance obligations. Foreign employees working in Norway will generally be liable to tax for salary income earned in Norway. Even though applicable double tax treaties may eliminate or reduce the obligation to pay tax in Norway, compliance obligations, such as payroll reporting, still applies in accordance with domestic law.

Employers with foreign workers on the continental shelf are also obliged to report foreign contracts to the Norwegian Tax Authorities. As compliance costs occur for the employer regardless of whether the employee shall pay tax in Norway, such costs should be taken into account when providing fee-estimates in bid processes.

It should also be added that certain double tax treaties do not include the continental shelf in its scope, e.g. Italy and Switzerland, making it less favourable for these states to exercise the above activities on the Norwegian continental shelf going forward.

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POLAND

MDDP

Łukasz Kosonowski

CIT exemption for companies attracts foreign investors

A so-called Estonian corporate income tax (CIT), a new form of taxation introduced in Poland in 2021, is becoming more popular among the taxpayers.

In 2022 the regulation on Estonian CIT was significantly amended in favour of taxpayers – some of the most restrictive conditions for entry were deleted or softened while the incentives (lower tax rate) became even more attractive. What is particularly worth mentioning is that this solution is allowed not only to Polish taxpayers but also to foreign investors – as long as they are individuals and invest through Polish company.

The main advantage of the Estonian CIT is that the tax is not payable until the profit is distributed. From 2022, an effective tax rate may attract taxpayers to choose this form of taxation.

While the tax burdens for companies paying taxes in regular way and sole entrepreneurs are getting higher, Estonian CIT allows to get the public duties burden to the level of 18%–25%; and this is the effective rate, including CIT, personal income tax (PIT) and social securities. If this is not attractive enough one should remember that in the Estonian CIT tax is not payable on a monthly or yearly basis, but only when the profit is actually distributed (even if that is to happen in next five years or more).

The main question that may be posed is whether this is possible for the foreign investor. The simple answer to the question is 'yes' and there are no exceptions.

The Estonian CIT may be chosen by a

Polish company owned by individual investors from abroad, regardless if it is from the US, Europe or any other jurisdiction. The only thing to remember about is that the Estonian CIT is a form of taxation projected for companies (CIT taxpayers) – so, if the foreigner wants to use it, the foreigner needs to establish a company in Poland (LLC, LP, joint stock company) through which the business operations or investments will be carried out; but this is exactly the same as for Polish investors.

In fact, the Estonian CIT may in some circumstances be even more favourable for foreigners than for the Poles. That is because the Polish tax regulation provides for a special relief in PIT upon the distribution of profits (dividends) by the Estonian CIT company.

The relief allows between 70% to 90% reduction of PIT due on dividends – which in Poland is calculated at the rate of 19%. In case the dividends are paid out by a Polish company to foreign investors, the tax rate (withholding tax) is usually lower and range between 5% to 15% – which should further decrease the level of taxation due in Poland.

The Polish company that chose Estonian CIT may also carry out activities out of Poland. The income from those activities may also be subject to Estonian CIT unless it has been taxed out of Poland (in such case, non-Polish tax shall decrease Estonian CIT base).

It is worth noting that the Estonian CIT is allowed for any businesses (with one exception being the broadly interpreted financing activity).

As long as there this is a real investment, generating non-passive income (such as interest or royalties), Estonian CIT may be chosen. The Estonian CIT may be a perfect solution for medium- and long-term investments generating on going profits.

If you invested PLN 100 million with a rate of return (income) at 5% annually. The annual profit of PLN 5 million will cost you approximately PLN 1 million of CIT – which you have to pay regardless of whether the gain has been distributed or not – plus another PLN 800,000 of PIT (if the profit is actually distributed). Multiply these numbers for five or ten years depending on how long the investment lasts and the numbers become significant. Now imagine what happens to the Estonian CIT – if you do not pay out the profits, you pay nothing, zero.

While the tax environment in Poland is generally getting more and more complicated, it is even more important than ever not to miss the opportunities that are offered by the legislator. The Estonian CIT is perfect example of that – and it may be used by foreign investors as well.

> “The main advantage of the Estonian CIT is that the tax is not payable until the profit is distributed”

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SPAIN

Garrigues

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Potential discrimination in the taxation of capital gains

On December 2 2021 the European Commission announced its decision to open infringement proceedings against Spain, requesting it to change its rules on the timing of recognition of capital gains for non-resident taxpayers in transactions with deferred payment, due to potentially being contrary to EU law.

Under the Spanish personal income tax and corporate income tax laws, for certain types of transactions with deferred payment or paid in installments, Spanish resident taxpayers have the option to pay the tax when the capital gains accrue or to defer it and pay it proportionally based on the cash flow.

However, the rules on the accrual and payment of tax on capital gains obtained by non-resident taxpayers without a permanent establishment do not offer that option and the tax must necessarily be paid when the capital gains accrue, i.e. at the time of the transfer of the assets (and even if payment has been deferred).

In the Commission's opinion, that difference in treatment could amount to an infringement of the free movement of capital, which is prohibited by Article 63 of the Treaty on the Functioning of the European Union.

The letter of formal notice requesting more information from Spain is the first stage in the infringement proceeding initiated by the European Commission. Spain has two months to reply in detail to the notice sent by the Commission, and if it so decides, propose the necessary amendments to its legislation.

> “Spanish resident taxpayers have the option to pay the tax when the capital gains accrue or to defer it and pay it proportionally based on the cash flow”

If Spain fails to provide a satisfactory response, the Commission may decide to issue a reasoned opinion explaining why it considers that a breach exists, and if Spain still fails to adopt corrective measures, it may refer the matter to the Court of Justice of the European Union (CJEU).

This is not the first time that the different tax treatment in Spain of income obtained by resident and non-resident taxpayers has been questioned.

In 2009, the CJEU held to be contrary to the free movement of capital the higher rate that applied for non-resident taxpayers than for resident taxpayers on capital gains obtained on asset transfers (C-562/07).

In 2010, it was also held to be contrary to the free movement of capital to lay down a higher ownership interest for non-resident taxpayers in order for the exemption on dividends from Spanish subsidiaries to apply (C-487/08). In a case that bears a certain degree of similarity to this case, the court held to be contrary to EU law (to the freedom of establishment, in this case) the obligation for individuals who transferred their residence to another member state to include any income not yet charged to tax in the tax base for the latest tax year they were resident in Spain, instead of applying regular timing allocation rules (C-269/09).

The question arises whether other potentially discriminatory rules based on similar principles may also require a similar analysis (an example that springs to mind is non-resident taxpayers not being allowed to offset capital losses against capital gains obtained in Spain, even during the same year).

The described precedents gave rise, after the CJEU had delivered a decision on them, to the required amendments to the legislation to align the taxation of resident and non-resident taxpayers, so we shall have to see how Spain will react to the proceeding that has now been opened and when the conceivably necessary changes to the legislation will occur.

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Tax after the Ukraine crisis

The unfolding crisis of the Russia-Ukraine war has widespread tax implications for multinational companies. The economic fallout of the war spells greater transfer pricing risks and higher taxes.

Josh White

Companies facing a global supply chain crisis, coupled with rising inflation, have seen these problems made much worse by the Russia-Ukraine war. Its impact has rippled through global energy markets. Europe was already facing a gas crisis before the war started, and this is only getting more severe.

Many governments have turned to cutting indirect taxes, particularly fuel duty and VAT on energy, to alleviate the cost of living crisis. Meanwhile, US and European brands, including Coca-Cola, McDonald's and Starbucks, have exited the Russian in protest.

The Russian government has responded with its own sanctions and even seized the intellectual property (IP) of foreign multinational companies leaving the country.

Businesses leaving Russia have had to factor in this risk as part of their transfer pricing (TP) policies, while also planning for greater uncertainty over benchmark data. There has been little data certainty because of COVID-19, but the war means there will be no return to normality for some time.

Here *ITR* journalists **Alice Jones**, **Danish Mehboob** and **Leanna Reeves** analyse the fiscal implications of sanctions on Russia for businesses and the economic fallout of the war.

The war continues to exact a terrible human cost and there is little sign of a peace deal, while the economic consequences are still playing out worldwide.

Russian aggression offers several tax lessons for governments

Russia's invasion in Ukraine has expedited some international tax developments including regulations on digital assets and beneficial ownership, as well as revisions on environmental tax incentives.

Danish Mehboob

Government leaders are calling for more tax transparency and cryptocurrency regulations, as well as changes to environmental tax policy and tax treaties amid the ongoing conflict in Ukraine.

Beneficial ownership

Politicians are reigniting calls for beneficial ownership registries to identify potential Russian ties in shell companies across several countries. The EU, US, UK, Switzerland, and other major governments could increase sanctions on Russian groups and individuals in coming months as a result of more tax transparency.

"FinCEN is taking aggressive aim at those who would exploit anonymous shell corporations, front companies, and other loopholes to launder the proceeds of crimes, such as corruption, drug and arms trafficking, or terrorist financing," said Himamauli Das, acting director of the US Treasury Department's Financial Crimes Enforcement Network (FinCEN).

Additionally, the concept of beneficial ownership is a key part of provisions in tax treaties for multinational enterprises (MNEs) to avail benefits, and companies have even restructured because of it.

The UN Model Double Taxation Convention and OECD commentary on tax treaties both advocate for beneficial ownership tests to determine whether MNEs should have access to treaty benefits, including exemptions on withholding taxes.

"Beneficial ownership cases changed how several companies consider the substance of their holding structures," said Richard Taylor-Whiteway, head of tax at the insurance provider Brockwell Capital.

"We are regularly asked to consider insuring against withholding taxes and denied interest deductions that cannot be matched against income," he added.

The consequences of failing beneficial ownership tests include denial of residency certificates, the application of directives, and no support for mutual agreement procedures under double tax treaties.

Environmental taxation

Russia's invasion in Ukraine has shown how countries are still dependent on fossil fuels, with many nations are struggling to shore up supplies when the world must slash the use of oil, gas and coal.

The EU intends to reach its net-zero energy target by 2050 under the European Green Deal. However, energy sanctions against Russia are slowing progress as Germany and other EU countries add temporary tax incentives on the local production of coal and gas to limit exposure to Russian energy, which provides 40% of the European energy supply.

Non-EU countries are taking steps to incentivise MNEs to avoid Russian energy too as UK Prime Minister Boris Johnson ruled out a months-long debated windfall tax on energy firms such as BP and Shell and the US Congress may suspend its federal gas tax in coming weeks to tackle high energy prices.

The ongoing energy crisis is increasing resistance to the European Green Deal, particularly the plan to extend the emissions trading scheme (ETS) and raise carbon taxes. "Many governments are more urgently focusing on alleviating near-term energy shocks than reducing their vulnerability to wild swings in the oil and gas markets since that transition will take years," said one tax analyst at a large energy company in the UK.

The European Commission's REPowerEU plan released on March 8 aims to make Europe independent of Russian fossil fuels by 2030, but the initial efforts focus solely on gas. The roadmap essentially proposes finding alternative supplies of gas by introducing a legal requirement for EU countries to ensure a minimum level of gas storage. The Commission is also encouraging the bloc to apply windfall taxes on the profits of energy companies.

The International Energy Agency also suggested the Commission introduce a windfall tax on the profits of utility companies as part of the plan to end the bloc's reliance on Russian hydrocarbons.

Vice President of the European Commission Frans Timmermans said that for some EU countries it might even make sense to switch to coal production in the short-term.

The European Green Deal aims to cut carbon emissions by 55% this decade, before cutting emissions to zero by 2050. However, Russia's invasion puts the Commission's aims under strain as carbon emissions will increase near-term, but the longer-term aim is still a transition to sustainable sources.

Cryptocurrency regulations

Separately, several countries are introducing regulations for the taxation of digital assets such as cryptocurrencies and non-fungible tokens (NFTs), and Russia's invasion might have exacerbated this trend. FinCEN warns that Russian groups and individuals could use cryptocurrencies to evade sanctions.

"We can expect to see a push for greater transparency in digital transactions via legislation and enforcement, particularly after the midterm elections in the US," said Johnson.

Russia holds $214 billion in crypto-assets, roughly 12% of the world's cryptocurrency market. The Federal Taxation Service of Russia announced plans for a 6% levy on cryptocurrency trading in January that could fetch at least $2.4 billion. There are also plans to regulate the large crypto market after the central bank proposal for a blanket ban on crypto mining and trading was declined.

The US Treasury Department is expected to address loopholes in digital currencies by March 23 to ensure sanctions on Russia. The US response could provide insights into future tax regulation on cryptocurrencies.

While Russia faces some tax constraints alongside several financial sanctions, the country is offering a carrot-and-stick treatment under which MNEs withdrawing business could face steep tax penalties while local businesses benefit from tax concessions.

Nevertheless, the legislative changes being expedited by governments worldwide in reaction to the Russian invasion of Ukraine means the way companies with Russian ties do business will never be the same again.

Tensions escalate over sanctions relating to Russia-Ukraine war

As the US and its allies limit trade with Russia in response to its invasion of Ukraine, China refuses to participate. The Russia-Ukraine conflict is generating further tension between China and the US over trade.

Alice Jones

Russia's invasion of Ukraine will spark trade disputes globally

Multinational enterprises (MNEs) are likely to be hit by an increasing number of economic sanctions as the US and European countries take measures against Russia, following the country's invasion of Ukraine on February 24. In addition to European countries and the US, countries including New Zealand, Canada, and Japan, have taken economic action against Russia.

Global oil prices have already been dramatically affected because Russia is the world's second largest exporter of oil after Saudi Arabia. Amid speculation that countries would ban oil and gas imports from Russia, oil prices soared on March 6 before subsiding.

Germany, which is heavily reliant on Russia for energy, is reluctant to ban imports because this would substantially impact the cost of energy for its businesses and citizens. However, Germany is not the only country that is concerned about the impact of action against Russia.

Nathan Piper, head of oil and gas research at financial services company Investec, told the UK Treasury Committee on March 14 that companies and consumers would be badly affected by increased economic restrictions against Russia.

"If more stringent actions are imposed upon Russia, and five million barrels a day is truly taken out of the market, then oil prices would really have no ceiling," said Piper.

Rising energy prices will have an effect on MNEs across industries, but they will most affect companies in the utility and energy provision space, as well as energy-intensive sectors such as steel and mining.

At the same time, Russia has begun to retaliate against western sanctions. On March 15, Russia imposed sanctions on US President Joe Biden and his Secretary of State, Antony Blinken. Russia has also targeted other high-profile American politicians and officials, including former presidential candidate Hillary Clinton, and the head of the CIA (Central Intelligence Agency), William Burns.

This indicates that Russia is willing to retaliate and could impose more sweeping sanctions that would affect multinational companies. Meanwhile, China's refusal to align itself with western sanctions against Russia has increased tension between China and the US.

China-US tension

The Chinese government is refusing to be drawn into alignment with sanctions that other countries are imposing on Russia to discourage its military advances in Ukraine.

"China is not a party to the crisis, nor does it want sanctions to affect China," said Wang Yi, the Chinese foreign minister.

Yi made the remarks in a phone call to his Spanish counterpart, José Manuel Albares, on Tuesday, according to the Financial Times.

"China has a right to safeguard its legitimate rights and interests," added Yi.

The US has warned China that there will be consequences for any efforts to help Russia evade sanctions or fill orders for goods that are restricted by other countries. US National Security Advisor Jake Sullivan met with Yang Jiechi, China's top diplomat, in Rome on March 14 for an intensive discussion about the Russia-Ukraine crisis.

There are reports that Russia has asked China to provide it with military equipment, which the US and its western allies would push back against. The Chinese government has denied the reports.

China and the EU are scheduled to hold a virtual summit on April 1 regarding the future of a long-awaited investment agreement. However, the deal looks increasingly uncertain as tensions build over the war in Ukraine.

There is no sign of the sanctions being lifted until there is a peace deal in place. Tax, customs, and logistics teams at MNEs, particularly those with stakes in the countries involved in economic disputes, will need to keep on top of the developments. Reacting quickly to any changes will be key to minimising any disruption to supply chains and the wider business.

Businesses face greater uncertainty over benchmark data following the Russia-Ukraine war

Tax directors must assess the impact of the Russia-Ukraine war on their transfer pricing (TP) policies as the fallout increases uncertainty over benchmark data and raises costs for businesses.

Businesses may have to restructure operations, review contracts, and reconsider TP policies in response to the Russia-Ukraine war. However, benchmarking and comparables are fundamental to forward planning, but there is a lack of data for such planning.

Any significant supply chain disruption means additional costs for MNEs and the TP team will have to consider how to allocate those costs.

"Most tax OECD guidance will always require an MNE to look to what would happen on an arm's length – which then involves reviewing contracts, documentation and so on and in particular what happens in the event of force majeure – which I assume a war would be," said Laurence Field, partner at Crowe UK.

Leanna Reeves

Businesses will struggle to find the data to benchmark their activities until the dust settles. When profit margins and costs are dynamic, it could be difficult to benchmark, particularly after two years of pandemic and the economic context.

"Benchmarking operations are no longer straightforward as they used to be. There's some detailed thinking that needs to be done here," said Field.

Sanctions against the Russian government have made the global supply chain crisis even worse. The rollercoaster of commodity prices generated by the invasion of Ukraine means TP teams have to assess how the additional costs will impact their pricing.

"The impact of the war and sanctions is definitely going to affect multinationals and consequently TP policies as well. The more heavily involved you are – that your operations are in these countries – the greater the impact will be," said Chantel Venter, founder and managing director at Impact TP.

Russia and Ukraine are rich in natural resources, being significant exporters of food and raw materials. Ukraine is an exporter of coal, corn and wheat, while Russia's biggest exports include diamonds, natural gas, and copper.

Hundreds of thousands of businesses around the world rely on Russian suppliers, as well as the low cost of labour in both countries. Many multinational enterprises (MNEs) today outsource the provision of intergroup services into these countries to decrease operating expenses.

Following the Russian invasion of Ukraine, governments have imposed sanctions including the US ban of Russian oil and gas imports, as well as the UK's decision to phase out Russian oil imports by the end of the year. This has caused a commodity market turmoil with prices skyrocketing.

The price of Brent crude went up by 18%, wheat up by 15%, nickel up by 91%, palladium up by 32%, and gold up by 4% since the beginning of

Businesses must consider TP risks related to benchmarking analysis following the Ukrainian conflict the war in February, according to Hargreaves Lansdown.

The UAE pushed for other members of the organisation of the petroleum exporting countries (OPEC) to pump more oil in a bid to appease the price surge and seek further stability. On March 9, Brent crude experienced the biggest drop since pandemic levels in April 2020 following the news.

While Russia and Ukraine provide for almost a third of wheat exports, the limited amount of goods coming out of both countries will continue to make prices soar – meaning consumers and businesses will have to bear the costs.

Businesses will need to take into consideration the potential TP risks caused by the conflict. The problem is that there is no TP playbook for wars. So many teams will have to improvise much like the response to COVID-19.

Cabrini McCarrick, TP partner at Regan Van Rooy, said distributors would face lower volumes of goods being traded. Such distributors would have to meet their target margin with lower sales or operate at the lower end of the arm's-length range.

Benchmarking would be needed for these multinational companies to account for a broader inflationary period. The lack of comparables made it more difficult for businesses to deal with benchmarking during the COVID-19 crisis, but the war imposed by Russia could make the process even more difficult.

"A large part of that is because there is a reliance on historical data when we do benchmarking, and that date doesn't correlate to what is happening currently. It may often need complex adjustments to account for differences that are happening," said Venter.

Taxpayers will need to make adjustments to their transfer pricing arrangements to factor in these risks and higher costs. Transfer pricing teams will have to consider other methods if pricing needs to be adjusted in these uncertain times.

Russia boosts tax incentives as businesses exit the country

Russia is enhancing its already favourable local tax regimes to support several growth sectors. At the same time, the Big Four accountancy firms have severed ties with their Russian offices.

Danish Mehboob

Russian Prime Minister Mikhail Mishustin signed a decree in March that introduces three years of exemptions on income tax payments and inspections for qualifying Russian companies. Technology companies will particularly benefit from the measures.

There are two-fold reductions in social insurance contribution rates for technology companies and special economic zones with significant tax exemptions for technology start-ups. Russia has also reduced the corporate profits tax rate from 20% to 3% and social insurance contribution rates from 30% to 7.6% for qualifying Russian technology companies.

"It is a dire situation for all businesses as no one is prepared for this level of uncertainty," said one head of international tax at a Russian cybersecurity MNE, referring to the implications of Russia's invasion of Ukraine.

"Businesses hate uncertainty, but there are also opportunities in economic downturns and we see certain benefits like the latest legislation," added the head of international tax.

If Russia's invasion continues, it will force the government to introduce more tax incentives to keep business capital in the country as foreign sanctions result in businesses leaving the country.

Business exits

Several sanctions have put pressure on MNEs to sever ties with Russia.

The Big Four accountancy firms announced on March 7 that they are cutting business ties with Russia, joining other companies in exiting Russia. While the firms will not close their offices, the Russian entities will legally separate from their parent companies. A change that affects more than 10,000 employees.

EY has the largest staff presence of the Big Four in Russia with 4,700 workers and partners. "This is not something we take lightly," said Yvonne Díaz, EY global media relations and social media director.

"EY has commenced a restructuring of its Russian member firm to separate it from the global network. EY will not serve Russian government clients, state-owned enterprises or sanctioned entities and individuals anywhere in the world," added Díaz.

Financial sanctions in the US, EU, and UK have made it illegal for firms to serve some of the biggest Russian businesses, including banks such as Sberbank, Gazprombank and VTB.

Divestitures of Russian equity amid a global market downturn will inevitably decrease group revenues. Companies are scrambling to limit their exposure to Russia after the sanctions. To add to business uncertainties, the Ministry of Economic Development in Russia announced it will seize assets of any departing business with at least 25% foreign ownership.

"The extent of the revenue loss will depend on the organisational and transfer pricing structures," said Jared Johnson, tax partner at White and Williams.

Some in-house tax directors have suggested utilising the losses in Russia to offset taxable gains in other areas of their business. Companies that incur capital gains, exit taxes, and other tax liabilities from relinquishing Russian operations might still be able to carry the losses forward in other countries.

In the meantime, financial sanctions are not the only concern for large businesses in Russia as some governments may even revoke their tax treaties with Russia as a punishment for invading Ukraine.

Treaty exits

Governments with existing business ties to Russia could face ripple effects from the sanctions, and they might consider revising or revoking their tax treaties to limit their exposure.

The Senate Foreign Relations Committee has already announced a review of the US-Russia tax treaty. "As the lists of Russian sympathisers such as Belarus and neutrals parties such as India grow, similar calls may be issued for their respective tax treaties," said Johnson.

Russia was already renegotiating a range of tax treaties with Cyprus, Malta, Luxembourg, the Netherlands, and other partner countries in 2020 after increasing its withholding tax rate from 5% to 15% on interest and dividend payments. Luxembourg is the latest country to ratify its tax treaty with Russia in March 2022 to avoid double taxation and prevent tax evasion on income and capital.

"For Russia it seems [treaty negotiations] depend on the

Russia introduces tax incentives to protect businesses from sanctions

size of foreign direct investment [FDI] and transit jurisdictions with lower tax rates," said Eduard Sporken, director at KPMG Netherlands.

Partner countries with ongoing treaty negotiations with Russia might use the sanctions to secure more favourable terms on taxing capital outflows from Russia.

The OECD also suspended Russia from participating in its programmes. However, Russia is not suspended from the BEPS Inclusive Framework, which involves G20 work on the digital tax agenda and the two-pillar solution. The extent of Russia's involvement in the OECD's tax work is not yet clear.

The situation is changing rapidly for businesses in Russia. With near-term capital inflows being unlikely, steep tax breaks might draw businesses back in the long-term.

Russia's IP threat poses TP risk for businesses

Businesses could face drastic transfer pricing (TP) consequences as Putin's government aims to seize intellectual property (IP) from companies leaving the Russian market.

Russia's threat to seize IP assets from top brands means businesses could be at risk of losing their patent work and royalties, ultimately affecting their TP arrangements. The decree issued by the Russian governmentcould be significant for those with IP in the country.

The decree is designed to amend the methodology used when determining the amount of compensation paid to a patentee without its consent. Patent holders from foreign jurisdictions that have committed "unfriendly acts against Russian legal entities and individuals" would receive 0% of revenue from the patent, according to the decree.

In short, the March 6 decree allows the Russian Federation to nationalise IP assets of organisations that have halted their operations in Russia.

Western retail brands including Facebook, BMW and Nike have rushed to protect their patent work in Russia as they applied for IP protection in the country. Companies that risk losing their patent protection could see Russian businesses use their IP without their consent. Russia could therefore continue to run businesses despite brands ceasing their operations.

"The type of questions we are dealing with these days rather relate to where the costs resulting from a certain decision around whether to continue operations in Russia ultimately should end up?" said Jonas Van de Gucht, TP leader and partner at PwC Belgium.

Ending operations

The impact on businesses will vary from a business

Leanna Reeves

model perspective and a parent company perspective, according to Van de Gucht, given that one would expect the holding company to have a significant influence on strategic matters.

"Tax functions of companies are being addressed multiple questions from their management. Imagine the example of an ultimate parent company in the US, and for TP and business model reasons they operate a principal type of structure in Europe and that entity has an IP license from the US also covering Russia," said Van de Gucht.

"In case the US parent company decides to stop its operations in Russia, several questions need to be answered from a TP perspective," he continued.

"One is that if they decide to quit overnight – does that mean that they are shutting down their operations or alternatively whether they're selling the shares in that business to a third party that might continue or is willing to continue operations? If so, at which value? One option could be to sell for zero so as to not realise any capital gains, at book value or at fair market value, which might be challenging to determine," he added.

If companies no longer want to have business in Russia and dispose of their shares, they will sell for zero, meaning the value of shares the shareholder held becomes zero overnight – even below book value.

The value of the share will also be far from the fair market price because many companies in Russia, particularly business-to-consumer (B2C) ones, consider the Russian market an important one, according to Van de Gucht.

"At that moment the question becomes whether the shareholder needs to be compensated for this loss by the parent company for the loss in value," he said.

"If you are the principal losing out on a significant market because of that decision, how are you going to deal with the loss of profit potential or the fact that as a result of the parent company decision one can no longer earn a return on historical investments made. Or would it be in the best interest of that principal company to avoid broader damages in other markets if it were to continue operating," he added.

Determining the value of the shares being sold – whether it is at book value or fair market value – will be a significant TP exercise for businesses with IP located in Russia.

Losing the royalty potential

Companies could also lose the revenue generated by royalties because of their IP being seized.

"If you've got the government threatening to seize these assets, then logically, they should become worthless in the hands of the entity that owns them," said James Ross, partner at McDermott Will & Emery. He explained that a company's home government will not be expecting the business to continue charging royalties on IP taken by the Russian government.

"The home government is not going to say, 'well you should still be charging a royalty into Russia when in practice you're not able to exploit assets in Russia because they've been seized by the Kremlin," he added.

Van de Gucht said businesses will need to assess the TP consequence of ceasing their operations in Russia, which will lead them to lose the right to license their IP to the Russia markets and the full royalty potential.

In April 2021, the United States Trade Representative (USTR) conducted its annual review on IP protection around the globe. The list of priority foreign countries included jurisdictions deemed to inadequately protect and enforce IP rights. Nine countries including Russia were on the US watchlist.

The USTR is expected to release the 2022 edition of the annual IP review on April 30.

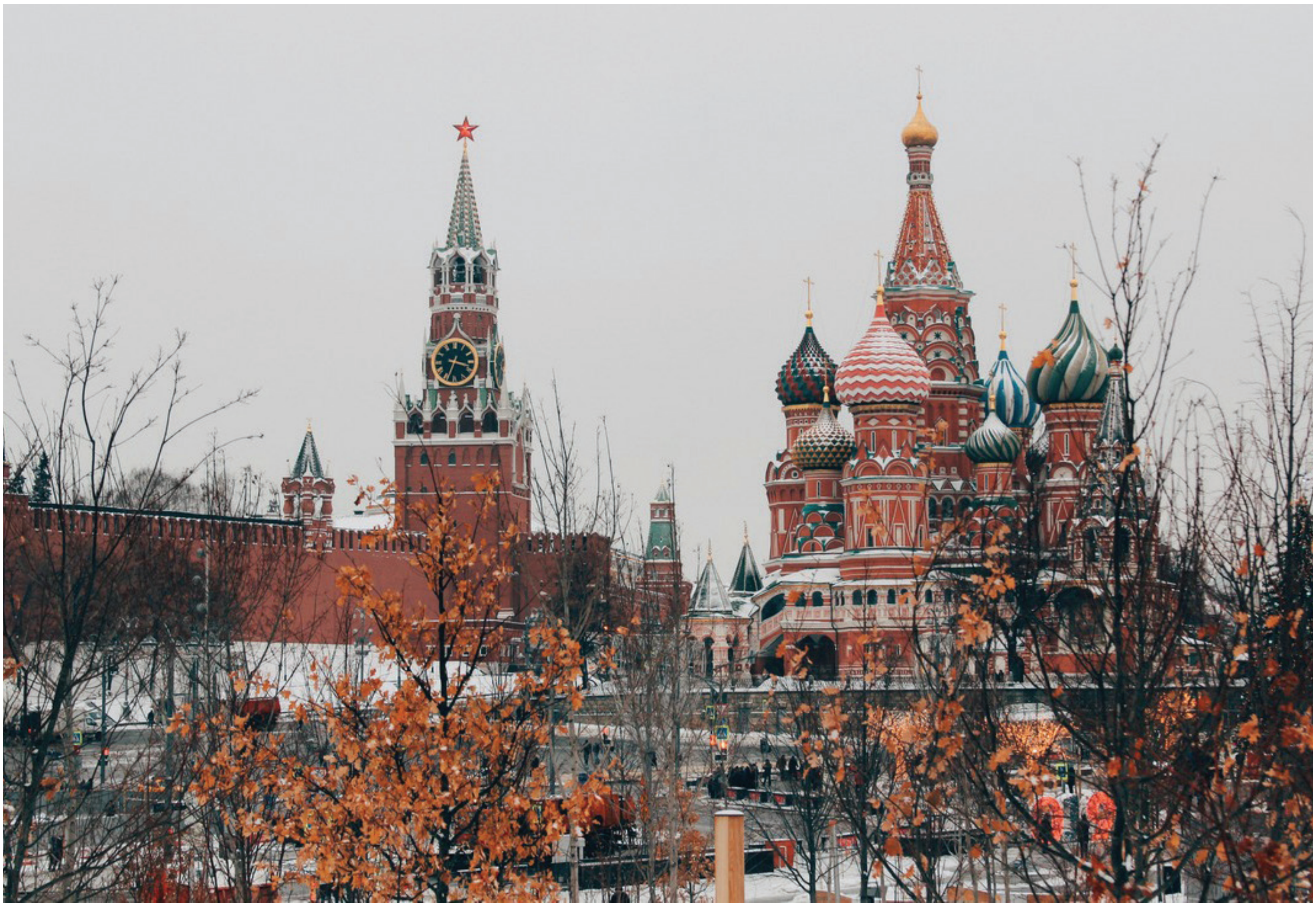
Following McDonald's announcement to temporarily close restaurants and halt operations in Russia, a patent lawyer in Russia filed an application to the Federal Service for Intellectual Property (FIPS), also known as Rospatent, to trademark a logo similar to the well-known American fast-food chain's own.

Rospatent has since reiterated that trademark applications such as Idea – a Russian imitation of the Ikea logo – remained to be examined and approved by the IP Office. The US Patent and Trademark Office (USPTO) severed ties to Rospatent on March 22.

Van de Gucht said companies are also registering their IP in case they ever want to return to the Russian market again.

Overall, the broader tax consequence resulting from the seizure of IP will depend on each company's precise holding and licensing structure that is being used by the entity – whether the IP is being held locally in Russia.

As for TP, companies will need to carefully understand how ending operations in Russia and losing their IP will affect the pricing put in place, particularly as they consider selling their shares. It wouldbe a significant hit for businesses as the value of their shares could be down to zero overnight.



Russia plans to seize businesses' IP assets

How to use hidden tools for managing international tax disputes

Taxpayers should not overlook the hidden tools in the MAP toolbox when it comes to dispute resolution, particularly supplementary dispute resolution (SDR). Here Emile Simpson and Peter Nias write about the routes open to businesses.


Emile Simpson


Peter Nias

The issue this article addresses is how to manage the resolution of international tax disputes falling under Article 25 of the 2017 OECD Model Double Taxation Convention on Income and on Capital (the Convention) in a timely and cost-effective manner using the techniques of supplementary dispute resolutionSDR.

By way of background, a key outcome of Action 14 of the OECD's 2013 BEPS Action Plan, which aims to make dispute resolution more effective, was the introduction of the mandatory submission to arbitration under Article 25(5) of the 2017 Convention.

However, we contend that dispute resolution under Article 25 can be made even more effective through the use of SDR both before, and after, the initiation of the mutual agreement procedure (MAP) by a taxpayer under Article 25(1).

What is SDR and its techniques? The acronym was first introduced by the OECD as part of its programme of work between 2004 and 2007 resulting in the 2007 Manual on Effective Mutual Agreement Procedures (MEMAP).

Its first report in 2004 referred to the existence of a number of possible SDR techniques and recommended an evaluation should be carried out of them and the situations for which they would be suitable.

SDR techniques – also referred to as non-binding dispute resolution (NBDR) techniques by the UN tax sub-committee – cover a range of forms: facilitation, mediation, non-binding expert advice or determination. While the OECD focused on two forms: mediation and expert determination**.**

The MEMAP Manual recommended: "*the use of process-related assistance such as mediation or facilitation*" to help "*provide a perspective on the discussions, identify process hindrances, and… bring more of a problem-solving focus to the discussion*". Both paragraphs 86 and 87 to the OECD Commentary to Article 25 suggest using both mediation and expert determination to support the MAP process.

SDR techniques are not in opposition to arbitration, but rather, are exactly as labelled, supplementary techniques that will typically come into play earlier in the overall scheme of the MAP under Article 25, in order to encourage disputes to be resolved in as timely and cost-effective a manner as possible.

We consider first the legal basis of the use of SDR in relation to disputes falling under Article 25, and then address some common objections to the use of SDR.

The legal basis of the use of SDR under Article 25

SDR can be employed within the form of MAP set out in Article 25(1), under which the taxpayer presents their case to the competent authority in respect of "*taxation not in accordance with the provisions of this Convention*", which in turn triggers the obligation under Article 25(2) that "*the competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State […]*".

Every taxpayer needs a dispute toolbox

SDR can be employed at any time before a mandatory submission to arbitration under Article 25(5) (notwithstanding its potential use thereafter, though that is not the focus of this article). Given that under Article 25(5), mandatory submission to arbitration can only be triggered by the taxpayer "*within two years from the date when all the information required by the competent authorities in order to address the case has been provided to the competent authorities*".

It may well be several years before any mandatory submission to arbitration. Even then, the arbitration process itself may be lengthy. It follows that the use of SDR before a mandatory submission to arbitration can provide a quicker, and therefore less costly, means to resolve the dispute.

However, and furthermore, SDR can also be used even earlier in a dispute, saving even more time and cost, in the period before Article 25(1) is engaged, that is, in the so-called "MAP gap" period when an issue that could develop into a dispute is first identified and before the formal notification of a MAP claim is made by the taxpayer.

When used in this way, the legal basis of SDR is under the first sentence of Article 25(3), which provides that: "*The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.*"

Thus, Article 25(3) can cover the issues within any specific dispute – that is, a dispute relating to a specific taxpayer – that could potentially be brought under Article 25(1), since all such specific disputes would necessarily concern the application or interpretation of the Convention. But unlike Article 25(1), Article 25(3) does not require a taxpayer formally to trigger its application.

Article 25(3) allows the competent authority to take the initiative independent of or prompted by a request from, the taxpayer effectively to resolve a dispute with a taxpayer though a mutual agreement with the other competent authority at a very early stage in the dispute.

One example of where it could be used to good effect would be as part of the process of managing the pillar one approach to providing tax certainty (with respect to amount A). It could be used at any stage: before or as part of the optional initial review; the review panel or even the determination panel.

The taxpayer could not get a different result through Article 25(1), as the two competent authorities would be bound by their agreement on the issue under the Article 25(3) procedure. Rather, it would be in the interest of the taxpayer to take an active role in the Article 25(3) procedure – Article 25(3) is silent as to the taxpayers' role, but certainly says nothing against taxpayer involvement.

Furthermore, Article 25(3) is not limited to providing a "pre-Article 25(1)" means of dispute resolution in specific cases. Rather, it can be used to cover "*any difficulties or doubts arising as to the interpretation or application of the Convention*", which could include for example an issue that arises in multiple specific cases, which might involve more than two competent authorities. Naturally, the time and cost saved is multiplied in this scenario, should SDR successfully resolve the issue.

In summary, Article 25(3) has the effect of making the overall mutual agreement procedure under Article 25 more flexible, and thus more efficient. Indeed, the OECD's 2013 report on BEPS Action 14 was right to identify as a problem "*insufficient use of paragraph 3 of Article 25*".

Finally, it is important to note that the obligation under Article 25(3) is an obligation on both competent authorities, and is mandatory (i.e. "shall"), recalling the text: "*The competent authorities* [i.e. plural] *of the Contracting States shall endeavour to resolve by mutual agreement [...]*".

Further, while the obligation is not so high as to demand that the competent authorities resolve the issue, neither is it so low as to be a mere 'box ticking' exercise which might be satisfied, for example, by a nominal exchange of e-mails.

Rather, the requirement to interpret a treaty in good faith demands that a substantive and genuine attempt (i.e. *shall endeavour*) has been made to resolve the issue. The same "shall endeavour" obligation applies under Article 25(2), in the context of the taxpayer-initiated MAP process, which makes clear how it is central to the overall structure of Article 25.

Indeed, if the "shall endeavour" obligation were a mere box ticking exercise, Article 25(1)-(3) would be practically meaningless, and as such, would negate the object and purpose of those provisions; that cannot be right.

In fact the 2004 report also suggested (paragraph 132) that the MAP process could be improved with a mandatory requirement to submit certain unresolved cases to SDR procedures, such obligation possibly being viewed as "*arising from the general international law obligation to apply and interpret the treaty in good faith*" and giving more content to the requirement in the Model Convention to "*endeavour… to resolve the case*".

In our view, it follows that, given the mandatory nature of the "shall endeavour" obligation, both competent authorities would have to have good reasons not to have at least attempted to resolve the issue by SDR.

Common objections around the use of SDR techniques

Mediation skills lie at the heart of all SDR techniques.

"Mediation " has been defined by CEDR (the Centre for Effective Dispute Resolution) as "*a flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute with the parties in ultimate control of the decision to settle and the terms of resolution*".

It is a voluntary process with the mediator in control of the proceedings (on a basis agreed with the parties) with the parties in control of the outcome and therefore not interfering with the national sovereignty of either state.

Whilst its voluntary nature has been criticised for not providing the certainty of a determined outcome, that factor is its very strength.

Human nature being what it is, where parties can engage with each other in an atmosphere in which they are not compelled by its process to accept the determination of a third-party, the taxpayer will be more willing to do so in the spirit of good faith. This would be with the assistance of an independent impartial third-party professional, potentially reaching more easily and efficiently an agreement on the issues in dispute. This would be a 'win-win' outcome for all concerned.

The flexible informal process has also been criticised for being too soft – 'fluffy' – lacking serious intent or the gravitas and formality of judicial proceedings. However, this is to ignore what lies at the heart of the process – to find a way of creating that very environment for both parties to feel more relaxed and confident and in that way better able to engage with each other.

> **"This would be a 'win-win' outcome for all concerned"**

It has been said the process has the potential to introduce more of a '*level playing field*' as the involvement of a neutral third-party increases the objectivity of debate and decreases the effect of '*inequality of arms*' where there is a difference in the skill sets and experiences of the parties involved

Critics also point to the term '*non-binding dispute resolution*' to highlight its shortcomings but this is to confuse the process with the outcome which is to facilitate the parties reaching a consensus agreement which is binding rather than to have a binding decision imposed on them.

Nor, in our view, is there a need for mediation to be a feature and part of a country's domestic law before a contracting state can engage in its use in the management of international tax disputes. The mere fact that a country has entered into a double tax treaty and committed to its terms gives it the mandate to use the SDR toolbox.

The way forward

The challenges regarding how to apply the Article 25(3) & (4) provisions are more practical than technical or theoretical.

How does the process work? Who organises the logistics and makes the appointments of the third party professionals? How is all this paid for?

All this can be brought together with the parties entering into an SDR Process Protocol for managing the process and is designed to complement (not compete with) MAP.

The SDR Process Protocol concept is based on the experience of using alternative dispute resolution techniques successfully in the UK domestic tax dispute management programme.

The SDR Process Protocol would be entered into by the competent authorities but also anticipate that the taxpayer could be invited to have some participation in the process.

It would introduce the issue(s), appoint a coordinator to coordinate the implementation and management of the protocol and liaise with the parties to agree a variety of administrative points comprising a menu of processes as appropriate from facilitated discussion, non-binding expert determination, mediation and, possibly, single or multiple issue arbitration.

The protocol would provide a timetable for how the various stages should proceed (including the appointments as appropriate of a facilitator, mediator, expert determinator and arbitrator), contain rules of conduct, confidentiality, the recording of action points and the content of an exit document.

Such a document would set out any agreement reached on the issues or the narrowing of the scope of the negotiation through review and discussion of the facts and arguments with a view to making more efficient any MAP Arbitration proceedings on any issues not agreed.

There is no reason why a couple or a group of EU member states could not consider getting together with a view to using this initiative in a pilot study programme where they jointly identify active or prospective cases where this process could be tested.

No mystique should be attached to SDR techniques: they are just tools in a toolbox. However, they need to be properly understood as does the most appropriate way to deploy them.

Ultimately, the use of SDR as envisaged in Article 25 alongside mandatory submission to arbitration promotes the objective to resolve international tax disputes in a timely and cost-effective manner.

OECD's Crypto Asset Reporting Framework could be pivotal for tax

Raffaele Russo, an international tax and policy expert, explains why the OECD's Crypto Asset Reporting Framework (CARF) offers a big opportunity for tax progression but it still needs some improvements.

Raffaele Russo

We are potentially at a turning point with regulations being introduced covering taxation and other fields. It would be important for the ecosystem to show maturity and willingness to engage, and for policymakers to approach subjects with balance, an open mind and without prejudice.

The cryptocurrency tax community is mobilising to provide comments on the OECD's Crypto Asset Reporting Framework (CARF), which was released for comments by the OECD on March 22 2022.

The release of the CARF comes at a time when regulations are being crafted also in other areas. It is a big opportunity for industry and policymakers alike.

In certain ways the situation resembles what happened a few years ago in relation to sharing/gig economy platforms and social media. The difference is possibly that platforms and social media were originally thought of as "savers of the world" and championing the notion of making the world a better place, then later accused of all sorts of wrongdoings in terms of political interference, social impact, tax and labour regulations. Actors of the cryptocurrency world were, in contrast, originally associated with tecno-anarchists, utopians, etc. but they can end up being the "savers of the world" and make the world a better place.

Emerging tax intermediaries

The original Action 1 BEPS Report (*Addressing the Tax Challenges of the Digital Economy*) identified certain trends that could have had an impact on international tax policy. Among these there were the sharing economy and virtual currencies. Fast forward seven years and the *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy* and the so-called DAC7 in the EU are being implemented in a number of jurisdictions. And now we have the above-mentioned CARF being discussed in draft form.

Defining moments in the crypto space

There are certain defining moments in the short history of cryptocurrency, which started in 2009 with a paper Satoshi Nakamoto sent to a mailing list, called *Bitcoin: A Peer-to-Peer Electronic Cash System*.

The book, *The Cryptopians: Idealism, Greed, Lies, and the Making of the First Big Cryptocurrency Craze*, by Laura Shin, details many of the notable moment. Some of these key moments include:

- When the first pizza was bought online via bitcoins on May 22 2010;
- The parity with the US dollar reached by Bitcoin on February 9 2011;
- The birth of HODL (a slang for holding crypto also in bad times) in 2013;
- The Mt. Gox bankruptcy in 2014;
- The launch of Ethereum in July 2015 by Vitalik Buterin and others;
- The hard forks that took place in subsequent years;
- The first decentralised autonomous organisation;

- The initial coin offerings (ICO) boom in 2017-18;
- The announcement of Libra in 2019;
- The increased attention of institutional investors in 2020; and
- The non-fungible tokens craze in 2021.

All eyes are now on regulations

Over the years, cryptocurrency has been steadily moving into the mainstream, as witnessed by a market cap close to $3 trillion at the end of 2021.

Success brings about accountability and regulators around the world have been focusing on the relevant aspects of cryptocurrency for a few years now. For example, The World Bank issued a report on distributed ledger technology (DLT) and blockchain in 2017, while the Financial Conduct Authority's taskforce issued its final report on cryptoassets in 2018.

Additional reports were released by numerous other organisations offering advice and insight. These included reports from:

- The European Securities and Markets Authority, *Advice on Initial Coin Offerings and Crypto-Assets*, January 2019;
- European Banking Authority, *Report with advice for the European Commission on Cryptoassets*, January 2019;
- European Central Bank; *Crypto-Assets: Implications for financial stability, monetary policy, and payments and market infrastructures*, May 2019;
- Bank for International Settlements, *Central Bank Digital Currencies: Foundational Principles and Core Features*, October 2020;
- Bank of England, *Central Bank Digital Currency: opportunities, challenges and design*, March 2020;
- International Monetary Fund, *Regulation of Crypto Assets*, January 2020;
- European Commission, *Regulation of the European Parliament and of the Council on Markets In Crypto-Asset*s, September 2020;
- FATF, *Virtual Assets and Virtual Asset Service Providers*, October 2021;
- Federal Reserve, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, January 2022; and
- Financial Stability Board, *Assessment of Risks to Financial Stability from Crypto-assets*, February 2022.

Significant policy angles include monetary policy, consumer protection, investors protection, market stability, AML/CFT requirements, accounting principles and tax rules. A balanced policy approach should safeguard public interest while nurturing a new ecosystem and supporting a potentially game-changer technology.

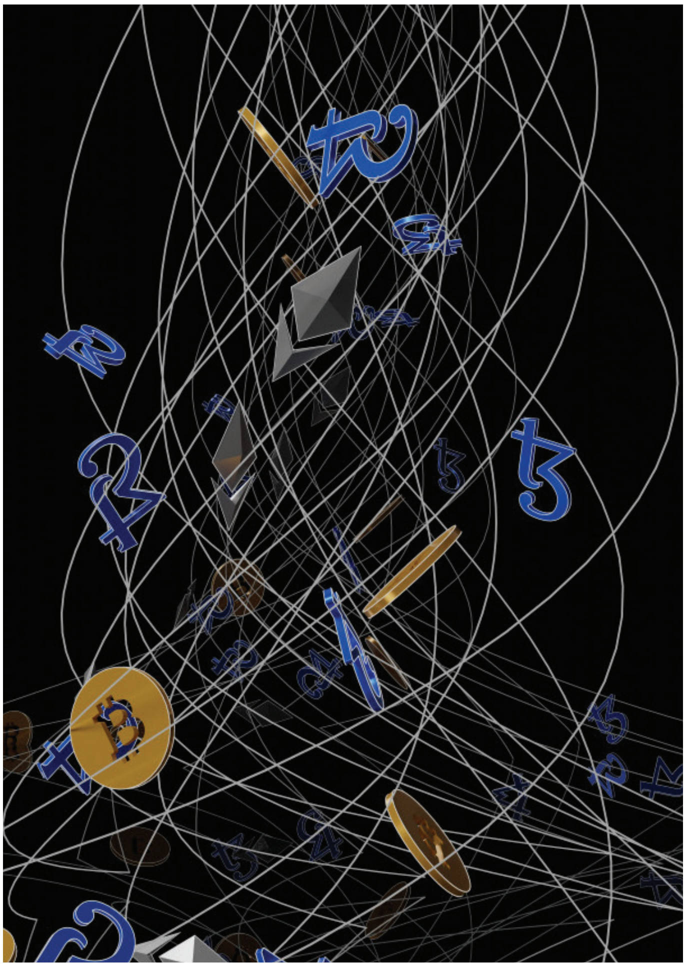
The CARF components

The CARF will be made of three components:

1) The CARF model rules and commentary for transpositions into domestic law;
2) The framework of bilateral or multilateral competent authority agreements for exchanging information; and
3) The relevant IT solutions.

The model rules and commentary have been published for comments. Once the work on this component is completed, the second and third ones will be further developed.

The model rules and commentary have been designed around four key building blocks:



Cryptocurrency and blockchain are here to stay

1) The cryptoassets covered;
2) The intermediaries in scope;
3) The information to be reported; and
4) The due diligence requirements.

The tight deadline for comments indicates that there must be momentum at political level to advance this agenda item on a multilateral level. The US had already moved ahead with the Infrastructure Investment Act of 2021, introducing certain reporting obligations on crypto intermediaries.

A solid reporting framework for tax purposes

The CARF is well written and solid in its content. It relies on concepts and due diligence requirements already agreed upon under the common reporting standard (CRS) and anti-money laundering (AML)/countering financial terrorism (CFT) rules based on the Financial Action Task Force (FATF) Guidelines.

The CARF should reduce the burden on intermediaries. Compliance would be very burdensome if not coordinated with the CRS and AML/CFT rules or, even worse, if each jurisdiction would introduce its own sets of requirements, uncoordinated across borders (as it had started to happen with sharing economy platforms).

At the same time, important IT and other investments will be needed to adapt to the reporting framework and this is extremely expensive. It risks creating a very high barrier for financial infrastructure firms to enter the market, which ultimately will negatively impact consumers. Safe harbours and sandboxes to encourage innovation and support new market entrants could be useful options to consider, as well as tax incentives for the IT investments needed.

Marginal improvements possible

There are, as always, marginal improvements that could be made to the CARF.

These relate chiefly to:

- The avoidance of overlaps with the CRS for cases that could be subject to both, as well as the alignment of due diligence requirements and information to be reported;
- he definition of intermediaries in scope, which for some reason makes reference to only a subset of the covered transactions;
- The additional clarity needed on the cryptoassets in scope, particularly in the case of low-value ones and non-fungible tokens (NFTs), acquired neither for investment nor for payment purposes;
- The application of the CARF rules to decentralised finance (DeFi) and the identification of the responsible persons;
- The relationship with AML/CFT rules when these rules do not exist or do not reflect FATF standards; and
- The identification of the consequences of complying (carrot) or not complying (stick) with the CARF requirements.

Don't leave the CARF alone

Information reporting is key and will certainly increase the rate of tax compliance.

A report by the US Government Accounting Office references Internal Revenue Service statistics that indicate taxpayer compliance is above 95% when there is third party information reporting, but below 50% when there is not.

In addition, it has the potential to improve customers' experience and make tax filing and compliance easier. This should allow compliant taxpayers (the great majority of them, we should never forget that) to approach the cryptocurrency world with a different, more trustworthy, perspective.

At the same time, several improvements are possible as mentioned above. Clarifications regarding its exact scope and additions like safe harbours and sandboxes will make the CARF more efficient and effective. This will avoid the compliance costs that prevent new market players from innovating and, at the same time, provide tax administrations with information that is indeed relevant for them.

Also, there are three other topics which are of systemic importance from a tax perspective and that should be addressed together with the CARF.

Defining the tax treatment of cryptoassets

It is fundamental that countries introduce rules or publish detailed guidance regarding the tax treatment of the acquisition, holding and disposal of cryptoassets.

Unfortunately, the appropriate direct and indirect tax treatment is still not clear in several instances.

It would seem logical to clarify the tax treatment of cryptoassets at the same time as introducing information reporting obligations. This should be done via legislation, taking into account developments in other areas to ensure coherence among different fields. This is in line with what was recommended by the OECD itself in the 2020 report, *Taxing Virtual Currencies*. Times seem to be mature enough.

Consider voluntary disclosure initiatives for the past

As the tax treatment for cryptoassets becomes clear and a reporting framework is in place, consideration could be given to the introduction of voluntary disclosure initiatives in relation to the past.

In a context in which tax rules were not clear and intermediaries were not reporting relevant information, it is rather likely that income or assets may have not been reported (properly).

As with the introduction of the CRS a few years ago, and possibly even more given the much more uncertain tax treatment compared to the case of income from offshore capital, voluntary disclosure initiatives could be an appropriate mechanism to start with a clean sheet. This would also ensure that as many taxpayers as possible become part of the new reporting framework rather than simply looking for (often cold) ways to game the reporting framework. Amounts involved may be substantial, an issue particularly relevant given the conditions of public finances in many jurisdictions.

Evaluate the use of blockchain for information collection and sharing

The cryptocurrency ecosystem is built on blockchain. The underlying technologies offer immense opportunities, and the crypto ecosystem has the merit of having showed already many possible uses beyond virtual currencies.

Leaving aside the geopolitical issues that keep many awake at night these days, the use of a blockchain-based technology appears to be a good fit to allow tax information collection and sharing among tax administrations.

Cryptography and distributed ledgers could be powering the CARF itself, and eventually the CRS, as well as pillar 1 and pillar 2 of the renewed BEPS Project. All these initiatives could definitively benefit from the use of a permissioned blockchain, in which all different actors would contribute to make the infrastructure secure and efficient.

Final thoughts

Cryptocurrency and blockchain are here to stay.

We are potentially at a turning point with regulations being introduced covering taxation and other fields. It would be important for the ecosystem to show maturity and willingness to engage, and for policymakers to approach subjects with balance, an open mind and without prejudice.

This can be the beginning of a new era. Developments in the area Web3 and DeFi show just that, with their challenges and opportunities. The impression is that challenges become bigger when trying to box innovation into existing categories while opportunities become bigger when systemically rethinking the system.

Regarding DeFi and NFTs, it is fundamental that business models are fully understood before regulating them and a constant dialogue between industry and policymakers is key in that respect.

Raffaele Russo, formerly worked at the OECD and at the Italian Ministry of Economy and Finance. He is now a senior fellow at the University of Amsterdam and works as Of Counsel at Chiomenti.

US

KPMG in the US

Mark Martin and Thomas Bettge

New regulations apply nexus rule restricting eligibility for US foreign tax credits

On January 4 2022, the US Treasury Department published final foreign tax credit regulations.

The new regulations span over a hundred pages in the Federal Register and address a dozen different topics, ranging from the timing for claiming tax credits for contested foreign taxes to the sourcing of subpart F and global intangible low-taxed income (GILTI) inclusions. One particularly significant change is a revised definition of what constitutes a creditable foreign income tax. This article focuses on a few of the most salient issues raised by that new definition.

Section 901 of the Internal Revenue Code provides US citizens and domestic corporations a credit for income taxes paid or accrued to a foreign country during a taxable year, subject to the limitation of section 904, which is designed to prevent crediting foreign taxes against US-source income.

Before the recent update, Treas. Reg. § 1.901-2 generally provided that a foreign levy constituted an 'income tax' if it was a tax (i.e. a compulsory payment made under the authority of the foreign government to levy taxes) and its predominant character was that of "an income tax in the US sense". This basic principle was fleshed out by in considerable detail in the regulation, but the historical definition of a creditable income tax notably did not include a requirement that the tax in question be levied on income with nexus to the taxing jurisdiction.

The new regulations change that. Proposed regulations issued in 2020 floated a jurisdictional nexus requirement that would generally require the foreign country imposing a tax to have sufficient nexus to the taxpayer's activities or investments that give rise to the foreign taxes for the taxes to be creditable under section 901.

This proposal drew a number of public comments arguing that a nexus requirement was inappropriate because section 901 allows a credit for income taxes paid to foreign countries, and the plain meaning of an 'income tax' refers to whether the base of the tax is net income rather than its nexus to the country imposing the tax.

Nonetheless, the final regulations adopted the jurisdictional nexus concept, though it was restyled as an attribution requirement and some changes were made to the initial proposal. Except for Puerto Rican taxes, for which a one-year transition period is provided, this revised definition applies to foreign taxes paid in taxable years beginning on or after December 28 2021. The new regulations also update the definition of taxes in lieu of income taxes (e.g. withholding taxes) under section 903.

In the preamble to the final regulations, Treasury explained that a nexus requirement is reasonable because judicial and administrative interpretations of section 901 "have consistently followed the principle . . . that the determination of whether a foreign tax is creditable under section 901 is made by evaluating whether such tax, if enacted in the United States, would be an income tax," and that "US tax law has long incorporated a jurisdictional nexus limitation in taxing income of foreign persons."

> **"One particularly significant change is a revised definition of what constitutes a creditable foreign income tax stop"**

Under the new nexus rules, foreign source-based taxes must apply sourcing rules similar to the US sourcing regime. For most other foreign taxes imposed on a nonresident of the taxing jurisdiction, the new regulations generally require that the tax be based on principles similar to existing permanent establishment and US effectively connected income rules.

If the foreign tax is imposed on residents of the taxing jurisdiction, the new attribution rule requires that the tax regime apply the arm's-length principle to any allocations made with respect to intercompany transactions, "without taking into account as a significant factor the location of customers, users, or any other similar destination-based criterion."

In other words, a residence-based tax is now creditable in the US only if the foreign jurisdiction applies accepted transfer pricing (TP) principles, rather than fixed prices or margins for controlled transactions or formulary apportionment.

Importantly, the residence-based tax rule does not mean that a specific taxpayer's TP needs to be arm's-length for the associated foreign taxes to be creditable (note, however, that the voluntary tax rules under section 901 may effectively require this in some cases). Rather, it means that the foreign jurisdiction's allocation rules must comply with the arm's length principle.

In other words, even if a foreign country's TP rules produce arm's-length results for a taxpayer's transactions, the tax paid to that country could be non-creditable if the country's rules produce non-arm's length results with respect to other transactions in which the taxpayer did not engage.

The IRS would need to make this determination on a jurisdiction-by-jurisdiction basis (though it is currently unclear how it would go about this), and a conclusion that the jurisdiction does not apply the arm's-length principle would render all of that jurisdiction's residence-based taxes non-creditable. An adverse determination in this regard seems most likely to apply to Brazil, but the IRS may determine that other jurisdictions fail to meet this standard as well.

The final regulations also require a foreign levy to meet the attribution requirement in order to qualify as an 'in lieu of' tax under section 903. This generally makes withholding taxes imposed on payments for services performed outside of the taxing jurisdiction, or withholding taxes imposed on royalties for the use of intangible property used outside of the taxing jurisdiction, non-creditable.

The attribution requirement was meant to prevent the US fisc from bearing the burden of credits for what Treasury regards as problematic digital service taxes (DSTs). However, the regulations go beyond just targeting DSTs and deny creditability for a much broader swathe of foreign taxes, many of which are of long-standing and have long been accepted as creditable in the US.

Notably, it appears that taxes under pillar one's Amount A – if adopted – would not be creditable under these rules. Because pillar one would also eliminate participating jurisdictions' DSTs, its implementation – which is currently targeted for 2023 – could provide an occasion for Treasury to revisit the role of a nexus requirement in the US foreign tax credit regime.

KPMG in the US

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China's Hainan free trade port
Sales tax reform brings new opportunities

Nicole Zhang of **KPMG China** discusses the progress made on Hainan Free Trade Port and considers the unique features of this tax regime, relative to the standard mainland China tax rules.

Following our last article on Hainan Free Trade Port (Hainan FTP) published in September 2020, remarkable achievements have been made. These include the rapid launch of Hainan FTP policies for the liberalisation and facilitation of trade and investment, taxation and the free flow of cross-border investment, talent, and materials.

Some key 2021 metrics of progress in Hainan FTP include:

- 11.2 % GDP growth – ranking #2 amongst China provinces (China's GDP growth was 8.1% in 2021);
- 16.2% growth in deployed foreign capital;
- 92.6% growth in newly established foreign invested enterprises;
- Hainan FTP Law took effect from June 10 2021, and 15 sets of associated regulations have since been issued;
- Over 150 detailed measures implemented in relation to market access, the free flow of trade and funding support;
- Successful opening of China's 1st International Consumer Products Expo; and
- Over CNY60 bn sales in the offshore duty-free market, with YoY growth of 84%.

Hainan FTP has several unique features to its tax regime, relative to the standard mainland China tax rules. These are the four pillars of 'zero-tariffs', 'lower tax rate', 'tax regime simplification' and 'tax reinforcement' and they have been pushed forward in parallel. Since 2020, 11 sets of Hainan FTP detailed tax measures have been announced in relation to 'zero-tariffs' and 'lower tax rate':

- Six sets in 2020, covering the tourist shopping policy for the offshore duty-free market, the "double" 15% income tax policy for both companies and individuals (standard China marginal rates are 25% and 45%, respectively), zero-tariff list for raw materials and transportation vehicles, and preferential VAT policy for international vessels; and
- Five sets in 2021, including zero-tariff list for self-used manufacturing equipment, and the bonded fuel policy in Yangpu district

As emphasised in the 2022 Government Report of Hainan Province, the year of 2022 is a critical preparation year for Hainan FTP for the island seal-off (i.e. Hainan island will be treated as outside China's customs border) no later than January 1 2025. One of the highlighted tax tasks is 'tax regime simplification' before the seal-off, among which the streamlining of current indirect tax (i.e. VAT, consumption tax, vehicle purchase tax and local levies) into sales tax plays a rather substantial role.

In the Hainan FTP master plan, it is explicitly stipulated that the consolidation and streamlining of the abovementioned indirect tax will take place at the same time of seal-off, where sales tax will be imposed at the final B2C stage only.

Before the seal-off, general importing into Hainan is subject to customs duty, import VAT and in some cases also consumption tax (CT). After the seal-off, no more VAT and CT for imports together with 'zero tariff' treatment, and with the launch of sales tax at B2C stage is considered to facilitate liberalisation of trade and investment.

Five-into-one transformation to sales tax is not simply adding-on and moving the total tax burden forward, but to create a brand-new category of tax bring along tremendous impact and benefits to all stakeholders. The tax authority is expected to enhance collection efficiency with the regime simplification, while manufacturing plants in Hainan FTP will be free of the current indirect tax burden with easier tax management and lower tax cost.

Based on our understanding, we uplifted the veil a bit to see the major differences between sales tax and current VAT:

	Sales tax	VAT
Tax rate	Single digit	13%, 9%, 6%
Output	B2C	B2B, B2C
Input	NA	Credit/refund
Exemption	To be confirmed	Sales/provision of designated goods/services
Export	To be confirmed	Exempt, credit and refund

This is another significant transformation of indirect tax since the nationwide VAT reform from 2012 to 2016. Based on our experience in advising our clients during the VAT reform, similar questions are yet to be answered for this sales tax scheme:

- How to determine the B2C transaction? Sometimes it is quite difficult by the supplier to tell at the time of the transaction. Take a hotel for example, the accommodation services could be for business or for personal leisure purposes.
- Are there any special sales tax treatment for cross-border sales or service provision, in particular those between Hainan and the mainland?
- For the seal-off of the entire island, Hainan will launch a new customs clearance operation adopting an import and export management system featuring free flow between the ‘first line’, which links the overseas market to the island, and the ‘second line’ connecting the island to the mainland market, with efficient controls.
- For the seal-off of the entire island, Hainan will launch a new customs clearance operation adopting an import and export management system featuring free flow between the ‘first line’, which links the overseas market to the island, and the ‘second line’ connecting the island to the mainland market, with efficient controls.
- For sales of goods from Hainan sellers to mainland buyers, the principle is set up in the Hainan FTP Law that it shall be treated as imports. It is generally interpreted that the mainland buyer declares at the customs for duty and import VAT/CT as everyone does for importation from overseas. In this case, it is to make sure that the VAT chain will not be broken within the mainland domestic market. It is not clear now that in this case, whether the Hainan seller is subject to sales tax for such cross-second-line transaction as it is B2B in nature.
- Are there any grandfathering measures to take care of creditable input VAT balance at the time of seal-off? Infrastructure development in Hainan (such as airport, harbour, highway, and warehouses) is under great boost-up before the island seal-off. It is known to all that the construction projects are with heavy capex. As the seal-off will take place in three-year time the longest, most likely during this period a large amount of input VAT will be retained by the project owner. It is critical for policy maker to consider a set of proper transitional measures to release their funding pressure, such as a one-off excess input VAT credit refund or creditable again sales tax in a certain period of time afterwards. It remains to be seen how to proceed.
- What can we do for our ongoing and new contracts to avoid indirect tax leakage as much as possible before the seal-off? Are there any legal terms to be considered and incorporated into our contract template?

Consolidation of indirect tax will kick off the entire simplification process of the tax regime in Hainan FTP. Further detail on the implementation of these initiatives is set to be released soon.

Consolidation of indirect tax will kick off the entire simplification process of the tax regime in Hainan FTP

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Nicole has abundant experience in the field of replacing business tax with a VAT on the real estate industry. She is familiar with the tax administration informatisation requirements for large holding group and real estate projects.

Special Taskforce for Hainan Free Trade Port (FTP)

Hainan FTP has become an eye-catching hotspot since the launch of the FTP Master Plan on 1 June 2020. The Plan indicates China's firm determination to build an open economy within the framework of globalization. Preferential policies, including tailored taxation mechanisms, a special market access list and negative list for Hainan FTP will facilitate free flows of trade, investment, capital, personnel, logistics and data with Hainan island. The new regime is attracting both domestic and international companies, including in the logistics, civil aviation, medical tourism, shipping, financial and service sectors.

KPMG has set up a special taskforce including experts from the regulatory, strategy, business, tax and customs fields to work with those interested in investing in Hainan and expanding their presence.

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Beneficial ownership in South Korea

Tax audit, appeal and planning opportunities

Kyu Dong Kim, Yong Whan Choi, Min Young Sung and Ja-Young Lee of Yulchon consider the tax audit, appeal and planning opportunities concerning beneficial ownership involving South Korean inbound investments.

For a foreign corporation deriving South Korean-source income, eligibility for tax treaty benefits is a decisive matter, as tax treaties provide more favourable taxpayer treatment than South Korean domestic tax law (for example, the South Korea-Ireland and South Korea-Hungary tax treaties provide exemption from source country taxation for interest and royalty income).

In most of the treaties entered into by South Korea, a core question in determining such eligibility is whether the recipient of dividend, interest or royalty income is the beneficial owner of such income.

The Supreme Court's standard for determining beneficial ownership

The South Korean Supreme Court has traditionally applied the substance-over-form principle to determine beneficial ownership, and where "(i) the nominal owner of the income does not have the authority to control or manage the income, with someone else controlling and managing the income and (ii) where this disparity in nominal and substantial ownership is caused by a tax evasion motive", the nominal recipient of the income does not constitute the beneficial owner and is thus not eligible for tax treaty benefits.

To date, the majority of cases disputed before the South Korean courts concerned foreign capital investments into South Korea through a holding company within a jurisdiction, which has entered into a tax treaty with South Korea providing a favourable tax treatment. Depending on the nature of the foreign capital, the Supreme Court's approach to these cases can be distinguished as follows.

First, in cases where foreign 'investment' capital establishes a holding company to invest in South Korea, the Supreme Court has consistently taken the position that holding companies established by foreign investment capital with a one-time investment purpose do not constitute the beneficial owners of the relevant income and as such are not eligible for tax treaty benefits.

Second, in cases where 'industrial' capital establishes a holding company to operate business in South Korea, the Supreme Court has shown the tendency to acknowledge the holding company as the beneficial owner. That is, an intermediary holding company with certain physical substance managing shares in subsidiaries established in various jurisdictions (including South Korea) and exercising the authority to control and manage the relevant income received, is recognised as the beneficial owner of such income by the Supreme Court.

> "Following the 2018 Supreme Court decision, numerous courts have found in favour of taxpayers in beneficial ownership cases"

There are tax audit, appeal and planning opportunities concerning beneficial ownership

Changes after the Supreme Court's case law in 2018

Although the Supreme Court did recognise holding companies established by industrial capital as the beneficial owner of their South Korean-source income, the Supreme Court's overall stance with regard to acknowledging beneficial ownership used to be rather conservative.

Backed by this conservative attitude of the courts, the South Korean tax authorities (the National Tax Service, 'NTS') did not shy away from issuing assessments denying beneficial ownership with almost no exception where an intermediary holding company was used, resulting in a tax benefit. The lower courts in turn tended to take sides with the tax authorities, resulting in taxpayers generally being unsuccessful in their tax litigation challenging such assessments.

However, in November 2018, the Supreme Court rendered a landmark decision in which it clearly specified the legal meaning of beneficial ownership for tax treaty purpose. The 2018 Supreme Court decision involved a US-headquartered multinational enterprise, whose holding company deriving South Korean-source income was established in Hungary, against the background of the South Korea-Hungary tax treaty being more favourable to taxpayers than the South Korea-US tax treaty.

Specifically, the Supreme Court clarified that "beneficial ownership must be determined in accordance with whether the recipient of the income enjoys the right to use and enjoy the income without any legal or contractual obligation to transfer the income to another party". The Supreme Court thus recognised the Hungarian holding company as the beneficial owner of the South Korean-source income even though the holding company structure resulted in a saving of South Korean taxes.

In its commentary, the Supreme Court expressed its view that "while it is difficult to consider a holding company which is established with a tax evasion motive and for an one-time investment purpose, and which transfers the income in full to its upper-level investors as the beneficial owner of such income, if the holding company conducts proper business activities for an extended period of time, a tax evasion motive cannot simply be assumed by the mere fact that there was a saving of South Korean taxes".

This explanation raises the alarm against denying beneficial ownership on the sole reason that using a holding company has the effect of reducing the taxpayer's tax burden. It further signifies that where a multinational enterprise's holding company has been operating for an extended period of time, this increases the likelihood of such holding company being recognised as the beneficial owner of the income received.

Indeed, following the above 2018 Supreme Court decision, numerous courts have found in favour of taxpayers in beneficial ownership cases. A frequent development was that an appellant court, after the 2018 Supreme Court decision, would reverse the decision of the court of the first instance which had denied beneficial ownership prior to the announcement of the 2018 Supreme Court decision.

The Supreme Court in turn would uphold such decision by the appellant court which found in favour of the taxpayer (South

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Korean case law considers the question of determining the beneficial owner as a factual question to be reviewed by the fact-finding courts (the courts of the first and second instances). As such, it frequently occurs that the Supreme Court (which is a court of law which does not engage in fact-finding activities) will close a beneficial ownership case with an expedited decision rejecting the tax authorities' appeal challenging the taxpayer's victory before the appellant court).

While the 2018 Supreme Court decision did not change or overturn the pre-existing case law in itself, it served as the turning point for the courts' broader acceptance of beneficial ownership and it is clear that the general trend of the case law has changed.

Recent trends regarding beneficial ownership issues

Despite the shift in the case law, the NTS continues to maintain its conservative position as to whether holding companies are the beneficial owners of the income they receive. The majority of the NTS's related assessments are being issued on dividend income received by holding companies of multinational enterprises, and in many cases, taxpayers are challenging these assessments before the courts, often with positive outcomes.

Many fact patterns involve a multinational enterprise which, as part of improving its governance structure over the Asia-Pacific region, establishes a holding company which in turn acquires shares in a South Korean subsidiary. The courts review whether there was a legitimate business purpose at the time of its establishment, how long the holding company has been in existence, whether it exercised its rights as a shareholder, and what the details of receipt and use of the dividends are.

A collective review of these questions is intended to determine "whether the holding company had any legal or contractual obligation to transfer the dividend income to another party". The number of cases where the courts find that holding companies constitute the beneficial owners of the dividend income and those where beneficial ownership is recognised even for holding companies with no personal or physical facilities is steadily increasing.

Considering this trend, there is a possibility that the NTS's strict approach to questions of beneficial ownership may change in the future. For example, in the past, it was almost impossible to expect the NTS to accept arguments of beneficial ownership raised by a taxpayer during a tax audit. This resulted in taxpayers being less motivated to defend their positions rigorously over the audit, and instead opting to facilitate tax appeal processes. However, going forward, it will be possible to consider situations where a taxpayer can defend its position and avoid an assessment in the first place by establishing how its holding company meets all the requirements for beneficial owner set out by the court precedents over the course of an audit.

It is also likely that the NTS's firm stance has deterred multinational enterprises from their restructuring efforts. This may no longer need to be the case, as going forward, a close review of the requirements for beneficial owner, combined with thorough record-keeping of supporting evidence, will be helpful in reducing risks relating to the beneficial ownership issues of cross border transactions. It will further be possible to pursue restructuring projects which result in a reduction of tax burden if such restructuring is backed by sufficient justification with business rationale.

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Remaining issues: Determining beneficial ownership of royalty income derived by global ICT businesses

So far, many of the recent beneficial ownership precedents finding in favour of taxpayers concerned dividend income. As far as royalty income is concerned, the NTS is advocating that an even stricter approach must be applied.

More specifically, the NTS is putting forward arguments that in order to qualify as the beneficial owner of royalties, the recipient must hold personnel necessary for the creation, improvement, management etc. of the intellectual property (IP), must engage in research and development activities and must further contribute to use of the IP by the South Korean payer of the royalties.

There have indeed been recent cases where taxpayers were unsuccessful in their appeals challenging tax assessments that were issued against royalty income derived by Irish holding companies (as seen above, the South Korea–Ireland and South Korea–Hungary tax treaty exempt royalty income from taxation in the source country. As such, if a multinational enterprise owning certain IP sells the rights to such IP to an Irish/Hungarian holding company, or alternatively grants a sublicense to the same, then this would result in an exemption from South Korean withholding tax where the Irish/Hungarian holding company enter into agreements with and receives royalties from South Korean corporation. It appears that the NTS is wary of situations where a transfer of IP is used merely to facilitate a tax evasion).

However, in 2021, the South Korean Supreme Court rendered a decision which held in favour of the taxpayer by recognising the Hungarian entity (to which the US-headquartered ICT enterprise had transferred its IP) as the beneficial owner over the royalty income received.

This decision marked the first beneficial ownership case decided by the Supreme Court regarding the royalty income of a multinational ICT business. In finding that the Hungarian entity was the beneficial owner of the royalties, the Supreme Court collectively considered the circumstances leading to the establishment of the Hungarian entity, its personal and physical facilities, the scope of its capital, the details of its ownership of the IP, as well as the details of its use of the royalty income received (such as research and development, purchase of intangibles, acquisition of other businesses, repayment of debt etc.).

With South Korean enterprises paying exorbitant amounts of royalties to global ICT companies, the relevant withholding tax revenue is also inevitably on the increase every year. It is as such in part understandable why the NTS would take a conservative stance in recognising beneficial ownership in a case where such recognition might result in an exemption from South Korean withholding tax on the ICT business's royalty income.

It is possible that determination of the beneficial owner may differ in the context of royalty income as opposed to dividend income. However, this does not mean that beneficial ownership can only be recognised if the recipient of the royalties has the capacity to develop the relevant IP or the personal or physical facilities to maintain or improve it. Instead, the core question of beneficial ownership, whether it is royalty income or dividend income, remains whether there exists the authority to control and manage the income.

Accordingly, it is expected that even in scenarios including the transfer or sublicense of IP, provided that such transfer or sublicense occurs with a proper business purpose for the multinational ICT business, related tax risks will be sufficiently manageable by reviewing the requirements for the beneficial owner set out by the case law and by conducting any restructuring efforts in line with such requirements.

AUSTRALIA

DLA Piper

Paul McNab

PepsiCo in DPT dispute

On February 2 2022 PepsiCo filed appeals in the Australian Federal Court against DPT assessments raised by the Australian Taxation Office. The appeal concerns the 2018 and 2019 years.

The matter is significant for a number of reasons. It is the first time that a DPT dispute has gone to court in Australia, and likely represents one of, if not 'the', first time the DPT provisions have been used in Australia.

But it is also significant for the subject matter, the question of 'royalty free' use of intellectual property (IP). The court filings disclose a common toll manufacturing arrangement, where PepsiCo sold concentrate to Schweppes Australia (an arm's-length unrelated party), who bottled drinks for the Australian market under direction of PepsiCo.

Under this arrangement Schweppes was provided with 'royalty free' use of the relevant intellectual property including trademarks for use in the bottling, sale and distribution of the drinks. The relevant agreement was entered into on April 9 2009. Schwepps had been acquired by Asahi on April 3 2009.

Whether a royalty should have been paid, and if so in what amount, is a question that might arise under the usual transfer pricing (TP) provisions in Australian law, or under the general law principles relating to the apportionment of bundled prices. But the Commissioner has chosen to attack the arrangement with our DPT, which gives him significant powers and advantages not available under the other provisions of our Income Tax Assessment Act.

It is important for groups to understand that TP documentation, and indeed TP defence file, does provide reassurance in relation to Australian DPT risk. Although parts of the TP documentation might be relevant to the process of assessing DPT risk, it is a separate process driven by unique Australian legislation, case law relating to our anti-avoidance rules, and the evidence.

This case is relevant not just for 'royalty free' IP use (both in the technology sector and the consumer goods sectors), but also for any reorganisation of Australian intellectual property assets of international groups. In particular it highlights a particular risk that must be addressed by groups considering their risk under TR 2021/D4 (licencing and distributing software and cloud services) and TA2020/1 (dealings with intangible assets).

It is important for groups to understand whether their arrangements have a DPT risk, and to understand what proactive steps they must take to successfully manage the risk. The need for proactive steps is driven by the advantages the DPT provisions give the Commissioner in any dispute.

Key elements of the DPT

The Australian DPT can apply to multinational groups with more than A$1 billion global group- wide revenue (SGEs) by imposing a penalty tax rate of 40% to Australian tax benefits obtained in income years commencing on or after July 1 2017, even if the scheme commenced in prior periods.

The 40% DPT penalty tax rate will apply to the amount of an Australian tax benefit if it would be concluded that there was a principal purpose of obtaining an Australian tax benefit, or both to obtain an Australian tax benefit and reduce foreign tax liabilities.

The rules require:

- Payment of the tax upfront whether there is an ongoing dispute or not; Deferral of any appeal processes for 12 months (the 'review period); and
- Restrictions on evidence that can be used in any court case.

Certain 'carveouts' are available.

What steps should groups take?

The most important aspect of managing DPT risk is that groups must prepare their 'case theory' against any DPT risk in advance, and have the key evidence available on file. This is because the legislation contains provisions preventing the admissibility of evidence in later court proceedings if that evidence was in the custody and control of the taxpayer (or an associate of the taxpayer) and was not provided by the taxpayer to the Commissioner before or during the 12-month review period following a DPT assessment.

The starting point for assessing DPT risk and deciding what a defence file should contain is a review to determine whether the Commissioner is able to suggest an alternative business model to your current Australian business model, which if you had used it, would lead you to pay more Australian tax. This alternative business model is the 'alternate postulate' and the additional Australian profits it would have generated are the 'diverted profits'. There may be more than one alternate postulate.

For example, the PepsiCo filings suggest that the Commissioner has argued that, but for its principle purpose of obtaining an Australian tax benefit, PepsiCo would have charged a royalty for use of intellectual property by Schwepps.

It is then necessary to consider whether any of the alternate postulates are 'reasonable'. This requires an understanding of the commercial factors which actually make them impossible or unlikely (the legislation has more details of this requirement). This may require expert assistance from inside the group or from external experts.

- It may be possible to work backwards from the offering to the end user, to show that the commissioner's alternative postulate is an unnecessarily complex approach to satisfying the customer's needs, making it an unreasonable alternative postulate; and
- It might also be possible to show that although there was a diverted profit amount, it arises because of substantial commercial purposes of the structure, rather than tax ones (a number of factors must be taken into account, including whether 'quantifiable non-tax financial benefits' exceed tax benefits).

It is possible that evidence as to usual commercial practice in the market, prior group practice and approaches adopted in other comparable agreements might be relevant in the PepsiCo matter, for example. As might evidence about the actual valuation of the rights to use the relevant intellectual property in the particular fact pattern.

The legislation also contains carveouts which might be relevant to risk assessment:

- Groups where Australian income does not exceed A$25 million;
- Groups where the diverted profits are actually taxed elsewhere in the world at a rate which is equal to or greater than 80% of the Australian tax rate of 30%; and
- Groups who can establish that every group entity involved has 'sufficient economic substance'.

Clearly evidence as to the second and third carveouts may be complex to assemble, and it clearly best done well in advance. Even if only to confirm that these carveouts are not available.

Australia's DPT has been dismissed by many groups as simply a threat used to ensure proper TP analysis. It is, however, a much more complex and important risk that must be independently assessed.

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CHINA

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Lewis Lu

Individual income tax policy changes implemented

IIT assessment for sole proprietorships and partnerships

China has, for some time, imposed individual income tax (IIT) on sole proprietorships and partnerships on a deemed basis. This is applied, in place of an accounts basis, where these businesses (i) fail to set up account books; (ii) have account books that are not robust; or (iii) fail to file tax payments on time.

This approach exists as a backstop and the use of higher deemed profits was originally considered more likely to push businesses in the direction of preparing proper accounts if they could. However, it has now been realised that this approach, in certain instances, creates tax avoidance opportunities for individuals making equity transfers.

IIT on non-exchange equity transfer gains is applied at 20% (disposal of listed equity through exchanges is exempt). Through use of the deemed IIT approach, some individuals had been able to reduce their tax exposure below 20%.

To address this, on December 30 2021 the Chinese Ministry of Finance (MOF) and State Taxation Administration (STA) released joint Circular No. 41 (2021).

Starting from January 1 2022, sole proprietorships and partnerships holding equity investments shall be subject to account audits for IIT assessment and reporting purposes. They also need to fulfil certain reporting obligations (with their in-charge tax authorities) in relation to the equity investments held by them. Otherwise, sanctions will be imposed.

This is in line with China's recent moves to increase scrutiny on equity transfers made by high-income earners. In recent times, local tax authorities and local market administrations, such as those in Beijing and Shenzhen, have enhanced inter-authority information sharing on equity transfers by individuals. Note that Chinese local market administrations maintain registers of changes in equity ownership in private companies.

Alongside this, the Chinese tax authorities are also focusing on tax avoidance by performers on live-streaming platforms, which have become a prominent part of China's digital economy.

In late December 2021, the tax authority in Hangzhou imposed tax, late payment and fines of RMB1.34 billion ($210 million) on Viya, a well-known live streamer in China. This comes after the Hangzhou tax authority imposed penalties on another two high-profile live streamers in November 2021.

They were subject to tax recovery and fines of RMB66 million and RMB28 million respectively. The Hangzhou tax authority detected their tax avoidance cases by leveraging analysis of tax big data. This will continue to be a focus area for tax authorities in China.

Fringe benefits for foreign individuals

In China, foreign employees can enjoy a special fringe benefits exemption for IIT purposes. This covers school fees, accommodation costs and various costs of living. Normally, the fringe benefits can be fully excluded from taxable income as long as they were paid on a reimbursement basis. In 2018 however, in MOF and STA Circular No. 164 (2018), it was provided that these tax-exempt benefits would finish by the end of 2021.

Foreign employees, and the companies that employ them, have paid a lot of attention to the abolition of the tax-exempt benefits concession as it would raise their IIT burden significantly.

To keep China competitive in the global talent market, on December 31 2021 the MOF and STA released Circular No. 43 (2021) extending the tax exemption treatment of special fringe benefits to the end of 2023. This is a welcome development for foreign employees in China, and their employers.

Bonus and equity incentives

On December 31 2021, the MOF and STA announced in Circular No. 42 (2021) the extension of the preferential IIT treatment of annual one-off bonuses to the end of 2023, and of equity incentives granted by listed companies to the end of 2022. Both of these two treatments were due to expire on December 31 2021.

This means that these two types of income can continue to be treated as separate income, outside the annual comprehensive income calculation. The applicable IIT tax rate bracket can thereby be determined based on the bonus/incentive amount divided by six or 12 months (depending on the specific circumstances). This moves the bonus/incentive to a lower tax bracket than the individual's marginal IIT rate.

While taxpayers may benefit from the extension of preferential IIT treatment, they need to look out for the enhanced tax administration on employee share schemes.

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HONG KONG SAR

KPMG

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Hong Kong SAR's proposed family office tax concession regime

On March 8 2022, the Hong Kong SAR government released a consultation paper on the proposed profits tax exemption for family-owned investment holding vehicles (FIHVs) managed by single family offices (SFOs) in Hong Kong SAR. Subject to legislative process, the proposed tax concession is expected to apply for any years of assessment commencing on or after April 1 2022.

The objective of the tax exemption is to provide tax certainty to investment holding vehicles owned by ultra-high-net-worth individuals and their family members, in order to attract family offices to be set up and operated in Hong Kong SAR.

Subject to meeting certain conditions, an FIHV managed by an SFO in Hong Kong SAR would be exempt from Hong Kong SAR profits tax for its profits derived from certain qualifying transactions and incidental transactions (subject to a 5% trading receipts threshold). The tax exemption may also apply to family-owned special purpose entities (SPEs) set up by an FIHV. An irrevocable election is required to be made to enjoy the tax exemption.

The proposed tax exemption regime for FHIVs is modelling on the existing unified tax exemption for funds.

Key features of the proposal

The key features of the regime, as outlined in the government's proposal, are summarised below.

Key requirements for an FIHV

- The FIHV must be a corporation, partnership, or trust set up in or outside Hong Kong SAR with the central management and control (CMC) in Hong Kong SAR;
- The FIHV must be exclusively and beneficially owned by one or more individuals who are "connected persons" of the same family (the single family). There is a broad definition of "connected persons" which covers multiple generations;
- The FIHV is allowed to set up SPEs to hold and administer the specified assets;
- The assets of the FIHV must be managed by an SFO in Hong Kong SAR;

- The aggregate average value of assets under management for a family-owned structure (either a single FIHV or multiple FIHVs) should at least be HK$240 million ($31 million); and
- The FIHV must only serve as an investment vehicle for holding and administering the assets of the single family and must not directly engage in activities for general commercial or industrial purposes.

Key requirements for an SFO

- The SFO must be a private company with its CMC exercised in Hong Kong SAR;
- It must be exclusively and beneficially owned by the single family; and
- It must not provide investment management services to other FIHVs not owned by the single family.

Qualifying transactions of the FIHV

- Although not discussed in detail in the consultation paper, the scope of qualified transactions in specified assets is expected to be similar to that under the existing unified tax exemption for funds, which should be broad enough to cover the typical types of assets that family offices are investing in; and
- For investment in private companies that hold Hong Kong SAR immovable property and short-term assets, the same tests that are currently applicable to funds will be applied to determine whether such investment qualifies for the tax exemption.

Substantial activities requirements

- The core income generating activities (CIGAs) in relation to the asset management must be performed in Hong Kong SAR; and
- Each FIHV or the SFO (if the FIHV outsources the CIGAs to the SFO) should employ at least two full-time qualifying employees in Hong Kong SAR and incur at least HK$2 million operating expenditure in Hong Kong SAR for carrying out the CIGAs.

Anti-avoidance provisions

- The number of FIHVs managed by the same SFO cannot exceed 50; and
- The modified anti-round tripping provisions are modelled on the existing ones applicable to funds, with two carve-outs: for Hong Kong SAR resident individuals, and for Hong Kong SAR resident entities. This is subject to certain anti-abuse measures, including that there should not be any arrangement of shifting taxable income from the single family to an FIHV for obtaining a tax benefit.

KPMG's observations

The introduction of the tax exemption regime for FIHVs in Hong Kong SAR is welcomed and represents a positive step forward to further promote Hong Kong SAR as a leading asset and wealth management hub in the region.

KPMG has been actively providing comments and suggestions to the Hong Kong SAR government on the design and key features of the regime. We look forward to the timely implementation of the regime and further guidance by the Hong Kong Inland Revenue Department on the practical interpretation and application of the regime.

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INDIA

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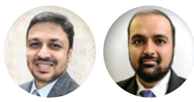

Deepesh Chheda and Saurabh Shah

Supreme Court denies tax deduction on incentives and freebies to medical practitioners

In a significant development in the case of *Apex Laboratories Pvt. Ltd* ('the taxpayer'), the Supreme Court of India ('the Court') denied a tax deduction on expenses incurred by pharmaceutical and allied health sector industries for incentives and freebies to medical practitioners.

The taxpayer, consistent with the practice in the pharmaceutical industry, provided freebies such as hospitality, sponsorship of conferences and seminars, laptops, and similar benefits to medical practitioners to create awareness and enhance the brand recall value of their products.

The limited question for dispute was whether expenditure incurred by the taxpayer on such freebies is tax deductible. Section 37 of the Income-tax Act 1961 ('the IT Act') provides that an expenditure incurred wholly and exclusively for the purposes of business is tax-deductible, provided it is not incurred for any purpose which is an 'offence' or for any purpose which is 'prohibited by law'.

The Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 ('the MCI regulations') prohibits medical practitioners from accepting gifts, hospitality, and so on from a pharmaceutical company. Censures and penalties are prescribed for violation of the MCI regulations. The Indian tax authorities ('the Revenue') disallowed this expenditure on the basis that such freebies are violative of MCI regulations and therefore prohibited by law.

However, the taxpayer contended that MCI regulations apply only to doctors and not to the company itself. It has been the taxpayer's contention that punitive action could be taken against the doctors, but if the expenditure was for legitimate promotion of business, then it should not be disallowed for tax purposes.

The status of expenditure incurred by pharmaceutical companies in providing freebies and incentives to doctors and other medical practitioners has been a vexed issue with conflicting jurisprudence on both sides. The Court has put the controversy to rest by deciding the issue in favour of the Revenue by holding that the expenditure incurred was indeed violative of law and was not tax-deductible.

In a well-reasoned judgment, the Court held that pharmaceutical companies were fully aware of MCI regulations and knew that the doctors accepting freebies would violate the regulations. The act of giving freebies was held to be an act of commission. The Court held that doctors have a quasi-fiduciary relationship with their patients and their judgment of prescribing medicines cannot be influenced by receipt of freebies. The cost of such freebies is built into the cost of medicines which is ultimately borne by the patients.

The moral tenets aside, the Court held that it cannot aid a party in causing an illegal act to be committed. The Court also held that an act which could not have been done directly can also not be done indirectly. Accepting the argument that the MCI regulations applied only to doctors and not to pharmaceutical companies would be an exercise in cementing the practice of medical practitioners.

This judgment also legitimises the amendment to the IT Act by the Finance Act 2022, which clarifies that such expenditure is prohibited by law and therefore not allowable as a deduction. Given the Court's judgment, the controversy over whether this amendment is retrospective or prospective is academic in nature, as the judgment is understood to clarify the law since its inception.

The judgment reaffirms that interpretation of law is not only an exercise in cementing, and that the interpretation cannot be carried out in a manner that would frustrate the intention of law.

Given the Court's decision, there are several areas which companies may want to analyse further. Companies may face disallowances related to proceedings which may be pending at any level. While companies could defend themselves against penalty action, there could be challenges in defending against interest liability, which is consequential in nature. Companies should reassess their advance tax liability to minimise interest exposure.

Companies should also consider whether there is any need to revise the tax returns of earlier years. The facility to file an updated tax return, as provided in the Finance Act, 2022 can be explored to optimise tax costs.

Pharmaceutical companies have worked closely with medical practitioners to promote and facilitate health care awareness, which in a country like India has been historically very low. This has taken various forms, some of which may be legitimate and some that may not be so. Given that this has been an industry-wide practice, companies will need to closely examine which of the freebies would be hit by the MCI regulations, the documentation required for defending the legitimate payments made in the past, and how the situation needs to evolve in future.

For example, can the provision of in-clinic items with company logos, such as stationery items, face masks, sanitisers, and so on, be regarded as permissible under the MCI regulations? Is the gift of low-value items, such as those worth less than the MCI regulation limit of INR 1000 ($13), permissible? Is the sponsorship of conference fees for doctors permissible under MCI regulations?

Companies will need to iron out these issues and have a proper demarcation in place on what is and is not permitted, as per the MCI regulations, to secure their tax deduction to the extent permissible under the law. Companies will also need to suitably plan for proposed provisions providing for the deduction of tax at source.

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INDONESIA

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Changes to tariffs, reporting and tax rates

Electric-based vehicles

The Minister of Finance (MoF) has set out a tariff of 0% import duty on the import of electric-based vehicles in the form of incompletely knocked down products (MoF Regulation No. 13/PMK.010/2022).

This regulation has been issued to encourage the increase in added value of assembly of the industry of motor vehicles with four or more wheels, in accordance with the needs of the development of the four-or-more-wheeled motor vehicle industry, and to accelerate the battery-based electric motor vehicle programme for road transportation.

Construction

The lower final tax rate on construction service with relevant qualification has been released through Government Regulation No. 9 of 2022 (GR/9-2022) as the second amendment of Government Regulation No. 51 of 2008.

This regulation provides legal certainty and ease in the imposition of income tax on income from the construction-service business. To keep the business climate of the construction services sector conducive, it is necessary to adjust the arrangement regarding income tax on income from construction-service business.

SPT reporting

By announcement letter No. PENG-5/PJ.09/2022, the Directorate General of Tax has stopped the annual tax return (SPT) reporting channel through the E-SPT application.

For SPT 1770 S, 1770, and 1771, this applies from February 28 2022, at 16.00 Western Indonesian time. For the corporate income tax return form in US dollars (1771$) and the special appendix for oil and gas taxpayers, it applies from March 30 2022 at 15.00 Western Indonesian time.

Free trade area

By announcement letter No. PENG-4/PJ.09/2022, the Directorate General of Tax emphasised that the implementation of the Notification of Acquisition or Expenditure of Taxable Goods or Taxable Services in the Free Trade Area and Free Port document should be conducted through the Indonesia National Single Window System.

Luxury sales tax, VAT and import declaration

By MoF regulation No. 5/PMK.010/2022, the MoF has stipulated the luxury sales tax borne by the government for fiscal year 2022 and for certain motor vehicles.

Through MoF regulation No. 6/PMK.010/2022, the MoF has stipulated the value added tax (VAT) borne by the government for fiscal year 2022 on the delivery of certain houses and apartments.

The MoF has issued the Procedures for Filing Request and Determination of the Origin of Import Goods before Import Declaration, through the MoF regulation No. 7/PMK.010/2022.

Biodiesel exports

A regulation (Update on Export Policy – Suspension of Export Permits Imposed on Certain Biodiesel Products, under tariff of 3826.00.21, 3826.00.22, 3826.00.90) is set out in the Minister of Trade regulation No. 8 of 2022.

This regulation is issued to optimise the availability of cooking oil raw materials and cooking oil. To achieve this, it is necessary to rearrange the policies and regulations for the export of crude palm oil; refined, bleached and deodorized palm olein; and used cooking oil.

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NEW ZEALAND

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Fred Ward and Young-chan Jung

New Zealand consults on taxation of the gig and sharing economy

The gig and sharing economy has quickly become a significant part of our lives, with many of us increasingly utilising services provided through digital platforms that facilitate transactions between sellers and buyers, such as booking short-term accommodation and ridesharing.

On March 10 2022, the New Zealand government released a discussion document 'The role of digital platforms in the taxation of the gig and sharing economy'. This discusses the suitability of New Zealand's existing tax framework to deal with the gig and sharing economy, and makes proposals for potential reform regarding information reporting and goods and services tax (GST).

The key goals are increasing taxpayer compliance and improving the competitiveness of traditional suppliers.

Key concerns arising from the gig and sharing economy

The two key concerns with the rise of the gig and sharing economy that are outlined in the discussion document are:

a) Taxpayer compliance obligations: It is recognised that many participants in the gig economy may not be familiar with their tax compliance obligations, which may contribute to non-compliance.

b) Improving fairness between traditional suppliers: The discussion document states that New Zealand's existing tax framework, in particular its GST regime, does not create a level playing field between traditional sellers and sellers using the gig and sharing economy.

Information reporting and sharing

One proposal put forward in the discussion document to address the concerns outlined above is the implementation of the 'OECD Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy'.

The implementation of the OECD Model would require New Zealand-resident digital platforms to report income information about both resident and non-resident sellers to the New Zealand Inland Revenue. This information may then be shared with foreign tax authorities in jurisdictions that have implemented the OECD Model.

In turn, the New Zealand Inland Revenue would also receive information on resident sellers using non-resident digital platforms from foreign tax authorities. The implementation of the OECD Model would affect digital platforms for the supply of accommodation, professional and personal services, the sale of goods and vehicle rental.

One concern with the implementation of the OECD Model is that the information reporting (done by calendar year) does not align with New Zealand's tax year (which ends on March 31). This presents issues with using gathered information to increase taxpayer compliance by pre-populating sellers' income tax returns.

The discussion document presents several possible solutions to this issue, including the implementation of bespoke New Zealand rules. One significant negative identified with implementing bespoke New Zealand rules is the increased compliance costs to digital platforms in having to comply with New Zealand rules in addition to the OECD Model.

GST reform

The proposal for GST reform in the discussion document arises from small-scale sellers (which are not required to charge GST on supplies due to being under the GST registration threshold of NZ$60,000 (approximately $41,000) of supplies in a 12-month period) being able to compete at a relatively low cost with their traditional counterparts through digital platforms.

One measure proposed by the discussion document is to lower the GST registration threshold for sellers operating through digital platforms in the gig and sharing economy to level the playing field with traditional operators.

The other key proposal is to require digital platforms to collect GST as if the platform itself had made the supply, similarly to New Zealand's existing GST on remote services and low-value imported goods regimes which provide for the collection of GST by marketplaces on behalf of suppliers (see previous articles on remote services and low-value imported goods).

Such a proposal raises the question of how affected sellers would claim back GST on their expenses. The discussion document suggests possible solutions for this including requiring all affected sellers to register for GST, the implementation of a flat rate scheme (under which a portion of the GST collected by digital platforms would be returned to the seller as a proxy for GST deductions, similar to reforms implemented in Mexico) and the refunding of GST on expenses as part of the annual income tax return process.

Next steps

The direction in which any reforms proceed will be of interest to those operating in the gig and sharing economy, both sellers and digital platforms. New Zealand has a history of closely following OECD model reforms where appropriate, recently with many of the OECD base erosion and profit shifting measures being implemented into domestic law.

However, New Zealand's unique position as a predominant importer of goods and services located at the bottom of the world may also result in more country-specific measures being implemented. Submissions on the discussion document close on April 21 2022.

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SINGAPORE

Crowe Singapore


Sivakumar Saravan and Liew Kin Meng

Tax highlights of the Budget 2022

The Singapore Budget 2022 was unveiled by the Minister for Finance, Lawrence Wong, on February 18 2022. As the COVID-19 pandemic enters its third year and global economies are slowly opening up, this year's Budget seeks to position Singapore for the opportunities and challenges in the post-pandemic world.

While the Budget addresses the immediate concerns of households, businesses and workers due to the lingering effects of the COVID-19 pandemic by providing targeted financial support packages, several of the proposed changes are forward-looking to make Singapore's tax system more resilient to meet the growing expenditure needs of the country and to tackle climate change.

Some of the highlights of the Budget 2022 proposals are summarised below.

Minimum effective tax rate regime

There is no change to the corporate income tax rate, which is 17%. However, in response to the Global Anti-Base Erosion (GloBe) rules under Pillar 2 of the OECD/G20 Base Erosion and Profit Shifting 2.0 project, Singapore is exploring a minimum effective tax rate (METR) that will top-up a multinational enterprise (MNE) group's effective tax rate in Singapore to 15%.

If introduced, MNE groups operating in Singapore that have annual revenues of at least €750 million (approximately $830 million), as reflected in the consolidated financial statements of the ultimate parent entity, will be within the scope of the proposed METR regime. There will be an industry consultation on the design of the METR and the METR regime is expected to be aligned with the Pillar 2 GloBe rules as far as possible.

Personal income tax

At present, resident individual taxpayers are taxed on a progressive scale of rates with a top marginal personal income tax (PIT) rate of 22% for chargeable income in excess of S$320,000 (approximately $236,000).

From the year of assessment (YA) 2024, the PIT rate will increase to 23% for chargeable income in excess of S$500,000 and up to S$1 million. For chargeable income in excess of S$1 million, the PIT rate will be 24%, which will be the new top marginal PIT rate.

In view of the proposed changes to the PIT rate structure for tax-resident individual taxpayers, the income tax rate for non-resident individuals that is pegged to the top marginal PIT rate will also be raised from 22% to 24%, with effect from YA 2024. This applies to all income, such as director's fees and remuneration, rental income and professional fees, except for employment income and certain income taxable at reduced withholding rates.

Goods and services tax

In Budget 2018, it was announced that the current goods and services tax (GST) rate of

7% will increase to 9%, sometime between 2022 and 2025. The proposed increase is now slated to happen but in two phases.

With effect from January 1 2023, the GST rate will increase from 7% to 8%. From January 1 2024, the GST rate will increase from 8% to 9%.

Wealth tax

Prior to the Budget announcement, there was much speculation about whether the government will introduce a new regime to tax the wealth of individuals.

Instead of introducing a new wealth tax, the following adjustments have been proposed to the existing property and vehicle tax regimes to make the overall tax system more progressive:

1) The progressive property tax rates for non-owner-occupied residential properties, including investment properties, will be increased from the current range of 10% to 20%, to a range of 12% to 36%.
2) The progressive property tax rates for owner-occupied residential properties, for the portion of annual values in excess of S$30,000 will be increased from the current range of 4% to 16%, to a range of 6% to 32%. This adjustment is targeted at higher-end residential properties.
3) A new tier of additional registration fees (ARF) of 220% for the portion of open market value (OMV) of vehicles in excess of S$80,000 will be introduced. The ARF is a tax imposed when a vehicle is registered in Singapore and is computed based on a percentage of the OMV. This change is primarily targeted at luxury cars.

For items 1 and 2 above, the rate changes will be phased in over two years, with the first rate change taking effect on January 1 2023 and the second change on January 1 2024.

For item 3, the change will be effective for vehicles registered with certificates of entitlement (COEs) obtained from the COE bidding exercise on February 23 2022. To register a car in Singapore, a car owner will first need to bid for a COE which gives the owner the right to own and use a vehicle in Singapore. For vehicles that do not need to bid for COEs, the change is effective from February 19 2022.

These changes strive to achieve a balance between ensuring the more well-off contribute a larger share to the tax revenue and to maintain Singapore's premier status as a wealth management hub. However, the Finance Minister said that the government will continue to study the experiences of other countries in the imposition of wealth taxes and explore options to tax wealth effectively.

Carbon tax

Carbon tax was first introduced in Singapore in 2019 at S$5 per tonne of greenhouse gas emissions. The carbon tax will be increased to S$25 per tonne in 2024 and 2025, and S$45 per tonne in 2026 and 2027. Beyond 2027, the Singapore government is looking to increase the carbon tax further to reach S$50 to S$80 per tonne by 2030.

From 2024, the government will allow businesses to use high-quality, international carbon credits to offset up to 5% of their taxable emissions, in lieu of paying carbon tax.

The planned increase in carbon tax affirms Singapore's ambition to achieve net zero emissions by or around 2050. The revenue from the carbon tax collection will be used to cushion the impact on households and businesses, and support investments in new low-carbon and more energy-efficient solutions that will help to reduce emissions.

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