Spring 2023
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The European solution

Crunch time for EU tax reform

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SANCTIONS
TP analysis

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South Korea's example

ITR

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Crunch time

Our cover story looks at the European Commission's work on the Business in Europe: Framework for Income Taxation initiative and what companies want to see from it. It's crunch time for European governments to decide whether there will be an EU corporate tax system.

An EU-wide corporate tax base with its own transfer pricing (TP) rules may finally be designed this year. The European Commission has taken some old ideas like the common consolidated corporate tax base and combined them with new concepts from the OECD's two-pillar solution.

A limited version of formulary apportionment may one day become a reality in the EU, but there are many obstacles to pass along the way. The future of the arm's-length principle and the prospects for a global minimum corporate tax rate are at stake.

Turning abstract concepts into concrete policies is easier said than done. The OECD may have created the groundwork for BEFIT, but the Commission's initiative could become an example of how pillars one and two should work in practice.

We have a comprehensive issue of *ITR* this season, covering everything from the Brazil-UK tax treaty and the tax challenges of global mobility to Indian tax disputes and the TP impact of US sanctions on China. This issue includes an analysis of the US budget proposal for 2024 and two features on the implementation of pillar two in Asia.

Josh White
Special projects editor

> “The prospects for a global minimum corporate tax rate are at stake”

Meanwhile, the Supreme Court of Canada is going to hear a case brought by Dow Chemical in its bid to secure a hearing at the Tax Court of Canada. This dispute will set a crucial precedent for taxpayers.

As we get further into 2023, the pace of change in tax continues to gather momentum. The OECD may have secured a global minimum corporate rate, but taxpayers are still waiting to see if there will be a final deal on pillar one this summer.

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MEET THE TEAM

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Market insight

Blank Rome adds counsel to New York practice

US law firm Blank Rome announced the addition of an experienced tax litigator to its team in its New York office.

Joshua Sivin arrives at the firm from the New York City Law Department, where he had served as senior counsel for more than five years. He had previously spent almost 11 years at Johnson Gallagher Magliery and five years with Paul Hastings.

Sivin's work with the New York City Law Department saw him appearing before the New York City Tax Appeals Tribunal on business and excise tax matters as well as real estate tax matters, general corporation tax, unincorporated business tax, commercial rent tax and real estate transfer tax.

Andersen Chicago office bolsters valuation practice

Andersen, the US branch of international network Andersen Global, announced the arrival of a managing director in its Chicago office's valuation practice.

Jordan Lamm joined the group from JGL Consulting. He had previously spent more than 25 years with the Chicago office of KPMG.

Lamm's work has involved valuations for financial reporting, gift, estate, as well as federal and international tax.

Bichara promotes tax associate to partner

Brazilian firm Bichara Advogados announced the promotion of one of its senior tax associates to the partnership.

Bruno Matos Ventura has been with the firm for two and half years, having previously spent more than 12 years with Pinheiro Neto Advogados.

Ventura's work is predominantly focused on advising clients in relation to indirect taxes and matters relating to taxation of the digital economy.

Norton Rose Fulbright includes three tax partners in 2023 promotions

International law firm Norton Rose Fulbright has promoted three new partners to its tax practice in its 2023 round of promotions, including two in its New York office.

Natasha Robertson advises clients on estate planning, intergenerational wealth transfer, and estate and trust administration as part of the tax, trusts and estates division of the New York team. She has been with the firm for more than six years, having previously been an associate with Stinson.

Shudan Zhou is also a member of the New York team and has been with the firm for more than three years after stints as an associate with several firms including McDermott Will & Emery. Her work is focused on high-net-worth individuals, trustees and financial institutions, and on the US tax implications of wealth transfer strategies, with an emphasis on international income and estate tax planning.

Martina Zanetti is a practitioner in the Vancouver office and has been with the firm for almost six years. She is part of the private wealth, trusts and estates team, and her practice focuses on estate planning, estate administration and incapacity matters.

Uría Menéndez appoints tax inspector as counsel

Ibero-American firm Uría Menéndez announced the addition of a counsel to its tax department in Madrid.

David Vilches de Santos joins the firm from the National Office of International Taxation, where he had spent more than seven years working as a state treasury inspector.

Vilches de Santos's work has been primarily focused on transfer pricing matters, specifically leading verification procedures and working on advanced pricing agreements. Since 2017 he has also combined his work with acting as delegate for the Spanish government in various OECD working groups.

Reinhart Marville Torre boosts tax practice with two hires

French firm Reinhart Marville Torre announced the arrival of two new members to its Paris-based tax practice.

Pierre Bonamy joins the firm as a partner and takes over the leadership of the tax team. He was previously employed as a manager at Arsene Taxand, where he had been a tax lawyer for more than a decade.

Bonamy operates as a tax generalist, working as both an adviser and litigator, and has experience in areas including restructuring, transfer pricing and innovation taxation.

He is joined at the firm by his colleague **Nicolas Guilland**, who has come on board as a senior collaborator. He also arrives from Arsene Taxand, where he had been for more than five years.

Andersen raises 23 practitioners to managing director in 11 locations

Andersen, the US branch of international network Andersen Global, has announced that 23 individuals from different locations across the US have been appointed managing directors in its 2023 round of promotions.

This includes five members of its New York office: US national tax (USNT) practice specialist **Caitlin Bradley**, private client services practitioner **Richard Dauman**, commercial specialist **Andrei Karp**, state and local tax (SALT) practitioner **Melissa Tegano** and valuation specialist **Fiona Wallace**.

In San Francisco, valuation team members **Kelly Ackel Crug** and **Christy Peterson** were elevated, alongside commercial specialist **Brian O'Connor** and the private client-focused **Jason Woolsey**.

There were two from the team in Seattle promoted – SALT specialist **Jin Choi** and commercial practitioner **Ralph Elder** – along with two in the District of Columbia team: **Keith Winchester**, a commercial specialist, and **Peter Elek**, another SALT specialist.

The Chicago team had private client member **Katie McCue**, SALT practitioner **Jacob Seitz** and commercial specialist **Peter Speranza** all promoted. There was similar positive news for Boston-based **Bill Long**, a USNT team member, and **James Chu**, a private accounting solutions specialist based in the Orange County office.

Rounding off the group, commercial specialist **Mark Lonnecker** and **Jonathan Storms** were both elevated from the Houston practice, private client practitioner **Daniel Johnson** and commercial team member **Patrick Lavelle** from the Los Angeles office, and SALT specialist **Randy Pedersoli** from Silicon Valley.

Schönherr promotes tax partner in Austria

Central and Eastern European law firm Schönherr announced the promotion to partner of a member of its tax practice based in Austria.

Marco Thorbauer has been with the firm for seven years, having previously worked at DLA Piper for almost two and a half years. His work is focused on advising international companies on tax structuring, transactions and tax proceedings, and he has been instrumental in recently expanding the firm's tax practice.

Noerr strengthens Germany tax practice

European law firm Noerr announced the arrival of a partner to its tax practice group in its Frankfurt office.

Andre Happel joins the team from Fieldfisher, where he had been for the past three years. He had previously spent almost a decade with magic circle firm Freshfields Bruckhaus Deringer.

Happel's practice is focused on providing tax advice on M&A transactions and corporate tax law, which he has done for domestic and foreign corporations, credit institutions, family-owned companies, as well as institutional, strategic and financial investors.

Vischer grabs tax partner from Baker McKenzie

Swiss firm Vischer announced the switch of an experienced partner to its tax team based in Zurich.

Tobias Rohner joins the firm from Baker McKenzie, where he had been for six years after previously holding roles at firms such as Froriep, Homburger and Walder Wyss.

Rohner's practice is wide-ranging, working on both advisory and litigation matters for a broad selection of clients in multiple industries. He has particular expertise in the banking and finance, life sciences, metals and private equity sectors. He also has an extensive history working as a lecturer and speaker on tax matters at both the University of Zurich and Zurich University of Applied Sciences.

Irwin Mitchell expands transactional tax team with five new hires

UK firm Irwin Mitchell announced the addition of five people to its transactional tax team based in Birmingham, UK, including a team of four from another firm.

Kate Featherstone joins the team as the head of the tax team. She comes from Knights, where she had been for almost two years, having previously spent more than seven years with Shoosmiths. She brings with her a team of three associates: **Jade Edgar**, **James Arnold** and **Eve Williams**.

Featherstone's experience includes advising clients on a range of corporate transactions, and she specialises in the tax aspects of domestic and cross-border M&A.

Featherstone and her team are joined at their new firm by partner **Jennie Newton**. She was most recently a property tax partner with Wright Hassall and brings with her more than 20 years' experience working in the market, having previously worked at firms such as Pinsent Masons and Eversheds.

Ogier welcomes partner in Luxembourg to lead tax team

International law firm Ogier announced the hire of a partner to its tax practice in Luxembourg.

Aurélie Clementz joins the team from magic circle firm Linklaters, where she had been for more than 17 years. She will lead her new firm's tax practice.

Clementz's work is focused on international transactions and tax structuring for investment funds, multinational groups and private equity sponsors. She has previously advised clients on the tax aspects of international structuring via Luxembourg vehicles, with a specific focus on infrastructure and real estate matters.

Garrigues bolsters Colombian tax practice with partner hire

International law firm Garrigues announced the addition of a partner to its tax team based in Bogotá.

Mónica Bolaños joins the firm from Deloitte, where she had been for more than 17 years, most recently serving as the lead M&A and international tax partner in Colombia and the Andean region.

Bolaños's work is primarily focused on advising clients in relation to corporate taxes, investment structures, financing and M&A.

White & Case recruits Travers Smith head of M&A tax

International law firm White & Case announced the arrival of a partner to its London tax practice.

Jessica Kemp joins the firm from Travers Smith, where she had been for more than 15 years and served most recently as its head of M&A tax. She had previously spent more than two years working with Clifford Chance.

Kemp's practice is focused on advising a range of clients on tax matters, particularly related to M&A, restructurings and capital markets.

Ashurst expands Australian tax offering with two hires

International law firm Ashurst announced the arrival of two partners to its Sydney-based tax practice.

Colin Little is a tax controversy partner who joins from Deloitte, where he had been a partner for the past eight years. He had previously spent time with both PwC and EY. His work is focused on assisting public and private sector clients to resolve complex disputes.

Vanja Podinic joins the team from Deloitte as well, having spent three years with the 'big four' company. Previous roles included working for Baker McKenzie, HSBC and PwC. Her experience is mainly in income tax and transfer pricing in both Australia and the UK.

DLA Piper boosts tax practice in Singapore

International firm DLA Piper announced the hire of a tax partner to its practice in Singapore.

Barbara Voskamp joins the firm from Loyens & Loeff, where she had been for more than five years. She previously spent two and a half years with EY.

Voskamp's work is primarily focused on advising international operating corporate clients on the tax structuring of their cross-border investments.

Andersen welcomes managing director to Washington DC office

Andersen, the US branch of international network Andersen Global, added a managing director to its US national tax practice in its Washington DC office.

Tony Brown joins the team from EY and had previously served as a partner with Arthur Andersen, where he was the head of the US real estate and mid-Atlantic tax practices.

Brown brings with him more than 40 years of experience in the market, primarily on tax consulting and transactions advice with a focus on real estate and financial services.

Manal Corwin set to become OECD tax director

Former US Treasury official Manal Corwin is set to take on the role of tax director at the OECD's Centre for Tax Policy and Administration on April 3.

Josh White

The OECD announced the appointment of Manal Corwin as the next director of the Centre for Tax Policy and Administration on January 13, just as the Paris-based organisation is trying to settle the final details of pillar one.

Corwin will take over from director Grace Perez-Navarro, who is due to retire on March 31. Perez-Navarro has served as director since Pascal Saint-Amans retired in November 2022.

Once in office, Corwin will be faced with the task of securing the multilateral convention on pillar one this summer. David Bradbury and Achim Pross will continue to serve as deputy directors in the tax unit to spearhead the work on the digital economy.

At the same time, the OECD is hoping to see the implementation of pillar two in multiple jurisdictions this year. However, the details of pillar one will decide the future of international taxing rights. This is fundamental to the success of the two-pillar solution to the digital economy.

Corwin will be building on the work of Saint-Amans, who served as OECD tax chief for 12 years. He led the BEPS project in 2012 and delivered the 15-point action plan in just two years. This included the multilateral instrument later signed by more than 100 countries.

Taking on this role means Corwin will be leaving behind her role at KPMG US, where she serves as principal-in-charge of the Washington DC national tax practice. She is also the lead director of the board of directors.

Corwin is a widely respected tax professional with more than 30 years of experience in private practice and policymaking. She has served twice in the Office of Tax Policy at the US Treasury Department under the Clinton and Obama administrations.

From 2009 to 2013, Corwin served first as international tax counsel and later as deputy assistant secretary for international tax affairs. During this time, Corwin played a key role in talks on the automatic exchange of information and the early work on the BEPS project.

Prior to this, Corwin was principal of the Washington DC national tax practice at KPMG from 2001 to 2009. She previously served as acting international tax counsel at the Office of Tax Policy from 1999 to 2001.

In her first major stint in private practice, Corwin was a tax attorney at Washington DC law firm Covington & Burling from 1992 to 1999. She previously worked as a judicial clerk for then Chief Judge Levin Campbell at the US Court of Appeals for the First Circuit.

This year the OECD may be about to make history with pillar one, but this is far from certain. No doubt, Corwin will be the tax policymaker to watch in 2023.

Manal Corwin was national leader for tax at KPMG US

Analysis

Biden budget proposal looks doomed to fail

President Joe Biden wants to raise corporate tax and impose a higher stock buyback tax on US businesses, but his budget proposal faces insurmountable obstacles in Congress, writes Ralph Cunningham.

Ralph Cunningham

US businesses and some of the wealthy people that own them would pay higher taxes and lose subsidies paid through the tax code as part of President Joe Biden's plan to cut US federal debt by almost $3 trillion in the next decade.

That is if the Democrats controlled Congress. However, the fact is, the president's party does not. So much – if not all – of the budget for the 2024 fiscal year that he set out on March 9 has no chance of becoming law.

International tax reform, including measures to inhibit profit shifting by US multinationals, and making it more expensive for corporations to buy their own stock are on the president's agenda. This is a part of the administration's drive to get companies to pay their 'fair share', a phrase that appears frequently in the budget proposal's 184 pages.

The measures include:

- Upping the statutory corporate tax rate to 28% from 21%;
- Increasing the tax on stock buybacks by corporations from 1% to 4%;
- Withdrawing incentives for companies to book profits in low-tax jurisdictions; and
- Doubling the tax rate on US multinationals' foreign earnings from 10.5% to 21%.

Higher corporate rate

The White House claimed that research by Congress's non-partisan Joint Committee on Taxation shows that President Trump's Tax Cuts and Jobs Act (TCJA) in 2017 slashed effective corporate tax rates to an average of 7.8% in the following year compared to 16% in 2016. "The budget would set the corporate tax rate at 28%, still well below the 35% rate that prevailed prior to the 2017 tax law," it added.

Biden also touted his administration's role in driving international tax reform. The budget proposal would go further than what more than 130 jurisdictions have signed up to so far and would seek "to reduce the incentives to book profits in low-tax jurisdictions, stop corporate inversions to tax havens, and raise the tax rate on US multinationals' foreign earnings from 10.5% to 21%".

In their reaction to the budget proposal, the leaders of the country's biggest businesses said they share Biden's concern about the national debt and budget deficits, but disagree that increasing corporations' tax bills is the right way of tackling them.

"Raising the corporate rate to 28% would make the United States' rate the second highest among the 38 [most] developed economies. This increase would give corporate America a higher tax burden than before the TCJA, a time when thousands of American businesses were moving overseas in search of a more competitive tax rate," said Joshua Bolten, CEO of the Business Roundtable, which is made up of the chief executive officers of the country's biggest companies, in a statement.

"The proposed changes to taxes on international earnings would make the situation worse, putting American businesses at an even greater disadvantage to our biggest foreign competitors. America will not win the competition with China, or with any international competitor, if the government is driving our businesses overseas by over-taxing," said Bolten.

The Biden administration hasn't given up its tax ambitions

The TCJA was successful in that it raised $425 billion in corporate tax in the last year, which was "43% higher than the $297 billion collected in 2017, the year before TCJA was signed into law," he added.

"TCJA levelled the playing field for American businesses and workers, stopped companies from relocating overseas and helped return $2.1 trillion in international earnings. Rather than significantly increasing taxes on American businesses, the administration should work with Congress to maintain and strengthen TCJA," the roundtable's statement added.

Preferences under threat

The president also wants to end "wasteful corporate subsidies", for example, by eliminating tax subsidies for oil and gas and real estate.

"Even as they benefit from billions of dollars in special tax breaks, oil companies have failed to invest in production," the budget statement said. "In 2022, they realised record profits and cut their investment as a share of operating cash flows to the lowest levels in a decade, while undertaking record stock buybacks that benefited executives and wealthy shareholders.

"The budget saves $31 billion by eliminating special tax treatment for oil and gas company investments, as well as other fossil fuel tax preferences," it added.

The association for the US oil and gas industry is unhappy with this approach: "The president's budget represents yet another example of contradictions in the administration's energy policymaking," said Lance West, the American Petroleum Institute's vice president of federal government relations, in a statement.

"The White House calls for increasing American oil and natural gas to meet consumer demands and then fails to issue leases and discourages future investment by proposing new discriminatory taxes," said West.

"The administration should be focused on enacting policies that continue delivering critical tax revenue for education and conservation programmes while supplying secure, reliable, and affordable American energy," he added.

Real estate targeted

Biden also wants to take away some tax benefits that he claims only the real estate sector receives.

"The budget saves $19 billion by closing the 'like-kind exchange' loophole, a special tax subsidy for real estate," it said. "This loophole lets real estate investors – but not investors in any other asset – put off paying tax on profits from deals indefinitely as long as they keep investing in real estate.

"This amounts to an indefinite interest-free loan from the government," the budget statement added. "Real estate is the only asset that gets this sweetheart deal."

Stock buyback tax rate

US companies have already seen their tax bills change since last year's budget.

The Inflation Reduction Act, which the president signed into law in 2022, introduced a 15% corporate minimum tax and a 1% "surcharge" on large, publicly-traded corporations that buy back their own stock.

In his budget proposal, the president said the surcharge "reduces the differential tax treatment between buybacks and dividends and encourages businesses to invest in their growth and productivity as opposed to funneling tax-preferred profits to foreign shareholders".

The budget would up this tax rate to 4% "to address the continued tax advantage for buybacks and encourage corporations to invest in productivity and the broader economy".

Little chance of success

Unlike in a parliamentary democracy, where annual budgets are often approved quickly, with perhaps only a few amendments, the US president's budget proposal is only the start of a negotiation with Congress before a new fiscal year begins on October 1.

It is, however, impossible to imagine the Republican majority in the House of Representatives being willing to negotiate a FY24 budget deal that is based on the president's budget proposal, or anything like it. It looks like the start of another bitter battle in Washington DC.

In detail

The UK and Brazil's double tax treaty

Brazil's new treaty shows an effort to align tax law with OECD standards, say local lawyers Allan Fallet and Ariene Reis, who list some of the agreement's key provisions.

Allan Fallet

Ariene Reis

Brazil and the UK have a solid long-standing trade partnership. According to data published by the UK Department for International Trade on January 20 2023, Brazil and the UK's trade was worth £6.5 billion (R$40.5 billion) in 2022.

Aimed at increasing the flow of commercial relations and guaranteeing legal certainty for parties involved, Brazil and the UK signed a double tax treaty (DTT) on November 29 2022.

PE and TP

In Article 5(3)b, the DTT says that the provision of services, including consultancy services, by employees of an entity may be qualified as a permanent establishment if such activities are carried out in the other contracting state for a period (or periods) of 183 days within any 12-month window beginning or ending in the tax year concerned.

Brazil is a key partner of the OECD (and aims to become a member), which implies a substantial change in several Brazilian rules, especially in tax. The DTT is the first tax treaty signed by Brazil that adopts the arm's-length principle – in the context of Article 9 (associated enterprises), it means transactions subject to transfer pricing (TP) rules.

Article 9 of the DTT allows an entity of a contracting state to promote unilateral adjustment to determine the profits subject to tax, as long as the requirements foreseen in the letters "a" and "b" of the article are met. the wording of the rule also allows the other contracting state to make the correspondent adjustment to the amount of tax charged on such profits.

Thus, this provision allows the tax treaty to solve controversies regarding TP rules. Consequently, the economic double taxation of such profits is also avoided – though legal double taxation is not – and it goes hand in hand with the new Provisory Measure n. 1.152, published on December 29 2022, which includes changes to the Brazilian TP regime.

Withholding taxation

Following the OECD Model Convention, Article 10 of the DTT authorises both states to charge a withholding tax on dividends. However, in case the beneficiary resides in the other contracting state, the tax rates applicable cannot exceed (i) 10% of the gross amount paid as dividend (if the beneficiary is an entity which directly holds at least 10% of the equity that pays the dividend throughout a 365-day period); or 15% of the gross amount paid as dividend in all other cases. At a time when Brazilian tax reform is back on the agenda, including taxation at source owing to dividend payments by Brazilian entities (which are currently tax-exempt), Article 10 of the DTT could be a great ally to reduce the tax burden.

Another relevant topic is the taxation of interests. Article 11 of the DTT establishes a withholding tax exemption for interests paid to a beneficiary that is a pension plan or government (and its subdivisions, agencies, and bodies) of the other contracting state. There is also a reduced tax rate (considering that the general tax rate is 15%) of 7% on interest paid for at least five years to financial institutions or insurance companies on loans used to finance infrastructure projects and public utilities. The tax rate of 10% is applied to interest arising from (i) loans made by financial institutions or insurance companies in general, as the parties are not associated enterprises; (ii) stock exchange-listed bonds and securities; and (iii) sale on credit due to the acquisition of machinery and equipment.

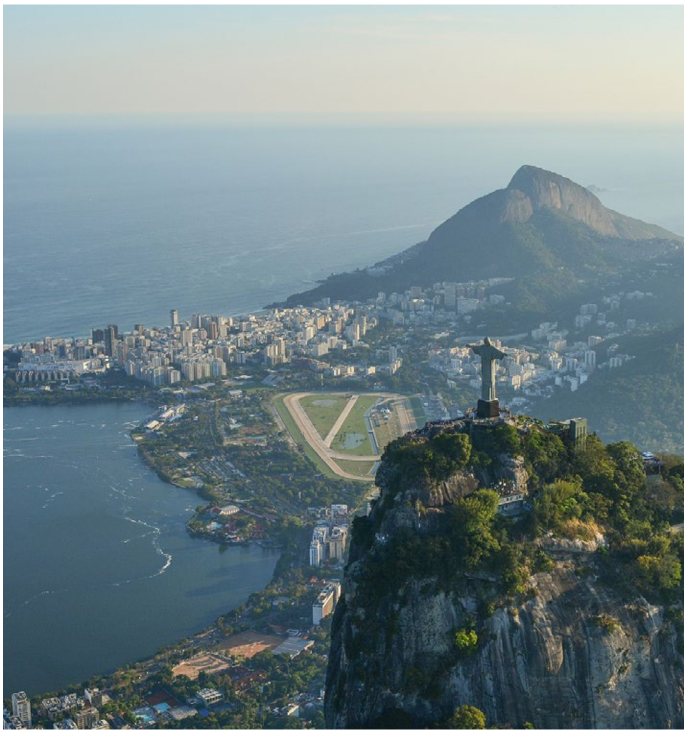
Royalties, remittances and more

Unlike the majority of tax treaties signed by Brazil, Article 12 of the DTT establishes a tax rate of 10% for all types of royalties paid, which may represent a significant reduction of the tax burden in this area.

The taxation of remittances as compensation for technical services imported by a resident in Brazil is a constant topic of discussion in administrative and judicial courts, even when a tax treaty is involved. That is because Brazil, when signing several of its treaties, has extended the scope of Article 12 of the DTT. In those cases, such services are taxed as royalties, resulting in the taxation of these remittances at source.

To add more heat to the discussions, some Brazilian courts have adopted the existence of technology transfer as a criterion for taxing technical services as royalties, both in domestic legislation and in the context of treaties.

To minimise those controversies, the DTT contains Article 13, which defines technical services as any payment for any managerial, technical or consulting service, unless the payment is made (a) to an employee (individual) of the payer; (b) as a result of teaching at an educational institution or for teaching provided by an educational institution; or (c) by an individual for services for her/his own use.



Brazil is pursuing historic tax changes

> "Some Brazilian courts have adopted the existence of technology transfer as a criterion for taxing technical services as royalties"

The same article says that payments for technical services can be taxed by both states. Nonetheless, in case the beneficiary is resident of the other contracting state, the tax rates applicable cannot exceed (i) 8% during the first two years; (ii) 4% during the third and fourth years; and (iii) 0% from the fourth year on. Regarding those terms, the DTT is not clear if they refer to the beginning of the commercial agreement which foresees the rendering of technical services or the date when the tax treaty enters force.

With reference to dividends, interests and royalties, the protocol establishes that if Brazil changes its internal legislation to attribute lower rates than those foreseen in the treaty, the contracting states will discuss updating the agreement. As for technical services, if Brazil adopts lower rates in any other tax treaty (except for treaties with Latin American countries), these rates will automatically apply for the purposes of the DTT.

Making gains

Article 14, dealing with capital gains from movable properties and rights, determines that the gains originating from the other contracting state may be taxed in this contracting state. However, if such gains are made in a third state despite being negotiated by parties from Brazil and the UK, they will be taxed only in the state of the seller's residence. Those rules do not apply to gains derived from the disposal of ships and aircrafts (or other properties related to this type of operation), as the taxing rights are attributed to the state of residence of the entity that operates the ship/aircraft.

It is important to have in mind that all those innovative benefits brought on by the rules above are applied to taxpayers of both contracting states only in situations in which there is no allegation of abusive tax planning, in line with Article 29 of the DTT.

Positive outlook

When compared to treaties already signed by Brazil, the new provisions demonstrate the commitment of the Federal Revenue of Brazil and the government to improve tax legislation and align it with the OECD standards.

Finally, while the DTT has been signed by both states, it is not yet in force because the legislative procedures have not been completed (there may or may not be wording changes). In Brazil, the treaty is currently in progress before the Ministry of Foreign Affairs and still needs approval from the National Congress and ratification by the president. After ratification, it will be incorporated in domestic legislation through the promulgation of a decree.

Allan Fallet is a partner at Mauger Muniz Advogados in São Paulo, while Ariene Reis is a tax specialist at Embraer, also in São Paulo.

CHILE

PwC

Loreto Pelegrí

Drilling into the detail of a new Chilean mining royalty tax

President Boric's government programme featured not only broad tax reform but also a proposal to change the taxation of mining activities in Chile.

Unlike other economic activities, mining involves a non-renewable natural resource owned by the state, which has exclusive, inalienable and imprescriptible ownership of all mines. Hence the state demands 'economic rents or Ricardian rents', where higher taxes are justified because mining generates extraordinary income given the use of the natural resources that are being exploited.

However, the taxation must be reasonable in such a way that a balance is found between allowing the mining industry to be competitive, making the necessary investments, and contributing to the economic development of the country.

Since 2006, a specific mining tax has been in force in Chile. In general terms, this tax is applied on the profits obtained by a mining exploiter, which are based on the level of annual sales and, from 2010, on the prices of the mineral. The tax rate varies between 5% and 14%, depending on the profit margin. This scale is applicable only to mining exploiters with annual sales that exceed a value equivalent to 50,000 metric tons of fine copper (MTFC).

Increased activity around the draft bill

A draft bill that would modify the mining royalty regime is under discussion in Congress. Although the bill started through a parliamentary motion presented by deputies to the House of Representatives on September 12 2018, its discussion has accelerated during the past year. The government has presented three packages of amendments to the bill, converting it into a project that complies with constitutional legality given the exclusivity that the president has in tax matters.

The first amendments to the bill were presented in July 2022 and specified that a new tax would be established (instead of a "compensation to the State", as indicated in the original bill) called a "mining royalty", repealing the tax on mining activity set forth in Article 64 bis of the Chilean Income Tax Law.

The new mining royalty would enter into force on January 1 2024. However, taxpayers benefiting from the tax invariability of Article 11 ter of Decree Law No. 600, Law No. 20.026 or Law No. 20.469 will continue to be governed by the provisions in force until the date on which the invariability ends. However, these taxpayers may voluntarily submit to the new rules in advance.

The proposed royalty has a hybrid nature and combines an ad valorem component that would be applied to annual sales of copper and a variable element linked to the mining operating margin.

A reformulated approach

On October 25 2022, the government of Chile submitted to Congress new substitute indications for the bill on mining royalties – the discussion of which is in its second constitutional stage in the Senate – due to discussions with mining companies from the private sector and experts in the mining industry.

The original project was significantly reformulated to include:

- A simplification and reduction of the ad valorem component without regard to the price of copper;
- A change in the base of the variable component, which will be determined based on mining operating margin ranges instead of copper prices;
- A reduction or elimination of the ad valorem component for companies that could face operating losses as a result of its application; and
- The inclusion of depreciation as part of the calculation of the mining operating margin.

Considering these changes, it is estimated that the mining royalty would collect an additional 0.6% of GDP, of which 0.46% of GDP would result from the new structure and the remaining 0.15% from a growth in production and costs.

According to the proposal, the hybrid nature of the royalty is combined as follows:

- *An ad valorem component* that will be applied to annual sales of copper, with a rate that will no longer be progressive, but flat at 1% for mining operators that annually sell more than the equivalent of 50,000 MTFC (mining operators with annual sales not exceeding 50,000 MTFC will be exempt from this component). If the adjusted taxable mining operating income (RIOMA) is negative, the ad valorem component paid will be the positive amount resulting from subtracting the negative amount of the RIOMA from the determined ad valorem tax; and
- *A component on the mining margin*, applied to the RIOMA:
  - i) Mining operators with annual sales that are more than 50% derived from copper and exceed the equivalent value of 50,000 MTFC will be subject to rates that will fluctuate between 8% and 26% depending on the mining operating profit (instead of between 2% and 36%, as established in the previous package of substitute indications), regardless of copper prices;
  - ii) For mining operators with annual sales that exceed 50,000 MTFC but that are less than 50% derived from copper, a progressive rate will be applied based on the mining operating margin, according to a progressive scale between 5% and 34.5%, per tranche, and with a maximum effective rate of 14%;
  - iii) Mining operators with annual sales greater than the value equivalent to 12,000 MTFC and that do not exceed the value equivalent to 50,000 MTFC will be subject to a rate equivalent to the average per ton based on a progressive scale between 0.5% and 4.5%, according to tranches of values equivalent to the MTFC sold; and
  - iv) Mining operators with annual sales not exceeding 12,000 MTFC will be exempt from this component.

Regarding the determination of the RIOMA, the idea is maintained that the component on the mining margin of the royalty is added to the tax base and the ad valorem component is accepted as an expense; and with respect to the depreciation of fixed assets, accelerated depreciation will be added, and the normal depreciation instalment may be deducted. Organisation and start-up expenses should be considered as an addition to RIOMA.

Next steps

In the first days of January 2023, the Mining and Energy Committee of the Senate approved the mining royalty. Before the vote, the executive branch presented a series of indications that modified the distribution of the resources collected by the royalty tax to regions, which were also approved.

Given the legislative recess in February, the bill will be reviewed and discussed during March by the Senate Finance Committee, before being voted on in the Senate, and then it must return to the House of Representatives.

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Crunch time as EU tax reform edges closer

The European Commission aims to finalise its proposals for an EU-wide corporate tax base and TP rules in the months ahead, as *ITR* reports.

Josh White

European leaders may be about to embark on a historic overhaul of corporate tax and transfer pricing rules, but there are many challenges ahead of a final EU directive.

Businesses and tax advisers raised concerns about the TP implications of the Business in Europe: Framework for Income Taxation (BEFIT) initiative in an EU consultation that ended on January 26.

The Information Technology Industry (ITI) Council, an industry group based in Washington DC representing US technology companies, fears the EU could be diverging from the arm's-length principle (ALP).

"We encourage the Commission to refrain from taking an approach that incorporates formulary apportionment risks, creating more disputes for companies doing business in the European Union," ITI said in its consultation document.

BEFIT would mean a consolidated corporate tax base across the EU whereby companies face formulary apportionment. Under such a system, EU member states may be able to claim tax revenue based on where a company, its staff and sales are located.

The European Commission is looking to the OECD two-pillar solution for a workable model. This would mean a three-tier set of profit allocation rules to impose a formula on residual profits and keep the ALP in place for everything else. But this is contentious.

Pillar one problems

The European Tax Adviser Federation (ETAF), a professional body representing more than 200,000 tax advisers, argued that the OECD approach might be too narrow.

"Pillar one only allocates a small part of extra profits based on a formula. This is very different from what the Commission is proposing here, i.e. to allocate all consolidated profits in the EU based on a formula," noted ETAF in its consultation document.

"We believe that finding an acceptable apportionment formula which accurately reflects the added value creation factors and the contribution of the market jurisdictions for all industries might be difficult," it added.

As a result, ETAF recommended that the Commission finalise the formula for BEFIT after pillar one has been implemented in the EU. But the success of pillar one is not guaranteed despite the OECD's best efforts.

The Commission may be able to strengthen the prospects for pillar one by pushing ahead with BEFIT on a similar design. This still leaves open a lot of questions and the clock is ticking. An EU-wide corporate tax regime could be run on the same TP rules, but a new approach may be necessary.

ITI strongly recommended keeping existing TP rules in place, arguing: "The ALP has been and continues to be a long-standing and well-understood foundational concept that underpins the global tax system.

"Any departure from the use of ALP increases the risk of mismatches between EU and non-EU jurisdictions and leads to double tax," it claimed.

If the Commission departs from the ALP outside the EU, ITI suggested it should take into account tax treaty obligations and the risk of trade tensions. The EU has had clashes with the US over state aid for several years, for example, but this could get worse.

"Taxpayers are likely to have to apply the ALP within the EU to ensure appropriate profit is recorded in each jurisdiction, despite BEFIT's intent to simplify paying corporate tax in the EU," said ITI.

The EU and the OECD are seeking a shift away from traditional TP rules, but the world is unlikely to completely discard the ALP. This may mean a mixed system is the most likely outcome.

The fourth factor

A fundamental issue for EU policymakers is how to properly design the BEFIT formula. Traditionally, it has been based on three factors – employees, sales and physical assets – but this does not take into significant elements such as intellectual property.

This is why some tax experts and business leaders have made the case for including a fourth factor in the profit allocation rules.

"Any allocation formula must include consideration of intangible assets, which are increasingly key value drivers in many global businesses," said ITI.

"Allocation factors should not result in an allocation of profits that does not reflect the economic reality of a company's business model," the council stressed.

These allocation factors will determine a company's tax base in a given jurisdiction, so the risks of getting this wrong are significant for taxpayers. However, it could also be costly to EU jurisdictions in terms of investment and tax revenue.

"Failure to recognise intangible assets in the allocation formula will decrease the attractiveness of the EU when compared to non-EU locations as a destination for investment," ITI claimed.

"Any departure from the use of ALP increases the risk of mismatches between EU and non-EU jurisdictions and leads to double tax"

Since the BEFIT consultation closed, the European Commission is weighing up its options for the next round of policymaking and negotiation. The OECD will be watching closely to see if its ideas make it through at the EU level.

Pillar two prospects

Meanwhile, the Netherlands was the first EU country to unveil draft legislation to implement the global anti-base erosion (GloBE) rules as part of international tax reform. But that may be about to change now the OECD has published technical guidance – on February 2 – which finalises the implementation framework for a key element of the changes: subjecting multinational companies to an effective tax rate of at least 15%.

The European Council, which is made up of the EU's heads of government, and the European Commission agreed last December to a directive "on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the union", a year after the Commission had issued its proposals in December 2021. The agreement pressed 'go' on the national enactment timetable.

Five member states – Germany, France, Italy, Spain and the Netherlands – tried to speed up the Council process by issuing a statement on September 9 2022 that they would push ahead with implementation of the GloBE rules in 2023 even if the Council cannot agree on the directive.

Hungary had vetoed the agreement earlier in the year in a row ostensibly over the damage it believed a minimum corporate tax would do to tax competitiveness and jobs. Hungary's corporate tax rate is 9%.

Drafting away

If the EU's 27 member states were waiting for the OECD's administrative guidance to drop before revealing their plans, we can now expect them to begin consultations and publish draft laws quickly. After all, they have less than 9 months to ensure that the directive is part of national law by the end of 2023.

The directive requires member states to start applying the income inclusion rule (IIR) for fiscal years beginning on or after December 31 2023, and the undertaxed profits rule (UTPR) for fiscal years beginning on or after December 31 2024.

It allows member states to implement a qualified domestic top-up tax, if they wish. This is to preserve member states' sovereignty in tax matters.

A member state can also postpone the application of the IIR and the UTPR up to December 31 2029 if a maximum of 12 ultimate parent entities (UPEs) are based there.

The European Council discussions did not hold up some member states. The Netherlands became the first to produce draft legislation for consultation on October 24 2022. Other member states, such as Ireland, which held a two-month consultation between May and July 2022, have also begun to plan for implementation.

"The Dutch are the most advanced in the process," says Raluca Enache, a member of KPMG's EU tax centre in Amsterdam. "We do expect many other member states to launch public consultations this spring and it would not surprise me if the other EU jurisdictions that have signed the September 9 statement in support of GloBE implementation will be among the first to follow suit."

David Gajda, senior manager of tax and financial policy for BDI, the Federation of German Industries, says the association is "eagerly awaiting the draft".

"Tempo is essential here, as companies will have to prepare for specific processes and to adopt IT tools," he says.

Advance preparation

Taxpayers did not have to wait for EU politicians to agree before starting to prepare for pillar two. It was a question of when – rather than if – for the Council with the OECD-led Inclusive Framework having already agreed to implement the international tax reform package from the end of 2023.

"We started our pillar two project right away in January 2022," says Christian Kaeser, the head of tax for Siemens, the German industrial group. "The political agreement from December 2022 did not change our project timeline. As our fiscal year deviates from the calendar year, the pillar two start date will be October 1 2024 for us.

"The relevant milestones influencing our implementation and pillar two readiness are the safe harbour rules, IIR and the German domestic implementation," he adds.

Kaeser predicts some German taxpayers will not be happy when they see what they will have to do to comply with pillar two rules.

"I anticipate that in Germany, given the large number of in-scope companies, including many medium-sized ones, there will be a wave of criticism building especially from those medium-sized companies which only now realise what complexity is coming their way," he says.

The European Commission would not confirm to *ITR* that it had set up a working group with the OECD to help member states transpose the directive onto their own statute books. It said it is important to coordinate its input into the OECD work to ensure that the outcome of this is aligned with the legal obligations that the directive imposes on member states.

The Commission plans to organise regular coordination meetings with member states, including discussing, as it usually does with a new directive, any technical questions that may arise around enacting the pillar two directive into national law.

Getting it right

Looking ahead, Enache of KPMG believes it is difficult to say if any member states will find enactment more or less difficult, but a couple of things, such as elections, might have an influence.

"This is not a given, but it is often the case that legislators take longer or are more reluctant to introduce new legislation during an election year," she says.

"And, of course, member states have different internal procedures for adoption of new legislation. Some can only do so as part of their budget cycles, many are required to give national parliaments ample time to consider draft laws," she adds.

Seven member states – Estonia, Finland, Greece, Luxembourg, Slovakia, Poland and Spain – are due to hold general or parliamentary elections in 2023, with state elections set for at least four others.

Time is ticking for EU member states to get pillar two rules into place. Help has arrived in the shape of the OECD's technical guidance, which the organisation accepts it will have to update as issues arise during implementation.

Taxpayers already have a lot of the detail about the two-pillar approach. Now they just want to see how member states intend to put it all into force. They will be watching closely. Much is still up for decision.

In the meantime, the European Commission is still working to finalise its proposals for a common corporate tax base. This is an opportunity to make the global minimum rate work in the EU and set an example for the rest of the world.

A new EU corporate tax system is in the works

Lawyers expect TP clarity from Dow Chemical case in Canada

The Supreme Court of Canada will decide a crucial issue of jurisdiction for taxpayers in a transfer pricing dispute between Dow Chemical and the Canada Revenue Agency.

Josh White

Taxpayers are hoping for certainty from the Supreme Court of Canada when it hears what could be a seminal transfer pricing case, say Canadian tax lawyers.

Dow Chemical Canada has taken the dispute with the country's tax authority to the Supreme Court, which will decide whether the Tax Court of Canada has jurisdiction in the case.

Jacques Bernier, partner at Baker McKenzie in Toronto, thinks the looming SCC decision is a positive sign for companies doing business in Canada. The question of jurisdiction affects whether Dow Chemical, a subsidiary of the US company, will be able to secure a downward TP adjustment.

"The SCC granting leave in the *Dow Chemical* case is good news for taxpayers and their advisers. Jurisdictional uncertainty, and the added costs it creates, hinders effective checks and balances on the CRA [Canada Revenue Agency] and dispute resolution generally," he tells *ITR*.

"It is hoped that the SCC's decision will provide added certainty to taxpayers not only in transfer pricing cases but in tax cases generally when similar issues can arise," he adds.

The case is expected to be heard later this year.

Dow Chemical is appealing an April 2022 decision of the Federal Court of Appeal (FCA) that supported the CRA's choice of tribunal for the TP dispute. Dow Chemical wanted to secure a hearing at the Tax Court, but the appeals court ruled against it.

The Supreme Court granted an appeal application by Dow Chemical on February 23. This turned heads because the SCC only hears cases of national importance.

Laurie Goldbach, partner at Borden Ladner Gervais in Calgary, suggests that the *Dow* case is part of a longer-term pattern.

"It's interesting that the Supreme Court has granted leave in another tax case," she says, pointing out that the court has seemed more willing to address tax disputes in recent years due to the growing prominence of such TP cases in Canada.

However, the Supreme Court of Canada favoured limited jurisdiction of the Tax Court in previous disputes, so the *Dow* case could upend past precedents.

"It's curious to me that they would grant leave on a similar issue, which makes me think maybe they're going to change that view or revisit that view," Goldbach adds.

Some tax professionals have speculated that the Canadian government will need to legislate to resolve this jurisdictional question once and for all, but this might not be the case if the SCC sets a strong precedent.

Case history

The case dates to the tax years 2006 and 2007, when the Canadian subsidiary made an additional $307 million through inter-company transactions with Dow Europe (DowEur), a Swiss operating unit, according to the CRA.

The Canadian tax authority reassessed Dow Chemical's TP arrangements for those tax years in 2011, and the minister of national revenue at the time, Gail

Canada's Supreme Court will clarify the issue of jurisdiction

Shea, issued an upward TP adjustment on the transactions with DowEur.

A downward TP adjustment to increase the interest expense was unavailable due to the limitation period of the Canada-Switzerland Tax Treaty, according to the minister.

Nevertheless, the Canadian subsidiary requested a downward adjustment for its 2006 tax year, but this was refused in 2013. It would have resulted in double non-taxation, according to the minister.

The Canadian subsidiary filed an application with the Federal Court of Canada seeking a judicial review of this decision, but it also appealed the minister's reassessment of the 2006 tax year at the Tax Court of Canada.

Dow Chemical took its case to that court in 2017, arguing that the minister's assessment was incorrect, but the Canadian government said this decision could only be challenged at the Federal Court.

In 2020, the Tax Court rejected Dow Chemical's argument that it was entitled to a separate right of appeal from the minister's decision. But the court also found that it was permitted and required to review the manner in which the minister concluded a downward TP adjustment was not allowed.

However, the Federal Court would still have the power to review the assessment following the Tax Court decision, so this opened up a potential clash between the courts. This is partly why the case has reached the highest court in Canada.

In response to the Tax Court decision, the Crown (Canadian government) decided to take the case to the FCA hoping to uphold the minister's authority in such matters and clarify the jurisdiction of the court.

The FCA agreed with the Tax Court that the taxpayer did not have a separate right to appeal the minister's opinion. However, the appeals court rejected the argument that the Tax Court had the power to determine the correctness of a tax assessment by the minister.

This split between the courts created greater uncertainty over jurisdiction. Dow Chemical responded to the FCA decision in April 2022 by filing an appeal application to the Supreme Court in the hope of getting the hearing it wants.

Uncertain times

David Chodikoff, partner at Miller Thomson in Toronto, says the issue of jurisdiction may be narrow but it has wider implications.

"My view is that there is uncertainty until we have a final determination by the court in connection with this particular issue," says Chodikoff.

"Even though it is a narrow issue, it has broader implications and, until resolved, it creates uncertainty for businesses," he adds.

Doug Ewens, counsel at Moodys Tax Law in Calgary, thinks the FCA's decision was correct. The Tax Court cannot change ministerial opinion and the means to challenge it can be sought only from the Federal Court of Canada via a judicial review, he explains.

A judicial review would allow Dow Chemical to appeal the minister's assessment at the Tax Court of Canada. But the taxpayer will not have recourse to such a review if a statutory appeal is possible.

Now, Dow Chemical will have to fight its case at the highest court in the country, and many taxpayers will be watching this dispute closely.

"In the *Dow* case, it is a question of jurisdiction. If the SCC answers the question with clarity – and that is expected – then this could be the end of the matter and provide certainty," says Chodikoff.

"This is not a case that is driven by facts but by statutory construct," he adds.

The uncertainty surrounding the jurisdiction of the Tax Court is a major concern for taxpayers, but the SCC has a chance to settle things once and for all.

UFLPA's influence on MNEs' TP comparability analysis in China

Xing Hu, partner at Hui Ye Law Firm in Shanghai, looks at the implications of the US Uyghur Forced Labor Protection Act for TP comparability analysis of China.

Xing Hu

The export control compliance burden imposed on multinational enterprise (MNE) subsidiaries in China has increased in recent years because of the geopolitical tensions between the US and China. Given that Chinese subsidiaries with a headquarters in Europe or other regions usually import and/or export raw materials, semi-finished or finished goods from or to the US market as part of their global supply chain, most MNE subsidiaries in China are affected by this growing export control compliance burden.

In this article, I will use the Uyghur Forced Labor Prevention Act (UFLPA) as an example to show the specific export control compliance measures to be taken by the MNEs' Chinese subsidiaries (the MNE Subs or Subs) and to analyse the impact of such new measures on the MNE Subs' transfer pricing (TP) comparability analysis.

The US government describes the UFLPA as follows: "It establishes a rebuttable presumption that the importation of any goods, wares, articles, and merchandise mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region of the People's Republic of China, or produced by certain entities, is prohibited by Section 307 of the Tariff Act of 1930 and that such goods, wares, articles, and merchandise are not entitled to entry to the United States. The presumption applies unless the commissioner of US Customs and Border Protection determines that the importer of record has complied with specified conditions and, by clear and convincing evidence, that the goods, wares, articles, or merchandise were not produced using forced labour."

Pursuant to the UFLPA, effective as of June 21 2022, and the accompanying operational guidance and strategic report, to avoid goods exported to the US market being detained, excluded, seized or forfeited by the competent US customs authority, the MNE Subs should either request an exception to the rebuttable presumption (a complex legal issue not discussed here) or prove that the imported goods are sourced completely from outside Xinjiang and have no connection to entities on the UFLPA Entity List.

Regardless of the approach, MNE Subs are required to create and build documentation tracing the complete supply chain of the imported and exported goods, including raw materials, components, parts and semi-finished goods. The documentation includes:

1) Evidence pertaining to overall supply chain
   - Involving a detailed description of the supply chain, roles of the entities in the supply chain, identified relationships with those entities, a list of suppliers associated with each step of the production process, etc.

> "MNE Subs are required to create and build documentation tracing the complete supply chain"

2) Evidence pertaining to merchandise or any component thereof
- Covering purchase orders, invoices and receipts for all suppliers and sub-suppliers, packing list, bill of materials, certificates of origin, payment records, seller's and buyer's inventory records, shipping records and import/export records.

3) Evidence pertaining to miner, producer or manufacturer
- This applies to high-risk commodities such as cotton and polysilicon.

In the event that a MNE Sub fails to provide the required documentation evidence to prove that the concerned goods are sourced completely from outside Xinjiang, that Sub's goods exported to the US market may be detained, excluded, seized or forfeited by the competent US customs authority.

The newly required documentation significantly increases the burden of export control compliance for the MNE Subs. Consequently, the costs and expenses arising from the additional compliance measures taken to satisfy the requirements of the UFLPA (UFLPA Expenses) could impact the MNE Subs' comparability analysis to some extent.

The extent of the impact will vary according to the robustness of each MNE Sub's internal global supply chain system, its bargaining power to negotiate revised contract terms with the suppliers and sub-suppliers, the level of relevance to the US market and other factors. Below are some considerations that will shed light on this issue.

Effects on calculation of profit level index

No matter which TP method and profit level index are chosen, the UFLPA Expenses will affect the calculation of key financial ratios. The relevant factors to be considered include:

1) What is the scope covered by the UFLPA Expenses?

It may cover the relevant workforce remuneration expenses, the expenses to set up new modules in the MNE Sub's internal supply chain system, the expenses caused by breach of contract with the suppliers and sub-suppliers, and other relevant expenses.

Xinjiang has become a major issue between China and the US

2) Will the UFLPA Expenses be recognised as cost of sales or operating expenses?

In China's TP practice, the transactional net margin method is more widely used than the resale price method and cost-plus method. It means that the differences arising from the different accounting treatment of the UFLPA Expenses may bring fewer effects generally. However, such differences should still not be neglected in the TP comparability analysis.

3) Are the UFLPA Expenses exceptional or 'new normal' expenses?

The OECD Transfer Pricing Guidelines provide that "exceptional and extraordinary items of a non-recurring nature should generally (also) be excluded". For that reason, exceptional expenses arising from the COVID-19 pandemic should generally be excluded from the net profit indication. However, for certain operating expenses that are related to "long-term or permanent changes in the manner in which business operate" may not be viewed as exceptional or non-recurring.

UFLPA Expenses should be treated in the same way, i.e. exceptional UFLPA Expenses are excluded from the net profit indication, while the 'new normal' UFLPA Expenses are not excluded. Because the UFLPA became effective only a short time ago, it is too early to give a final answer to this question at this moment. The implementation and evolution of the UFLPA needs to be observed carefully.

Effects on reliability of assumptions of comparability analysis

The reliability of assumptions has an impact on the choice of the most appropriate TP method and the result of TP comparability analysis. In the event that the assumptions made in a MNE Sub's TP comparability analysis have a bearing on that Sub's overall supply chain, the reliability of assumptions should be reconsidered by taking into account the UFLPA's compliance requirements and the UFLPA Expenses.

Effects on completeness and accuracy of comparable data

The MNE Subs should consider:

1) Will the UFLPA Expenses cause material differences to the comparable data?
2) If yes, will the effect of such material differences on prices and profits of the goods be determined? Will such effects be able to be eliminated after comparability adjustments?

In the event that a MNE Sub's UFLPA Expenses cause material differences, but such material differences' effect on prices and profits is not able to be determined or eliminated after comparability adjustments, the reliability of that Sub's TP comparability analysis would be lessened resulting in a failure to reach a range in line with the arm's-length principle.

Effects on extent of comparability

The UFLPA Expenses may have an impact on the extent of comparability in many areas. Some examples relating to five comparability factors are listed below.

1) The functional analysis, considering assets deployed and risks borne

The documentation evidence required under the UFLPA has a bearing on each step of the overall supply chain of the MNE Subs. As a result, all risks in relation to each step of the supply chain, including R&D, production, marketing and sales, should be reassessed in the Subs' TP comparability analysis.

> "Reliability of assumptions has an impact on the choice of the most appropriate TP method"

2) The contractual terms of the transaction

Some contractual terms signed by the MNE Subs with their suppliers, sub-suppliers and other business partners, such as the terms on origin of sourcing, prohibition of forced labour and right to unilateral termination may be renegotiated and revised, thus leading to necessary comparability adjustments in the Subs' TP comparability analysis, especially in the case of an uncontrolled transaction to which the party is much less influenced by the UFLPA.

3) The characteristics of property transferred and services provided

For example, some MNE Subs' capacity and supply volume of goods exported to the US market may be substantially reduced or altered due to the export control requirements under the UFLPA, thus leading to necessary comparability adjustments in those Subs' TP comparability analysis.

4) The economic circumstances of the market

For example, the market share and competitiveness of some MNE Subs may be considerably reduced or impaired in the event that exportation to the US market plays a major role in their business and they fail to satisfy, or take immediate remedial measures to satisfy, the documentation requirement under the UFLPA. Such material changes would necessitate comparability adjustments in those Subs' TP comparability analysis.

5) The pursued business strategies

Some MNE Subs may consider searching for a substitute for the US market considering the impact on their business strategies of the additional high UFLPA Expenses. The constructive changes in those Subs' business strategies would have an impact on their TP comparability analysis.

Besides the UFLPA, the MNE Subs face other export control compliance requirements such as the Bureau of Industry and Security Entity List, which is applicable to semiconductors, biotechnology, the photovoltaic sector and other industries driven by the cutting-edge technologies.

The proposal for a Directive on Corporate Sustainability Due Diligence issued by the EU may also exert an extensive influence on the MNE Subs' exportation to EU markets in the near future.

In addition, some MNEs have chosen to prioritise the safety and stability of their global supply chain over the minimisation of the production costs, so they may to seek alternative or a backup manufacturing bases in other countries.

Together these factors will force thousands of MNEs to scrutinise their operations in China and reassess whether their Subs' affiliated transactions fully satisfy the arm's-length principle.

Why anti-avoidance has become big tax news in Asia

In some cases because of pressure from jurisdictions and organisations outside the region, Asian countries have put taxpayers on notice that they intend to focus more resources on anti-avoidance. Ralph Cunningham reports.

Ralph Cunningham

Anti-avoidance measures and incentives have grabbed the attention of tax executives in Asia in the first quarter months of 2023, with three jurisdictions in the region either unveiling or reforming legislation with implications for large business taxpayers.

Add to that the growing number of Asian countries that have announced plans to implement at least the pillar two rules from the OECD's dual-track approach to the taxation of the digitalised economy, and tax executives have much to occupy them for the rest of the year and beyond.

What is noteworthy about the measures announced is that they owe their emergence to global political and tax developments, illustrating that few jurisdictions can implement tax policy without paying attention to what is happening outside their shores.

Possibly the most significant measure of all is Hong Kong SAR's update to its foreign passive income exemption (FSIE) regime.

Asian countries are cracking down on tax avoidance

The Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance, which took effect on January 1 this year, targets companies that may be tempted to use Hong Kong's territorial tax principles for their generous foreign-sourced passive income rules.

The updated FSIE regime allows an exemption for such income – interest, dividends, disposal gains in relation to shares or equity interests (disposal gains) and intellectual property income – which taxpayers receive in Hong Kong only if they adhere to the legislation's economic substance and nexus requirements.

With the implementation of the new law, Hong Kong has steered clear of the EU's blacklist of non-cooperative tax jurisdictions. The bloc has kept Hong Kong on the watchlist since October 2021 but, on February 14, moved it to what the EU describes as Annex 2 of 18 jurisdictions that have committed to improving their tax governance.

However, Hong Kong will still need to reform the rules again before the end of 2023 – and has said it will do so – as the EU updated its requirements for FSIE regimes in December to include capital gains.

The new law

Whether a company meets the applicable economic substance requirements can very much depend on the facts and circumstances of each case, says Pierre Chan, a partner at Baker McKenzie in Hong Kong.

"The analysis will predominately focus on whether sufficient functions are carried out in Hong Kong by, or on behalf of, the company and what constitutes 'adequate' human resources, premises, employees and operating expenditures in the context of the operations of the specific company," he adds.

The Inland Revenue Department will operate an advance rulings system, especially for more complex cases. Chan believes taxpayers would be wise to use it if they want more certainty about their situation.

While the law has no general grandfathering arrangement, the Hong Kong government said it would discuss with the EU "the possibility of allowing the rebasing of the value of the equity interest to the fair value as of 31 December 2022", according to the government.

"This would effectively exclude pre-1 January 2023 unrealised gains from the new regime," says Chan.

Recalculation in Indonesia

Indonesia has also been focusing on anti-avoidance. Regulations enacted in December have given the director general of tax (DGT) the power to recalculate a company's tax payments for related parties' transactions by comparing its financial performance with other taxpayers in similar businesses, and for transactions related to hybrid entities or instruments.

The DGT will also be allowed to redetermine tax payable according to the substance-over-form principle.

"It seems that the GoI [government of Indonesia] has been under the impression that the old anti-avoidance rules stipulated under Article 18 of the previous Income Tax Law were very limited and specific," say Ponti Partogi, partner and head of the tax and trade practice group at HHP Law Firm, and Daru Hananto, a partner of the same firm.

"The previous Indonesian Income Tax Law adopted the specific substance-over-form rule that has been applied during the tax audit process, which, in relevant circumstances, led to the issuance of tax assessments.

"However, at the Court of Tax Appeal, a certain number of these tax assessments were cancelled and the GOI seems to believe that one of the cancellation reasons is the possible lack of more general anti-avoidance rules," they add.

In drawing up the new regulations, the Indonesian authorities are believed to have studied anti-avoidance rules in other jurisdictions such as Australia, Canada, India, Japan, the UK and the US.

> "The impact of pillar two implementation will command the international tax headlines this year"

Chinese tax relief

While Hong Kong and Indonesia have made anti-avoidance the centrepiece of recent tax policymaking, China has looked to make more of tax relief, extending its favourable tax treatment for equity incentive income for another year until the end of 2023.

This is the second extension of a policy unveiled in 2018. It was due to expire at the end of 2021 but was kept in place for another year.

While the measure comes under the Individual Income Tax (IIT), it could have implications for businesses, depending on seniority, say Jason Wen, head of the tax controversy practice at Baker McKenzie FenXun joint operation, based in Beijing, and Amy Ling, senior tax practitioner at Baker McKenzie in Hong Kong.

"It is not uncommon for multinational companies to provide tax equalisation treatment as part of a relocation package for expatriates to work in China," say Wen and Ling. "In such a case, the preferential IIT treatment is helpful to reduce the overall tax cost. Without such treatment, the company will need to bear the increased tax costs.

"Further, given the relatively high IIT rates in China, expatriate employees may request a relocation to manage their IIT costs on equity incentive income, and the preferential IIT treatment is helpful to alleviate such issues," they add.

Pillar two progress

Meanwhile, on a global level, China has yet to announce any plans to implement the OECD's two-pillar approach to the taxation of the digitalised economy. Hong Kong, Indonesia, Japan and Singapore are among the Asian jurisdictions that have said in recent days and weeks that they will implement the pillar two rules.

South Korea became the first country in the world to enact the GloBE rules into domestic legislation at the end of 2022.

The impact of pillar two implementation will command the international tax headlines this year, but tax executives in Asia will also have important anti-avoidance measures to take care with.

Korean companies stay cautious despite pillar two push

A steady stream of countries has announced steps towards implementing pillar two, but Korea has got there first. Ralph Cunningham finds out what tax executives should do next.

Ralph Cunningham

The member jurisdictions of the Inclusive Framework on BEPS have some months to go yet before they iron out the most controversial and contentious aspects of the agreed two-pillar approach to the taxation of the digital economy. Even so, the OECD, which is facilitating the talks, is still committed to having pillars one and two in place by the beginning of 2024.

The implementation discussions have not stopped some jurisdictions from moving ahead with enacting the agreement nationally, particularly the Global anti-Base Erosion (Globe) rules under pillar two.

These rules impose a minimum effective corporate tax rate of 15% on groups with total consolidated revenue above €750 million ($815 million) in at least two of the four preceding years. Comprising the income inclusion rule (IIR) and the undertaxed profits rule (UTPR), the mandates help companies determine whether they and any group entities are liable for the tax and how much they should pay to comply with the minimum rate.

On December 31 2022, South Korea became the first country in the world to enact national legislation to implement the GloBE rules. The law is due to take effect on January 1 next year following the publication of detailed regulations in a presidential decree.

The rules generally follow the OECD Model Rules, including the top-up tax calculation to bring a liable company up to the minimum rate, the IIR and the UTPR, as well as the de minimis exclusion for entities whose revenue and income do not reach a certain level.

Taxpayer concerns

Tax executives are taking a cautious approach to the enactment of the law, according to practitioners.

"They [clients] are mainly concerned about the ambiguity of the OECD Model Rules and the increase in tax compliance costs," says Kim Kyu-Dong, partner and co-head of the international tax practice at law firm Yulchon, in an email to *International Tax Review*.

"Korean MNEs are in the very early state of preparation for pillar two, e.g., identification of taxpayer (UPE [ultimate parent entity], POPE [partially owned parent entities]), reviewing CbCR [country-by-country reports] and consolidated financials, etc. to consider the likely tax impacts," he adds.

Other concerns include whether implementation of the GloBE rules will affect the tax benefits that Korean taxpayers already enjoy.

Kim believes the legislation may create unforeseen anomalies or irregularities with existing law, saying: "For example, the effects of the current R&D and investment credits available for MNEs operating in Korea may be negated."

Korean corporations with extensive interests overseas have their own worries, particularly those that do business in the US.

"Many Korean MNEs have significant operations in the US," says Kim. "The tax refunds under the IRA [Inflation Reduction Act] credit regime may result in a Korean top-up tax since they can be treated as QRTC [qualified refundable tax credits] to be included in GloBE income."

Prepare to implement

Kim urges taxpayers that may be in scope of the rules to take some important steps to prepare for any impact, such as top-up tax simulations to identify the jurisdictions to be affected, enhancing their ERPs so they can comprehensively manage their financial and corporate income tax information, and discussing alternative incentives with the government.

The OECD Model Rules sets out steps that a taxpayer can take to identify if they are liable for a top-up tax. This analysis could bring hundreds of Korean companies into scope, according to PwC in Korea.

"We are estimating anywhere between 270 and 300 UPE Korean MNEs that may be subject to the IIR as per the Korean pillar two rules," says Michael Kim, head of the firm's outbound tax practice and responsible for its pillar two initiatives, in an email interview. "If we include POPEs, JVs, etc., this number will grow to anywhere between 400 and 500."

Paying up

Coming up with a number of companies that may be subject to Korea's UTPR rule is more difficult, as Michael Kim notes.

"Unfortunately, we cannot predict the number of Korean subsidiaries/PEs that will be impacted as this will depend on whether or not the foreign jurisdictions where the foreign UPE is located will eventually adopt the IIR," he says.

Michael Kim emphasises the importance for Korean MNEs of working out where their constituent entities (CEs) – which the Model Rules refer to as all entities within a group with any permanent establishment of a group entity being treated as a separate CE – are based and what their top-up tax liability may be.

"From an IIR perspective, Korean MNEs should pay attention to the grouping of the CEs by jurisdiction and the determination of which CEs should be responsible for filing and paying top-up taxes as there are quite often multiple listed companies within each MNE group," he says.

"The exact calculation methodology should be reviewed carefully once the Korean government issues the presidential decree in the near future," he adds.

Timetable change?

Korea may not be in a position to implement the rules on January 1 2024 as planned. A number of Korean MNEs are believed to be talking to the government about a delay.

"Most Korean MNEs are still awaiting the presidential decree before taking any measures to assess the detailed top-up tax impact as we are not sure whether the rules will be effective from January 1 2024," says Michael Kim.

"There is a possibility that the rules may be delayed for another year (i.e., effective from January 1 2025) depending on the timing of the OECD's release of the implementation framework, the Korean presidential decree as well as the pillar two enactment progress in other developed countries."

The road to international tax reform has been a tortuous one. It will be 10 years this year since the G20 group of the world's biggest economies commissioned the OECD to lead negotiations to change a system that had barely seen any for decades. It is getting on for eight years since the final reports on the first stage of the BEPS project came out. No one said it was going to be easy.

National Assembly of South Korea

AUSTRALIA

DLA Piper Australia

Jun Au

ATO accepts deductibility of exploration costs in pivotal Shell Energy Federal Court decision

After the High Court dismissed the Australian Tax Office's (ATO's) application for special leave to appeal, the ATO has released a draft decision impact statement (DIS) on the Federal Court case involving Shell Energy.

Very broadly, the Shell Case and the subsequent draft DIS should be of particular interest to taxpayers in the mining, oil and gas industries. They concern the application of the uniform capital allowance rules and more specifically, the availability of an immediate deduction for certain intangible assets (including mining, quarrying and prospecting rights) that are first used in exploration.

Comments on the draft DIS are due by March 3 2023. The ATO has also withdrawn Taxation Determination (TD) 2019/1 with effect from February 2 2023, given that that the TD is now inconsistent with the Federal Court's decision on the concept of 'first use'.

Shell Energy Holdings Australia Limited v FCT (2022)

In 2012, Shell and Chevron Australia (Chevron) were both participants in a petroleum venture known as the Browse Project. Relevantly, the participants in the Browse Project were the legal holders of an exploration permit and numerous retention leases (the statutory titles) which gave permission to the holders to explore for petroleum.

Subsequently, Shell acquired Chevron's participating interest in the Browse Project for approximately $2.3 billion and claimed a deduction for this amount under sections 40-80 and 40-25 of the Income Tax Assessment Act 1997 (1997 Act). This was for the cost of acquiring 'mining, quarrying or prospecting rights' (MQPRs) in the form of an additional proportional interest in the statutory titles, and based on Shell 'first using' those MQPRs for 'exploration or prospecting'.

In May 2021, the Federal Court affirmed Shell's entitlement to most of its deductions. The Commissioner appealed this decision in the Federal Court but his appeal was dismissed, with the ruling in favour of Shell and all its claimed deductions. The Commissioner's subsequent application for special leave to appeal was dismissed by the High Court in September 2022.

ATO releases draft DIS on the Shell case

Meaning of 'exploration'

A key issue in the Shell case was whether 'exploration' was merely limited to activities that related only to the discovery of resources, or whether the determination of the commercial viability of resources also constituted 'exploration'.

In the Federal Court decision, the judges adopted a wider meaning of 'exploration' and held that it should not be limited to the discovery of petroleum. Instead, activities directed at investigating the commercial recoverability of petroleum should also be included. Importantly, the extended meaning of 'exploration' is equally applicable to both the relevant petroleum legislation and the 1997 Act.

In the DIS, the Commissioner accepts that given the history of the relevant petroleum Acts, it was open for the Federal Court to conclude that 'explore' and 'exploration' had a wider meaning. The identification of the characteristics of the petroleum field or whether the identified resource was commercially recoverable were therefore found to have met the definition of 'explore' or 'exploration' under the relevant petroleum Acts.

However, the Commissioner cautions that this more expansive view of 'exploration' may not apply in all cases, and that a more limited meaning may be intended for the purposes of the 1997 Act.

Concept of 'first use'

The Federal Court held that the 'first use' and 'start time' of the MQPRs (viewed as a bundle of rights) commence once the rights are held for use.

As set out in the DIS, the Commissioner's view is that the principles expounded by the Federal Court are limited to the circumstances of the Shell case. Therefore, whether other intangible assets will also have a start time once they are held for use, will depend on the nature of the assets and the operation of any relevant legislation.

Acquisition of the MQPRs

The Federal Court held that by acquiring Chevron's participating interest in the joint venture, Shell also acquired a commensurate additional proportional interest in the statutory titles.

The Commissioner is reluctant to wholly endorse this approach and cautions taxpayers not to assume this to be case in every scenario. Whether and to what extent a joint venture party has an interest in joint venture property, and the nature of any such interest, will depend on the facts of each case.

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CHINA

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China's VAT legislation makes progress

On December 27 2022, the draft Chinese VAT law (the Draft) was submitted to the National People's Congress (NPC) for the first round of review. As part of the legislative process, the Draft was also open for public consultation until January 28 2023. It is expected that the Draft will be approved by the NPC in the course of 2023.

For context, since their inception the Chinese VAT rules have existed as regulations issued by the State Council (i.e., the cabinet) rather than as a law passed by the NPC. However, in recent years China has sought to put existing taxes on a statutory basis, and the enactment of a VAT law has long been a core objective of this initiative. Indeed, VAT is the most significant tax in China in terms of revenue raising.

The last major change to the Chinese VAT regime came in 2012–16 when business tax (BT) was merged into VAT. BT applied to service provision, financing arrangements, real estate and IP transactions, and the merger left various oddities in the Chinese VAT system which the new VAT law is seeking to address.

In addition, the new VAT law seeks to better align Chinese rules with the OECD International VAT/GST Guidelines' place of consumption rules for determining whether the place of supply is in China. It also seeks to strengthen the provisions on granting refunds of excess input VAT credits, a relatively new innovation in the Chinese VAT space.

Key changes in the draft Chinese VAT law

Highlighted below are some important changes in the areas of non-creditable input taxes, simplified taxation, deemed sales, and mixed sales.

- Non-creditable input taxes – different from most other countries, China does not exempt loan interest from VAT. Previously, BT applied to interest and this was carried into the VAT regime. However, up to now, no input credit was provided for loan interest. This changes in the Draft, and the new credit will provide much welcome relief to businesses. At the same time, simplifications are brought to the granting of VAT input credit for food, beverage, and entertainment services provided that the consumption is business related.
- Simplified taxation – the existing VAT rules provide for a 'simplified' VAT levy (i.e., without consideration of input credits) for smaller businesses of 3%, and a 5% rate applying to the sale and rental of real estate (a legacy of the old BT regime). The Draft flags that the 3% rate will be retained but it remains to be seen whether the 5% rate will also be 'folded' into it.
- Deemed sales – the existing VAT rules set out a multitude of instances in which a supply is deemed for VAT purposes; these are narrowed significantly in the Draft. The axe is taken to the deeming charge on consignment sales, inter-province transfers between branches of the same company, capital injections, distribution-in-kind to shareholders and free-of-charge provision of services. That said, the Draft still applies the deeming rule to free-of-charge supplies of financial products.
- Mixed sales – the application of mixed sales rules (which apply the VAT rate of the main supply) have been widened in the Draft. Going forward, where the supplies are subject to VAT at two rates, the mixed sales rule can be applied; up to now, there needed to be both goods and services in the mix.

For more details on the draft VAT law, please refer to KPMG's publication via this link.

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HONG KONG SAR

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Proposed tax concession for family offices in Hong Kong SAR

Further to the Hong Kong SAR government's consultation on the proposed family-owned investment holding vehicles (FIHVs) tax regime in March 2022 (see KPMG's previous tax alert), the Inland Revenue (Amendment) (Tax Concessions for Family-owned Investment Holding Vehicles) Bill 2022 (the Bill) was gazetted on December 9 2022 and set out the draft legislation for the regime.

The tax concession

Under the concessionary regime, assessable profits derived by an FIHV from qualifying transactions and incidental transactions (subject to a 5% threshold) will be taxed at a 0% profits tax rate if the specified conditions are met. The tax concession will apply retrospectively from the year of assessment (YOA) 2022/23 upon enactment of the Bill into law.

The key requirements for an FIHV are that:

- It must be an entity with its central management and control (CMC) exercised in Hong Kong;
- At least 95% of its beneficial interest is held by one or more members of

a family (the broad definition of "a member of the family" can be referred to Appendix 1 of this publication); and
- It must not be a business undertaking for general commercial or industrial purposes.

The concession extends to cover special purpose vehicles held by an FIHV which are set up solely for holding and administering specified assets (i.e., Schedule 16C assets) and/or investee private companies (i.e., a family-owned special purpose entity, or FSPE).

The key requirements for an eligible single family office (an ESF office) are that:
- It must be a private company with its CMC exercised in Hong Kong;
- It must provide services to an FIHV (and its FSPEs and IFSPEs (a special purpose entity that is indirectly held by an FIHV and interposed between an FSPE and an investee private company)) and/or member(s) of the family (specified persons) and the related service fees must be chargeable to Hong Kong profits tax;
- At least 95% of its beneficial interest is held by one or more members of the relevant family; and
- It must satisfy the safe harbour rules.

Transactions eligible for the tax exemption

An FIHV may enjoy a tax exemption for profits derived from the following transactions:
- Transactions in Schedule 16C assets (qualifying transactions); and
- Transactions incidental to the carrying out of qualifying transactions (incidental transactions), subject to a 5% threshold.

The qualifying transactions must be carried out or arranged in Hong Kong by or through an ESF office.

The tax exemption for an FSPE also covers profits from transactions in:
- Specified securities of, or issued by, an investee private company or an IFSPE;
- Rights, options or interests in respect of the specified securities; and
- Certificates of interest or warrants to subscribe for, or for the purchase of, the specified securities.

If an FIHV or an FSPE has derived assessable profits from both (i) transactions eligible for a tax exemption and (ii) non-qualifying transactions during a YOA, only those assessable profits derived from non-qualifying transactions will be subject to profits tax.

Minimum asset threshold

The aggregate net asset value (NAV) of Schedule 16C assets held by one or multiple relevant FIHVs managed by the ESF office must be not less than HK$240 million (about $31 million) as at the end of the basis period of a YOA.

In computing the aggregate NAV, (i) the NAV of Schedule 16C assets of the FSPEs held by the relevant FIHVs will count and (ii) a maximum of 50 relevant FIHVs that are managed by that office can also be included upon an irrecoverable election.

Substantial activity requirements

During the basis period of a YOA, each FIHV must meet the minimum economic substance requirements and the adequacy test.

For more details on these requirements, as well as other features of the regime – such as exceptions to the tax exemption, anti-round tripping and anti-avoidance provisions, etc. – please refer to KPMG's publication here.

KPMG observations

KPMG welcomes the adoption of numerous refinements to the FIHV tax regime by the government based on the feedback received during the consultation exercise. However, there are still issues that have not been addressed and that may impact the attractiveness of the regime (detailed discussion on the key features of the regime can be accessed via this link).

It is understood that the FIHV tax regime will be regarded as a preferential tax regime in Hong Kong for the purpose of the specified income exclusion under the revised foreign-sourced income exemption (FSIE) regime. As such, foreign-sourced dividends, equity disposal gains and interest income derived by an FIHV or FSPE, though it may not be tax exempt under the FIHV tax regime, may be excluded from the FSIE regime and continue to be non-taxable.

Given that the draft legislation of the FIHV regime is complex, family offices which currently operate in Hong Kong or plan to be set up in Hong Kong should evaluate how the specified conditions in the regime can be fulfilled and consider whether any changes to the investment holding structure/business models are required.

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INDONESIA

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Classification of tax objects and determining sales value for land and building tax

The Minister of Finance (MoF) has issued PMK-234 to amend MoF regulation PMK-186, concerning the "classification of tax objects and the procedure in determining the sales value of taxable objects for land and building tax (LABT)". PMK-234 became effective on January 1 2023.

The main changes between PMK-186 and PMK-234 include: the definition of a tax appraiser, additional information on taxable objects, exclusion of tax objects and the issuance of tax assessment letters. Under the amended regulation, the Directorate General of Taxes (DGT) may conduct a field assessment based on the LABT Return.

Extension for electronic certificates, EFINs and verification codes

On January 3 2023, the DGT issued PENG 1/2023, concerning the extension for electronic certificates, electronic filing extension numbers (EFINs), and verification codes. The announcement is related to the renewal of the core tax administration system and redesign of the tax administration business processes as stipulated in MoF regulation PMK-63.

PMK-63/2021 outlines the provisions regarding electronic certificates issued by the DGT in accordance with PMK-147/2017, which were valid until December 31 2022. However, the DGT has not issued technical provisions related to signing electronic documents and using electronic certificates in accordance with PMK-63/2021.

The PENG 1/2023 announced that electronic certificates, EFINs, and verification codes shall remain valid until the electronic certificates and authorisation codes of the DGT are available in the DGT information system.

As for the electronic issuance, signing and delivery of decisions or decrees processed automatically through the DGT website using non-certified electronic signatures, these can still be done until a certified option is available in the DGT information system.

Table 1

Partner Country	MoF Regulation Number
ASEAN Countries*	221/PMK.010/2022
Australia	222/PMK.010/2022
Korea	223/PMK.010/2022
China	224/PMK.010/2022
Japan	225/PMK.010/2022
New Zealand	226/PMK.010/2022

Notes
- ASEAN countries in this regulation refers to 10 countries: Brunei Darussalam, Cambodia, Indonesia, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam and Laos;
- A CEPA for India has yet to be implemented; and
- If the most favoured nation (MFN) import duty tariff rate is lower than the preferential import duty as stipulated in the regional CEPA, the applicable import duty tariff is the MFN.

Regional Comprehensive Economic Partnership Agreements

To implement regional Comprehensive Economic Partnership Agreements (CEPAs) or free trade agreements (FTA), the MoF has issued several regulations determining import duty tariffs effective from January 2 2023. The list of MoF regulations is shown in Table 1.

These regulations generally stipulate as follows:

- The preferential import duty tariff for imported goods from ASEAN countries follows the regional CEPA; and
- The differential import duty tariff is applied to imported goods from ASEAN countries, if:
  - The imported goods classification is included in the appendix of the relevant MoF regulation; or
  - It is based on the examination result, the goods' classification is included in the appendix of the relevant MoF regulation.

Republic of Korea

To implement the CEPA between Indonesia and the Republic of Korea, the MoF issued regulation PMK-227 concerning the determination of import duty between the two countries. PMK-227 is effective from 1 January 2023.

This regulation stipulates that the preferential import duty tariff for imported goods from the Republic of Korea follows the CEPA with Indonesia.

If the MFN import duty tariff rate is lower than the preferential import duty as stipulated in the agreement, the applicable import duty tariff is the MFN.

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NEW ZEALAND

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New Zealand Inland Revenue updates anti-avoidance guidance after Supreme Court decision

The New Zealand Inland Revenue issued Interpretation Statement: Tax Avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007 (the 'Interpretation Statement') on February 3 2023.

The Interpretation Statement sets out the Commissioner of Inland Revenue's (the 'Commissioner's') view on how New Zealand's general anti-avoidance rule (GAAR) applies and replaces the previous interpretation statement that was issued in 2013. Of relevance to the updated Interpretation Statement is the Supreme Court's decision in *Frucor* delivered in September 2022.

The GAAR

The GAAR provides that a tax avoidance arrangement is void as against the Commissioner and that the Commissioner may counteract a tax advantage obtained from or under a tax avoidance arrangement. A tax avoidance arrangement has tax avoidance as its sole purpose or effect, or if it has more than one purpose or effect, tax avoidance is more than merely incidental to any other purpose or effect.

In determining whether an arrangement has the purpose or effect of tax avoidance, the 'Parliamentary contemplation test' as set out in the Supreme Court case *Ben Nevis* has been adopted as the authoritative approach by New Zealand's courts, including by the Supreme Court in *Frucor*.

The Commissioner's approach to the GAAR

The Interpretation Statement sets out the Commissioner's approach to applying the GAAR in detail, which can be summarised as the following steps:

- Understanding the legal form of the arrangement;
- Ascertaining Parliament's purpose for the specific provisions involved;
- Understanding the commercial and economic reality of the arrangement as a whole;
- Considering whether the arrangement makes use of, or circumvents, the specific provisions in a manner consistent with Parliament's purpose;
- Deciding whether there is a tax avoidance purpose or effect; and
- If tax avoidance is not the sole purpose or effect of the arrangement, whether the tax avoidance purpose or effect is merely incidental.

Supreme Court decision in Frucor

In September 2022, the Supreme Court delivered its decision in *Frucor*, under which the Commissioner was successful in arguing that the GAAR applied to a cross-border financing structure on the basis of interest deductions being claimed in excess of the economic funding cost under the structure.

While the *Frucor* decision adopted and applied the Parliamentary contemplation test as set out in *Ben Nevis*, the approach of the Supreme Court majority could be considered to have applied a broader economic substance test, with much emphasis placed on the impression the structure gave.

The Interpretation Statement, while generally following the same thrust as the previous version, reflects the approach in *Frucor* and provides that the Commissioner's approach also places greater emphasis on the economic substance of arrangements.

Practical considerations

The Interpretation Statement is not technically binding on the Commissioner; however, from a practical perspective, it is of use to taxpayers as a risk analysis tool because it provides an updated statement as to the Commissioner's approach to the GAAR.

Although not addressed in the Interpretation Statement, also of relevance to taxpayers is the liberal approach to the imposition of shortfall penalties by the Supreme Court in *Frucor*, which may necessitate an increased threshold for taxpayer certainty as to the GAAR's application before implementing structures.

As a result, a continuing trend of caution is expected from businesses when engaging in structuring and considering the potential application of the GAAR, with likely continued reliance on the ability to obtain binding rulings from Inland Revenue before implementing structures.

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Lifting the corporate veil on tax planning

Sanjay Sangvhi and Sahil Sheth of Khaitan & Co explore this legal concept and its implications for companies doing business in India.

Sanjay Sanghvi

Sahil Sheth

Lifting or piercing the veil of corporate means ignoring the separate legal identity of the company and to look back at the true owners or promoters who control the company. The norm among common law jurisdictions was that the corporate veil should not be lifted under normal circumstances.

However, with the passage of time and the growing complexity of transactions and the laws which govern them, courts have become more agreeable to piercing the corporate veil and to go behind the curtain of a corporation when needed and look back at the real nature of the transaction and the persons responsible for it and this trend has been particularly strong and used in case of tax matters.

In the past few years, the Income-tax Act has gone through a paradigm shift wherein several measures have been introduced to combat tax evasion and move towards more 'substance' based taxation. One such measure was introduction of 'general anti-avoidance rule' (GAAR) with effect from April 1 2017.

GAAR codifies the doctrine of 'substance over form' where the intention of the parties, real effect of the transactions and the purpose of an arrangement are considered for determining the tax consequences.

Hence, it can be said that the doctrine of 'piercing the corporate veil' has now taken a new avatar in the form of GAAR which is a highly sophisticated anti-evasion statutory tool.

Evolution of the corporate veil doctrine

In the late 19th century, the judgment in the classic case of *Salomon v Salomon* [(1897) AC 22] was passed, ruling that a company is a separate legal entity distinct from its members and in doing so protected Aron Salomon, the founder of A Salomon and Company, Ltd, from being personally liable to the creditors of the company he founded. Hence, this became the first jurisprudence dealing with the concept of lifting the corporate veil.

The corporate separate identity of a corporation can be pierced in situations where this identity is used as a shield covering wrongful or illegal tasks or used to conceal or defend the actual persons in control of the corporation and masterminds behind the transactions.

Some exceptions to lifting the corporate veil have been explicitly identified in statutes and some others have been developed through judicial precedents, which have evolved and enhanced the law and the principles for piercing the corporate veil of corporations, over time.

Analysis of the doctrine in India through legal jurisprudence

Corporate entities with their structures are used as means of reducing tax liability by minimising tax exposures. This kind of structuring and minimised tax liabilities triggered application of the doctrine of corporate veil to tax matters.

The expectation by piercing the corporate veil, was to identify the tax evaders and to try recovering the loss made by the exchequer. As tax laws evolved and the tax department and courts became more vigilant, there were series of tax cases where the doctrine was discussed and applied.

Some significant judicial observations are worth noting here:

- In *Sunil Siddharthbhai v CIT, Ahmedabad* [[1985] 156 ITR 509], the Hon'ble Supreme Court (SC) held that "to determine whether a transaction is a sham or illusory transaction or a device or ruse, tax authorities are entitled to lift the veil covering it and ascertain the truth".
- In *CIT v Sri Meenakshi Mills Ltd and Others* [AIR 1967 SC 819], the Hon'ble SC, while applying this doctrine, observed that from the juristic point of view, "a company is a legal personality entirely distinct from its members. But in certain exceptional cases, courts are entitled to lift the veil of the corporate entity to see through the economic realities behind the legal façade".
- In *Life Insurance Corporation of India v Escorts Limited* [AIR 1986 SC 1370], the Hon'ble SC asserted that corporate veil may be lifted in cases where the "aim is to avoid a taxation statute or to evade obligations imposed by the law or for the protection of public interest".
- In *McDowell & Co Limited v CTO* [[1985] 154 ITR 148 (SC)], it was observed that taxpayers "cannot be allowed to get away with any colourable device or artificial sham transaction". Therefore, it becomes an important function of the tax authorities to investigate the devices and nature of transactions used by the taxpayer and decide upon the true character and nature of such devices and transactions.
- In *Juggilal Kamlapt v CIT* [[1970] 75 ITR 186], the Hon'ble SC held that it is well established that the "income tax authorities are entitled to pierce the veil of corporate entity and look at the reality of the transaction". The court has the power to disregard the corporate entity if it is used for tax evasion or to overcome tax obligation or to carry out any fraud. However, the court also cautioned that this doctrine is to be applied only in exceptional circumstances and not as a routine matter.

Recent jurisprudence

- In *Ajay Surendra Patel v DCIT* [[2017] 394 ITR 321], an investigation revealed that the company was set up as a public limited company, but immediately after incorporation and commencement of business, it had partaken the character of a private limited company as public had not been invited to subscribe to the share capital of company. The Gujarat High Court found that the company was formed only to provide accommodation entries in the form of bogus share capital and share premium after induction of the taxpayer as director and substantial cash flow and significant increase in capital and certificate of commencement of business was also obtained by company only after taxpayer joined. Further, during the taxpayer's tenure as director, he held 98.33% shareholding and after his resignation, substratum of company eroded, and it was left with huge liabilities. Hence, it was held that the company was a de facto private limited company, and the Income Tax Department was justified in uplifting of corporate veil to hold the person liable for tax demand against the company.
- In *CIT v MAC Public Charitable Trust* [[2022] 144 Taxmann.com 54], the Madras High Court held that there is no bar to apply the doctrine of lifting corporate veil in the case of trusts and that the same applies in situations relating to tax evasion, and in cases where public interest and noble policy are sought to be defeated by fraud.

Fairness for whom?

Lifting of corporate veil in international transactions

1) *Vodafone International Holdings BV v Union of India* [[2012] 341 ITR 1]

Vodafone International Holdings BV (Vodafone) a Netherland entity purchased 100% holding in CGP Holdings limited (CGP), a Cayman Island company from Hutchinson Telecommunication International (HTIL).

CGP investments had a fully owned subsidiary in Mauritius. CGP directly / indirectly controlled 67% of Hutchinson Essar Limited (HEL), a joint venture company of the Hutchinson group (foreign investor) and the Essar group (Indian partner). HEL had obtained telecom licenses to provide cellular telephony in different circles in India from November 1994.

The revenue authorities held that by virtue of holding of shares in the foreign entity, the transaction per-se involved a transfer of capital asset situated in India which gave rise to income chargeable to tax in India, i.e. the revenue authorities lifted the corporate veil and held that transfer of shares from CGP to Vodafone resulted in an indirect sale of shares in HEL and therefore the transaction ought to be subject to tax in India.

Further, the revenue authorities disregarded the legal character of the transaction in pursuit of 'substance' and held that the transfer of shares from CGP to Vodafone resulted in indirect sale of shares in HEL. The revenue authorities, by lifting the corporate veil, attempted to tax capital gains arising on transfer of shares of a foreign company of an Indian subsidiary, on the basis that such transfer involves an indirect change in controlling interest in underlying Indian entity.

The case had reached to the Supreme Court, where a 3-judges bench overturned the decision to pierce the veil as held by Honourable Bombay High Court and noted that "it is common for foreign investors to enter India through foreign holding companies and special purpose vehicles (SPVs), which have been recognized by Indian corporate, securities and even tax laws" and observed that:

"Lifting the corporate veil doctrine is readily applied in the cases coming within the Company Law, Law of Contract, Law of Taxation. Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction."

2) *Richter Holding Limited v ADIT* [[2011] 243 CTR 149 (Karnataka High Court)]

Richter Holding (a Cyprus-based company) and West Globe Limited acquired 100% shares in Finsider International Company Limited (registered in the UK). Finsider in turn held 51% shares in Sesa Goa Limited, an Indian company. The Indian tax authorities sought to tax the transaction under the head of capital gains.

Against the said action, Richter Holding filed a writ petition before the Karnataka High Court and relied on the Vodafone case to argue that acquisition of shares in an offshore company does not amount to acquisition of immovable property or control of management in an Indian company, and "it is only an incident of ownership of the shares in a company which flows out of holding of shares."

Moreover, it argued that controlling interest in a company is not identifiable as a distinct asset capable of being held. The tax authorities, on the other hand, contended that the transaction resulted in an indirect transfer of 51% interest held by Finsider in Sesa Goa, which is subject to Indian taxation.

In its judgment, the Karnataka High Court refused to be drawn into the merits of the taxation dispute, however the court allowed the tax authority to lift the corporate veil to ascertain the true transaction and held that: "It may be necessary for the fact-finding authority to lift the corporate veil to look into the real nature of [the] transaction to ascertain virtual facts. It is also to be ascertained whether [the] petitioner, as a majority shareholder, enjoys the power by way of interest and capital gains in the assets of the company and whether transfer of shares in the case on hand includes indirect transfer of assets and interest in the company."

> **"The Court can always lift the corporate veil and examine the substance of the transaction"**

Landmark case where court refused to lift the corporate veil

In *Azadi Bachao Andolan v Union of India* [(2003) 263 ITR 706 (SC)], in the context of India-Mauritius Tax Treaty, the court held that even if a transaction has been entered into with the primary motive of avoiding tax, such transaction would not become a colourable device and thus not result in disqualification.

Here, the court relied the judgment of Westminster case and held that "an act which is otherwise valid in law cannot be treated as non-est merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents." The court in this case also made a distinction between 'tax planning' and 'tax avoidance.'

Illustrations where corporate veil lifting may be considered

1) *Fraudulent conduct:* Where it appears that any business of the company has been carried on with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, if the court thinks it's appropriate, the people who are knowingly a party to such a fraudulent act may be made personally liable.
2) *Ultra vires act:* Directors and other principal officers of the company will be personally liable for all those acts which they have been done on behalf of a company if the same are ultra vires any law.
3) *Sham transactions:* The most widely accepted meaning of sham is that provided by Lord Diplock in *Snook v. London & West Riding Investments*, [1967] 1 All ER 518, where it was observed to include 'acts intended to give third parties the appearance that certain legal rights and obligations have been created, which are different from the actual legal rights and obligations (if any) which the parties intend to create'. It basically covers transactions which are made to mislead or deceive others.
4) *Colourable device:* A colourable device is a "dubious" method or a method which is unfair and used for reduction or avoidance of a tax liability and differs from fraud to the extent that fraud results in evasion of an existent liability, whereas a colourable device is a method of avoidance that is not within the legislation. The introduction of a GAAR regime also influences the interpretation of what may be 'considered colourable.'
5) *Non-payment of tax:* When any private company is wound up any tax assessed on the company whether before or in course of liquidation, in respect of any previous year cannot be recovered, every person who was director of that company at any time during the relevant previous year shall be jointly and severally be liable for payment of tax.

To sum up the above, under Indian tax law, it would only be possible to disregard the corporate structure where (a) the structure is used to fraud the revenue department or colourable device is entered into to avoid tax or (b) a sham transaction intended to mislead or deceive others.

Introduction of GAAR

It is a sophisticated anti-tax avoidance law to curb tax evasion and avoid tax leaks and came into effect on April 1 2017 and is applicable from Assessment Year (AY) 2018-19 and onwards. It is intended to check aggressive tax planning especially that transaction or business arrangement which is/are entered into with the objective of avoiding tax and lacks 'commercial substance'.

GAAR would apply to a tax arrangement which may be declared to be an 'impermissible avoidance agreement' (IAA). In effect, GAAR codifies the doctrine of 'substance over form' where the real intention of the parties and purpose of an arrangement is considered for determining the tax consequences, irrespective of the legal structure of the concerned transaction or arrangement.

Hence, the doctrine of piercing corporate veil has taken up a new avatar in form of GAAR. This is the first time the Indian tax regime has unambiguously adopted a 'substance over form' approach. Introducing the GAAR takes India into the league of several other tax jurisdictions which have used an anti-avoidance rule.

The Income Tax Act (1961) as it stood before the introduction of GAAR, did not have the explicit provisions for 'looking through' the transactions. However, GAAR has implicit provisions for the lifting of corporate veil.

Piercing of the corporate veil

In *Federal Coke Co Ltd v FCT* [(1977) 7 A.T.R. 519], it was noted that "in taxation matters, the court is obliged to have regard to the actual facts and not to their equivalents. Where there is no statutory warrant for doing so, the court cannot disregard certain facts or re-arrange the facts or decide the case according to its view of the substance of the matter. It is not legitimate to disregard the separateness of different corporate entities or to decide liability to tax upon the basis of the substantial economic or business character of what was done".

In Slutzkin v FCT [(1977) 140 C.L.R. 314], it was held that 'taxation is one area where the courts have been most amenable to lifting the veil'. Further, the Asprey Report (Taxation Review Committee Full Report) has recommended that "it is in principle necessary to go behind the veil of separate legal personality which the company enjoys and translate the tax into a set of individual tax burdens".

In *Apthorpe v Peter Schoenhofen Brewing Co* [(1899) 4 TC 41], UK company was formed for the purpose of acquiring a brewery in the US on the property of a US company consisting of five persons, who then became vendors of all the shares (except three) in, and of the property, plant, and business of, the US company. The larger number of the shares in the UK company were held in the US and the manufacture and sale of the beer was carried on in the US. The directors of the UK company had the entire right of control over the affairs of the US company and of the business in the US, but they delegated their power to a committee of management, consisting of the former directors of the US company. A portion only of the profits, sufficient to pay the dividends due to UK shareholders, and the expenses in the UK, were remitted to this country and the dividends of the shares in the UK company, held in the US, were paid in the US. It was held that the business being carried on in this country, the UK company was assessable to income tax under the First Case of Section 100, Schedule D.

In another case, *Firestone Tyre & Rubber Co. v Llewellin* [[1957] 1 W.L.R. 464], a US company had an arrangement with its distributors in continental Europe whereby they obtained supplies from the UK manufacturers, its wholly owned subsidiary.

The UK company credited the US company with the price received after deducting the costs plus 5%. It was conceded that the subsidiary was a separate legal entity and not a mere emanation of the US parent company, and that it was selling its own goods as principal and not its parent's goods as agent.

It was observed that these sales were a means whereby the US company continued its European business and evade the taxes, and it was held that the substance of the arrangement was that the US company traded in the UK through the agency of its subsidiary. In this case, the corporate veil of the company was lifted.

Concluding comments

The facets of this doctrine are only an illustrative list of the non-exhaustive interpretation accorded by judicial precedents. As stated, the principle is ever expansive and is applied as per the facts and circumstances of a given case.

However, in sum and substance, the application of the doctrine will revolve around, facts of each case and the identity of the person(s) involved in the misdoings and taking a holistic view of the matter.

It can be said that the approach to be adopted by the tax department is to determine the dominant purpose of a structure or transaction by paying heed to certain indicators, which include the duration of the holding structure, the period of business operations and generation of taxable revenue in the Indian domestic economy as well as the timing of the exit and continuity of business after exit.

The following circumstances are not (in themselves) sufficient to pierce the veil although they may be relied upon to support allegations of fraud, agency, colourable device, and sham:

- A controlling shareholding interest
- Lack of business activities or transactions
- Poor corporate governance practices such as investments and divestments being made without requisite due diligence and opinion from experts.
- Common directors across group companies.

The following propositions could seem a fair conclusion:

a) Tax planning is an entitlement of the taxpayer within the boundaries of law.
b) Any genuine attempt of planning to streamline the financial and economic affairs of a corporate should not be discouraged and doubted.
c) Tax incentives availed by taxpayer should be within the ambit of legitimate tax planning and applicable tax laws.
d) Tax planning should not involve use of colourable devices for evading tax liability.

Accordingly, the use of corporate entity in tax planning is legally valid provided its use within the contours of law and are not used for tax evasion. The intention of a transaction should be viewed holistically from a business point of view, and it should be determined whether making tax savings was the primary driver or only a collateral benefit in a legitimate commercial transaction.

Tax authorities would be expected to take a balanced and reasonable view while dealing with such transactions and strive to determine whether the transaction done in good faith even if has resulted in some tax saving would be tantamount to tax evasion.

Considerations such as economic reality and the substance of the transaction should be critically evaluated, and unless there are compelling circumstances, one will have to respect the sanctity of the corporate veil and the independent corporate personality that comes into existence upon incorporation of a company.

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The tax challenges of global mobility

Sandy Markwick, head of the Tax Director Network at Winmark, looks at the challenges of global mobility for tax management.

Sandy Markwick

Despite the increasing phenomenon of employee 'mobility' and associated tax risks, 40% of large international companies still do not have formal tax and payroll guidelines in place to manage the challenge.

That statistic comes from our survey of in-house tax directors undertaken on the phenomenon of the 'mobile' workforce, in which employees spend extended periods of time outside the jurisdiction of their employer.

Global mobility is a longstanding tax management issue in large international groups made more acute by lockdowns during the COVID-19 pandemic. Businesses, especially those in service industries, demonstrated that it was possible for employees to be effective while working remotely, which provided an impetus for people to choose to work from other countries out of choice or to provide care for their families.

The phenomenon has become a legacy of the pandemic as hybrid working patterns are sustained. More than half of tax directors in the Tax Director Network (TDN) survey reported higher, or significantly higher, levels of requests to carry out work outside their home countries than before the pandemic.

The associated issues take up a disproportionate amount of time in in-house tax functions, though the degree to which this issue affects tax directors will vary according to global footprint, business model and corporate culture as well as the extent to which cross-border working is required or deemed desirable.

The main tax concern is that, in allowing employees to work in other jurisdictions, companies are creating a taxable entity. When determining whether a permanent establishment (PE) threshold has been reached, local tax authorities will consider a number of facts and circumstances, such as the frequency of visits, the length of time of each visit and the cumulative presence (counting time spent by different employees from the same company).

The nature of activity is important too; if the activity is 'preparatory' or 'auxiliary' it may avoid PE status.

Other issues might include whether a business is reimbursing employees for use of an office at home or whether a desk is available to people in a jurisdiction – considered indicators that business premises are at the disposal of the company and may encourage an assessment that the operations constitute a PE for tax purposes.

There will be a significant degree of interpretation as well as domestic law considerations and reference to tax treaties between relevant jurisdictions that will determine whether a fixed place of business or an agency arrangement results in a permanent establishment.

Considerations

There are lots of specificities to consider and local practice differs dramatically. The commentary to the OECD's Model Convention is the best source of guidance.

Your location can mean a lot to your company

In terms of geography, Asia emerged as the region presenting the highest risks from global mobility according to the TDN survey. As far as individual countries are concerned those presenting the highest risks were perceived to be India followed by China and the US. In Europe, Italy was seen as the highest risk jurisdiction.

A complementary issue concerns payroll withholding requirements or registration requirements for payment and reporting.

At the same time, there are multiple considerations outside tax, such as the legal status of employees; pay and benefits; data security associated with people working outside company premises; data privacy connected with employees' personal travel arrangements; regulatory compliance; and company law-related registration.

The wide-ranging impact underlines the need for central coordination across groups. That means a clear agreement within the organisation about who is part of the decision-making process and who is ultimately responsible.

Having processes in place to manage requests is likely to be more cost effective than referring to advisers on a case-by-case basis, especially where the costs of preventing risks from crystallising outweigh the risk in material terms.

Accompanying guidelines should cover the various categories of relevant travel (business, personal, cross-border etc.). How far is the business willing to accommodate requests? To what extent is a business rationale required?

Find consistent rules to take account of most cases. Companies will never be able to eliminate risk completely. As is always the case with tax management, companies will also take into consideration the notion of materiality in balancing costs of compliance with tax risk liabilities.

The need for guidelines

Once guidelines are in place it is important to ensure there is supporting communication and education across the business.

For the most part, central control of global mobility is an HR responsibility – that was the case in two-thirds of respondents in the TDN survey. Among respondents, 22% reported that the tax function had final responsibility.

In any case, there is a requirement for the tax function to collaborate closely with non-tax colleagues to manage these issues, not just with HR colleagues but with those in IT, risk, data, legal and commercial teams.

It is a big task keeping track of multiple requests to work overseas across a large group, especially considering the variety of facts and circumstances, details of relevant treaties and payroll guidelines, and conditions applied as part of company rules.

The large advisory firms as well as boutique providers are developing software tools to help manage this, an area that is ripe for automation as long as the tools have the sophistication to allow users to apply their own rules. Around 70% of respondents said they plan to automate processes to manage global mobility requests and monitoring.

Tracking and monitoring travel and return dates may lead to additional benefits in the form of commercial insights. At the heart of much of the global mobility challenge is a 'people' issue in which businesses will want to balance sensitivity and flexibility with consistency and fairness.

There may also be significant competitive pressure to accommodate requests for flexible working arrangements, not just at senior executive levels but beyond, especially in the context of tight labour markets where this is an additional incentive to attract and retain talent beyond remuneration.

ISRAEL

Yaron-Eldar Paller Schwartz & Co

Henriette Fuchs

Israel jumps on board the digital and crypto tax bandwagon

Israel's proposed Budget Law 2023–24 shows the new government is rolling up its sleeves to get to work on the tax front.

The tax proposals, inter alia:

- Encourage a more affordable housing market by limiting tax breaks on residential property;
- Combat improper conduct regarding VAT receipts;
- Force partial payment of tax debt, although an appeal is pending in court;
- Limit the amount of cash used for transactions; and
- Cancel the 0% VAT benefit for tourism-related services and hotels.

Other significant proposals seek to cut a tax slice from, and to regulate, digital business; create a VAT charge on certain digital services offered by foreign providers; and find ways to tax income from, and regulate, digital asset dealings.

VAT registration obligation for foreign B2C digital service providers

The Israeli government has proposed an amendment to the Value Added Tax Law, 1975, in an effort to facilitate the collection of VAT on digital services purchased by Israel residents from foreign suppliers.

Today, the responsibility for the payment of the 17% VAT, on incoming services from non-resident businesses, rests on the Israeli resident recipient. The amendment seeks – in line with the OECD's developing plans and recommendations – to obligate those non-resident service providers to register in Israel and charge, collect and pay VAT. The creation of a VAT registration obligation for non-residents was first proposed in 2016, and appeared in several other legislative proposals, none of which made it to the finish line.

The creation of a VAT charge on incoming digital transactions should first and foremost neutralise the perceived 'economic discrimination' of local businesses providing similar services and that charge VAT to their local customers. But an expected income of $100 million in 2023 – and then of about $140 million each following year – is an interesting forecast for the treasury in Jerusalem.

The memorandum of the proposal of law explains that a digital service is a "service provided through the internet or by other electronic means, allowing brokerage for service providers and the sale of intangible goods, including visual or audio content, remote teaching, entry and use of applications, authors content, games etc". Television, broadcasting services and services provided by the transfer or receipt of signals, words, sounds, images, etc. through a fibre optic cable, radio transmission or other electromagnetic system would also fit the bill.

VAT on services to VAT-registered businesses, NGOs and financial institutions can already be self-reported (by reverse charge) and paid by these entities. The disadvantage for the last two types of organisations is that they are not eligible to offset the input VAT they charged themselves and it becomes a hefty cost.

The bill does not yet specify the manner of registration or reporting. The Minister of Finance shall set out, in new regulations, how foreign VAT-registered businesses registered in the special foreign providers registry should act, manage records and retain documentation for at least seven years (including data regarding the service provided, presentable within 30 days upon demand by the tax assessor).

The plans shall come into effect the moment that legislation is accepted and published as law by Israel's parliament, unless the law indicates a specific date and any grandfathering rule. The draft will definitely incur some changes in the last legislative phase now before us.

A framework to enforce tax on digital assets

The draft bill presents a framework for the organising of, and infrastructure pertaining to, digital assets and their trading, including regulatory, security and banking law.

The proposal classifies 'digital currencies' as assets for the purpose of income tax and VAT law. The profit on a sale or an exchange of a virtual currency is subject to gains tax at a 25% rate. Non- and incorrect reporting can trigger criminal proceedings and penalties.

The draft law prescribes, inter alia, how the historical cost price and date of purchase of a digital asset must be determined, and defines the 'location' of an asset. The latter is pivotal for tax, as domestic- and foreign-held assets result in different Israeli tax rules for different types of taxpayers. The sale of digital assets executed through supervised and licensed entities would be subject to withholding tax and if the appropriate tax has been charged at source, the taxpayer is discharged from further reporting.

Resident taxpayers would have to disclose to the authorities when their digital assets are worth more than ILS 200,000 (approximately $52,000) if they are not held through a qualifying 'supervising entity' on a regulated platform.

The Bank of Israel might create a bank account to which taxpayers could transfer tax due. Today, the payment of tax by a willing taxpayer is a difficult chore; banks in Israel will often not accept transfers that originate from crypto activities, for fear of money laundering. In connection with this, the Supervisor of Banks is to create infrastructure for reporting, to monitor the issuance of licences to entities wanting to facilitate trading in digital assets and to determine whether a bank is rightfully refusing the opening of an account or a transfer.

The draft bill wrestles with decentralised autonomous organisations (DAOs, which are comparable to partnerships) and an inter-ministerial committee will be appointed to establish the corporate and legal status of DAOs and their proper taxation.

The Supervisor on Financial Service Provision would be given the authority – under the Control on Financial Services Law – to license (foreign) entities wanting to provide services, provided they meet all the (new) conditions. A foreign service provider requesting a licence must also convince that it offers adequate protection against financial risks (bearing in mind recent international crypto thefts) and comply with Israel's Prohibition on Money Laundering Law. The government has also published an intention to create infrastructure for services pertaining to backed digital assets.

Not only does the proposal ensure regulatory oversight and financial protection, but the constellation of legislative proposals surrounding digital asset trading may actually encourage foreign players to offer digital asset services in Israel.

The final text of this proposal will be before parliament for approval on May 29.

Heading in a good direction

All in all, Israel may be taking excellent steps to ease crypto trading out of the corner it has been in, but also in opening its borders, which will surely benefit the economy of Israel, a proven leader also in blockchain technologies.

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ITALY

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Intangibles and DEMPE analysis: on tax authorities' radars worldwide

Tax administrations worldwide (including Italy) are paying increasing attention to intra-group transactions involving intangible assets. It is indeed a hot topic.

In particular, tax authorities are focusing on the correct allocation of profits deriving from the exploitation/use of intangible assets, which must take place according to the functions performed, the assets used, and the risks assumed by the companies involved in the transactions.

Mere ownership of the intangible is not sufficient to allow retention by the legal owner of the benefits derived from its exploitation.

Although the legal owner of an intangible may receive profits from its exploitation, other entities of the same multinational entity (MNE) group may have performed functions, used assets, or assumed risks that may have contributed to the value of the intangible. Such entities should be remunerated for their contributions at arm's length.

DEMPE functions

In the above cases, as stated in Chapter 6 of the OECD Transfer Pricing Guidelines, 2022, it is necessary to analyse the so-called development, enhancement, maintenance, protection and exploitation (DEMPE) functions (and associated risks), with the aim of identifying which entity involved in the transaction performs these functions.

- Development – refers to all activities and strategies associated with the conception and creation of the related products, including R&D activities.
- Enhancement – refers to all activities aimed at strengthening the brand(s), understood as recognisability by the customer, externally, and efficiency enhancement of the production process and its supporting technologies, internally. These activities allow the intangible asset to be guaranteed as having successful performance over time and be subject to constant improvement.
- Maintenance – covers all activities carried out to ensure the continuity and profitability of the business. Among other things, the function ensures the maintenance and control of product quality standards.
- Protection – refers to initiatives aimed at maintaining the value of products, in terms of legal protection of intangible assets.
- Exploitation – refers, in a broad sense, to the way in which intangible assets are used to generate benefits.

As such, tax administrations will only recognise the deductibility of the cost of a royalty if:

- The taxpayer succeeds in demonstrating through the DEMPE analysis the allocation of functions and risks between the companies involved in the intra-group transactions; and
- The taxpayer paying the royalty succeeds in demonstrating the financial benefits derived from the exploitation of the intangible asset. For example, the recognition of a royalty due for mere group membership or use of the group's corporate name is frequently challenged by tax administrations.

Similarly, if the group company owning the intangible decides not to charge royalties to the associated properties because the latter contribute to increasing the value of the intangible by performing DEMPE functions, it is advisable to document the analysis performed in order to avoid a potential challenge by the tax authorities.

Case law

The increase in recent case law confirms the importance of DEMPE analysis for MNE groups and a non-uniform approach by courts (sometimes).

Italy is not an exception. In recent case law, tax authorities have used DEMPE analysis in the context of a valuation of intangibles.

In this regard, reference is made to three unpublished decisions issued by the same Turin Court of First Instance, which decided differently on identical cases, albeit with reference to different tax years.

The main issue at stake was the relationship between the parent company of the group (an Italian company) and its foreign subsidiary (an American company). The Italian Revenue Agency challenged the fact that the Italian company, as exclusive owner of a trademark, had not accounted for, or reported, any royalties with reference to tax years 2014, 2015 and 2016.

The company challenged the three tax assessment notices (*Avvisi di Accertamento*), considering that the prerequisites for the charging of royalties by the Italian parent company to the US subsidiary were absent. In addition, the company referred to Article 6.81 of the Transfer Pricing Guidelines, which provides that: "As a general rule, no payment should be recognised for transfer pricing purposes for simple recognition of group membership or the use of the group name merely to reflect the fact of group membership."

The court of first instance upheld the Italian company's appeal for 2014 and 2015, ruling that the American subsidiary:

- Had been completely independent from the Italian company for many decades;
- Was not linked by any legal or shareholding relationship, because it was only a sister company and belonged to the same group; and
- Did not benefit from any support from the Italian company for the development of the brand on American territory.

The judges of first instance ruled out the possibility that this case could constitute a transaction of a transactional nature between the Italian company and the American affiliate, given that:

- The US subsidiary's complete IT, managerial and production autonomy;
- The substantial irrelevance of the trademark (i.e., group name) in supporting the marketing of its products; and
- The lack of connection between the production activity of the American company and the reference to the group name.

Contrary to what was decided regarding the other tax years, the first-instance judges rejected the appeal concerning 2016, having considered that the documentation showed continuous attention by the Italian parent company to the protection of its trademarks and products worldwide.

Furthermore, contrary to the rulings for 2014 and 2015, the judges held that the use of the word trademark resulted in the US subsidiary being charged the relevant royalties.

The discrepancy between the three rulings' outcomes and approaches is evident: the first two applying fully the OECD Transfer Pricing Guidelines (in particular, paragraph 6.81) and the last one not assessing any of the factual and legal circumstances alleged by the party.

A difficult question

From the above, it is clear to see the difficulty of the courts and the Italian tax authorities in applying the OECD's transfer pricing principles with reference to the remuneration of intangibles through the application of DEMPE analysis.

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LUXEMBOURG

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Directors' functions: direct tax, governance, and VAT considerations

Good governance plays an important role in navigating an organisation to success. This explains the increasing demand for professionalised boards of directors in the market.

To meet this expectation and to prepare for future regulatory changes, it is crucial that boards use their authority to establish a functioning organisation and secure remuneration packages. These changes may include limits on the number of mandates a director can hold and a requirement for independent directors.

To ensure an adequate remuneration structure, it is important to determine directors' income tax and VAT status.

In Luxembourg, income tax status is defined in articles 91 and 95 of the Luxembourg Income Tax Law (LITL). It is also determined by a director's mission and responsibilities. Moreover, the LITL refers to the Law on Commercial Companies (LCC) to define the roles of non-executive directors (NEDs), described in Article 59 of the LCC, and executive directors (EDs), described in Article 60 of the LCC.

Proper interpretation of the LITL and LCC is necessary as boards nominate individual directors. Applicable tax obligations may include withholding tax requirements and the ability to deduct directorships' costs. Failing to handle the tax obligations related to directors' fees properly may result in tax penalties for the parties involved.

The changing face of boards of directors

Other important developments in corporate governance are on their way. It is important to note that the promotion of good corporate governance is not self-explanatory.

To mobilise new resources, boards of directors need to realign with a mix of EDs, NEDs, and a sufficient number of independent non-executive directors (iNEDs). Additionally, iNEDs have become a critical element of board diversity; therefore, independent and transparent recruitment processes that prioritise gender balance are needed.

This trend can be observed in regulated industries, specifically in the banking sector, where iNEDs' presence is mandatory on boards, and in the fund industry, where iNEDs' presence is strongly encouraged by the regulatory authority. Present trends, such as creating room for more diversity on boards, can have a positive effect on governance procedures and future expected changes.

Independence also plays a key role in determining the VAT-able status of directors, but this concept may vary from the independence criteria used for corporate tax and governance purposes. The Court of Justice of the European Union (CJEU) has ruled that the EU VAT Directive does not necessarily have a link with other directives.

CJEU cases

The question of whether a director acts independently has recently been referred to the CJEU (C-288/22, the 'TP' case) as a result of a Luxembourgish NED who refused to pay VAT on his directors' fees.

The director argued that he does not act independently because he is a member of the "organ" – i.e., the board of directors – that represents the company. Therefore, he personally does not bear the economic risks related to his activity or any personal obligation or liability towards the company or third parties.

One exception to this rule is when a director clearly exceeds the limits of acceptable conduct, which is a wrongful act separable from the function of director. This argument reflects the opinion of the CJEU in the 'IO' case (C-420/18, June 13 2018), which held that a natural person who was a member of the supervisory board of a Dutch foundation was not a VAT-able person because the person did not act independently and bore no economic risk.

The Luxembourg VAT authorities, on the other hand, argued in the TP case that a director acts independently because, unlike an employee, they organise their activity independently and their position is revocable without delay. Therefore, third parties could find the director responsible for failure to pay VAT.

Potential impact of the CJEU decision

Should the CJEU decide that a director is not a VAT-able person, the decision will have an effect on any EU member state that considers directors to be taxable. It will also reduce or eliminate the administrative obligations of directors and the non-deductible VAT of companies such as banks or holding companies.

Ultimately, it is in directors' best interests to promote a board's independence, diversity, and transparency, thereby better preparing themselves for future challenges, fully contributing to the next level of resource requirements, and seizing new opportunities.

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NORWAY

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Norwegian taxation of partnership investors: an overview

Investor taxation will depend on whether the partnership is considered tax-transparent or not for Norwegian tax purposes.

If the partnership is tax-transparent, the investors are taxed on an annual basis for their proportionate share of the fund income. Norwegian investors are taxable for income from both Norwegian and foreign based partnerships. Foreign investors are taxable to Norway for income derived from Norwegian-based partnerships.

The partnership investors will have to file Norwegian tax returns that include their share of the partnership's profit or loss.

Tax classification

A partnership carrying out economic activities will be considered transparent if at least one of the partners has personal unlimited liability for the fund's obligations and the fund's activities are conducted for two or more of the partners' joint expense and risk.

The assessment of the "personal unlimited liability" criterion will usually relate to the general partner. This condition will usually be fulfilled if the general partner is considered personally liable for the partnership's obligations under the relevant partnership agreement and the domestic law in the partnership's country of registration.

The "joint expense and risk" condition usually means that the general partner must be entitled to a sufficient financial interest. This could be either by having an ownership share in the partnership and thus taking part in its profits and losses like other investors and/or being entitled to carried interest.

The Norwegian tax authorities consider a general partner as having sufficient financial interest in the partnership when having an ownership interest of 0.1% or more, and/or if it is entitled to a share of the partnership's profits in excess of its ownership interest (e.g. carried interest).

Should the conditions above not be met the foreign partnership will be qualified as an opaque entity.

Taxation of the partnership's income

If the partnership is considered transparent for Norwegian tax purposes, the investor is taxed on an annual basis for their proportionate share of the partnership's net income. The taxable income is calculated at partnership level and based on Norwegian tax rules as if it was a Norwegian tax resident. The partnership investments need to be assessed to determine the taxable income that is allocated to the investors for the annual taxation.

The investor is allocated their proportionate share based on ownership percentage. Taxation of the annual profit share applies regardless of actual distributions made from the partnership to the investor. The income is taxed at 22%. But if the partnership income qualifies under the Norwegian participation exemption method it would essentially be tax exempt.

Under the participation exemption method, dividends and realised gains on shares in corporations within the EU/EEA are tax exempt. Losses are not deductible. If the dividend or realised gain relates to a corporation in a low tax jurisdiction within the EU/EEA there is also a substance requirement.

Dividends and realised gains on shares in corporations outside the EU/EEA are tax exempt if the partnership held at least 10% of the shares (both capital and voting rights) for at least two years. Dividends qualify if distributed during this period, while capital gains qualify if earned at the end of the period. Losses are not deductible if the partnership at any time during the two-year period held more than 10% of such shares. Three percent of the tax-exempt dividend is recognised as taxable income (with an effective tax rate of 0.66%). Dividends from corporations in low tax jurisdictions outside the EU/EEA are always taxable.

Net losses must be offset against future partnership income or capital gains upon disposal of partnership interests.

Upon sale of partnership interests, the profit or loss attributable to those interests is allocated between the buyer and seller based on actual ownership months in the sales year. The month of transfer is allocated to the buyer.

Taxation of distributions from the partnership

Repayment of invested capital is not subject to Norwegian taxation for the partnership investors. Distribution of excess profits is subject to an effective tax rate of 0.66% for corporate investors and 37.84% for individual investors.

Taxation of realisation of partnership interests

Realisation of a partnership interest is, as a rule, tax-exempt under the participation exemption method for a corporate investor. However, realised gains are taxable at a 22% tax rate if the value of shares (that do not qualify under the participation exemption) at any time during the two-year period prior to realisation exceed 10% of the partnership's total value of shares. Realised loss is only tax-deductible if the value of disqualifying shares exceeds 10% consecutively over the two-year period prior to the realisation. For personal investors, realised gain or loss is taxable at 37.84%

Exit tax

If a Norwegian investor sells partnership interests in a foreign partnership to a foreign investor, the underlying partnership assets may, if certain conditions are met, be subject to exit taxation.

Opaque foreign entities

If a foreign partnership is considered opaque from a Norwegian tax perspective, the Norwegian investors are only taxed for actual distributions and/or realisation of the ownership interest. For Norwegian corporate investors, the income would be tax exempt if it qualifies under the Norwegian participation exemption method (but 3% income recognition of exempted dividends), whilst individual investors are taxed at 37.84%.

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POLAND

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Mandatory e-invoicing in Poland postponed till July 2024

A European Council derogation decision allowed Poland to introduce a mandatory e-invoicing system starting from January 1 2024 and draft regulation stated this date. However, according to the latest announcements from the Ministry of Finance, it will be postponed to July 1 2024.

The latest plans of the Polish Ministry of Finance regarding obligatory e-invoicing were presented on its website but are still not reflected in the draft law.

The planned changes are significant for taxpayers, especially given that large companies have already started the implementation process, which is very complex and time consuming, and involves substantial financial investment.

The National System of e-Invoices

Polish e-invoices will be issued and received in real time in a standardised XSD format through a governmental clearing system, the National System of e-Invoices (*Krajowy System e-Faktur*, or KSeF).

Each invoice will be validated by the KSeF from a technical perspective. An e-invoice with any technical mistake will be rejected by the KSeF, as well as e-invoices issued by unauthorised entities. When validated positively, the e-invoice will be assigned a unique KSeF ID number and will be made available for the purchaser to download. All invoices will be accessible by the tax authorities.

The clearing model of e-invoicing is against the European Council proposal "VAT in the Digital Age" (ViDA). The same issue will arise in Italy. However, Poland and Italy are likely to receive a derogation due to implementing national e-invoicing before publishing the ViDA provisions (even in draft form).

In fact, e-invoicing has already been introduced in Poland as of January 1 2022 under a voluntary model. Not many taxpayers have switched to standardised e-invoices, although there are incentives to do so. The main benefit is the shorter period of VAT refund (40 days instead of 60 days).

Updates to mandatory e-invoicing in Poland

The first draft regulation regarding mandatory e-invoicing was published by the Ministry of Finance in December 2022 and submitted for public consultation. A lot of comments were raised by business organisations and tax advisers with regard to the technical aspects, but also some of the essentials of the system, such as the scope of obligatory e-invoicing.

From the information on the ministerial website, it seems that a lot of the comments submitted by businesses during the public consultation period were accepted. Apart from the postponement of the starting date for obligatory e-invoicing, other changes included:

- An exclusion from obligatory e-invoicing for B2C transactions – this was one of the main problematic areas for the retail sector, especially with regard to in-store sales. However, for some entities providing mass services (for example, telecommunications, gas or electricity suppliers), it would be easier to implement e-invoicing for both B2B and B2C. It is likely that facultative e-invoicing for B2C will not be possible.
- Small taxpayers exempted from VAT (below the threshold of PLN 200,000, approximately $45,000, yearly) will fall under the KSeF obligation half a year later – starting from January 1 2025.
- An additional half-year postponement (till December 31 2024) for invoices issued from cash registers and for cash receipts as a simplified invoice (with the purchaser's VAT ID and the value of up to PLN 450).
- Specific railway tickets and toll receipts treated as invoices will not be covered by the obligatory KSeF.
- The procedure for system failure – invoices issued offline, but afterwards submitted to the KSeF.
- Sanctions for non-compliance with the KSeF will be softened and postponed till January 1 2025.

Problems with mandatory e-invoicing in Poland

The Ministry of Finance plans to retain the scope of taxpayers covered by the obligatory KSeF as defined in the draft provisions. The system will cover entities established in Poland or entities operating in Poland via a fixed establishment (such as a branch). In practice, the latter creates significant doubts, because the issue of having a fixed establishment is controversial in the EU, which is reflected in many judgments of the Court of Justice of the EU and the Polish administrative courts, and tax binding rulings issued by the tax administration.

The Ministry of Finance plans to issue explanatory notes specifically on the fixed establishment criteria to help foreign companies and their Polish contractors to assess whether a fixed establishment is created in Poland.

Foreign companies registered for VAT purposes in Poland not acting through a fixed establishment will not fall under mandatory e-invoicing. They will still be allowed to issue and receive standard invoices – in electronic form (such as a PDF) or even on paper.

One of the important practical issues while implementing changes in the process is the lack of an option to add attachments to invoices issued in the KSeF system.

There is a significant practical issue for large companies issuing large numbers of invoices to be sent to the central system in batches. The verification will not proceed in 'real time' and may take longer (even a few days). If one invoice fails verification, the whole batch of invoices will be rejected. Moreover, the system will not give any hint as to which invoice was incorrect.

For all taxpayers, one problematic issue is the date of e-invoice issuance, which is defined in the law as the date of submitting an e-invoice to the KSeF when positively validated. This date should be entered into the relevant financial systems for reporting purposes, but it may differ from the date of invoice issuance stated on the invoice itself. Although businesses submitted a lot of comments on the practical issues resulting from this provision, the Ministry of Finance is not willing to change the rule because it is committed to automatic verification of VAT settlements based on the clearance date.

Preparation is essential for taxpayers

The new e-invoicing system is a revolution in invoicing in Poland. Implementing the KSeF is a complex and time-consuming process that involves not only technical aspects, but also the inevitability of making significant changes to processes, internal procedures, contracts, and regulations.

Only comprehensive and early planning for the new e-invoicing implementation process will allow companies to prepare properly for the changes. Taxpayers should start to plan now, to ensure they will be ready on time.

The updated draft of the new legislation is expected soon. However, it will probably not be the final one.

It would be good to have a final version of the VAT Act introducing the obligatory KSeF provisions that will not be changed until its implementation, so all taxpayers would have a stable period in which to prepare for the new e-invoicing regulations.

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ROMANIA

EY Romania

Andra Caşu and Diana Giuşcă

Automatic exchange of financial account information: a new focus for the Romanian tax authorities

The root cause

While Romania commenced exchanges under the Standard for Automatic Exchange of Financial Account Information in Tax Matters (the AEOI Standard) in 2017, the OECD's Peer Review of the Automatic Exchange of Financial Account Information, released in November 2022, led to the conclusion that the country's legal framework does not fully meet the requirements of the AEOI Terms of Reference.

In this respect, Romania's domestic legislative framework requiring reporting financial institutions to conduct due diligence and reporting procedures needed an additional alignment, particularly in relation to the scope of financial accounts and reportable accounts, as well as the due diligence procedures to identify them and the framework to enforce the requirements.

Following the conclusions of the peer review report, Romania has updated its legislative framework and implemented significant changes as regards the obligations of Romanian reporting financial institutions.

New challenges for Romanian financial institutions

In June 2022, Romania published Government Emergency Ordinance No. 102/2022 amending the Tax Procedure Code. The ordinance updates the existing AEOI legislation to transpose the OECD and European Commission recommendations regarding the implementation of the Common Reporting Standard on financial accounts. Additional amendments to the Tax Procedure Code were introduced in February 2023 through Government Ordinance No. 16/2023.

The following main legislative updates have a practical impact at the level of reporting financial institutions in Romania:

- Reporting financial institutions are now obliged to maintain in electronic and/or physical format all the records and documents obtained during tax due diligence procedures and supporting documents of the efforts performed in complying with the Common Reporting Standard or Foreign Account Tax Compliance Act (FATCA) regulations for a period of 10 years from the annual reporting deadline;
- The reporting and tax due diligence procedures with regard to the AEOI in terms of reportable accounts have been updated, which, in practice, require Romanian financial institutions to undergo an internal review of their procedures and update their procedures, processes and IT systems to be able to comply with the new legislative requirements; and
- The National Agency for Tax Administration should perform inspections regarding compliance with the reporting and tax due diligence procedures set out in domestic legislation, and monitor undocumented accounts reported. Upon request by the tax authorities, reporting financial institutions have a 45-day deadline to provide information and documents related to the measures taken, and any evidence they relied on, for the application of tax due diligence and reporting procedures, special tax due diligence procedures, and additional reporting and tax due diligence procedures for the exchange of information relating to financial accounts, including specifically for FATCA purposes.

Moreover, in addition to the legislative amendments, the Romanian tax authorities have published on their webpages the Common Reporting Standard/FATCA Guide for Romanian Financial Institutions, along with other relevant materials and useful links to offer additional support to financial institutions in their reporting and compliance obligations related to the AEOI area.

Risks of non-compliance with the new AEOI rules

In addition to the reputational risks that reporting financial institutions have incurred with regard to potential non-compliance with the AEOI framework, the recent legislative amendments introduced significative administrative sanctions and fines:

- Between €400 and 1,000 (about $427 and 1,069) per each reportable account in the event of inaccurate or delayed reporting;
- Between €1,000 and 2,000 per each reportable account in the event of failure to apply the tax due diligence and reporting procedures in terms of FATCA and the Common Reporting Standard; and
- Between €4,000 and 20,000 in the event of failure to keep all the documentation obtained during the tax due diligence and reporting procedures for 10 years, failure to provide the tax authorities with the requested documentation within the 45-day deadline, or non-reporting of the financial information related to the reportable accounts.

Final thoughts

Considering the strong focus of the Romanian tax authorities towards ensuring correct implementation of the AEOI Standard and the international tax transparency framework, it is expected that enhanced tax inspections will be initiated at the level of the Romanian reporting financial institutions soon.

More than that, given the significant fines (multiplied depending on the number of instances of non-compliance), it becomes crucial that reporting financial institutions apply due diligence procedures in a consistent manner and maintain with high accuracy any relevant information and documents to be able to provide them upon request to the tax authorities.

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