Autumn 2023
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Worlds apart?

The UN's challenge to the OECD

MOORE CASE
TCJA on trial

DISPUTES
Amazon and Meta

FASTER PLAN
EU tax reform

TAX LEAKS
Senator O'Neill

ITR

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Fork in the road

Josh White
Special projects editor

Our cover story takes an in-depth look at the UN proposals to expand the organisation's role in global tax policy, a move that could threaten the pre-eminence of the OECD.

UN Secretary-General António Guterres has presented three options for a new tax convention, and the UN General Assembly will have to decide what course to take. The world may be moving towards a new tax convention – it could be a voluntary framework or a demanding set of standards to rival OECD guidelines.

The UN is a much more open forum for emerging economies, as the OECD has just 38 (mainly wealthy) member states; rising powers such as China and India want the UN to have a greater say on international tax standards.

Multilateralism is difficult precisely because it involves competing interests. This is why the Inclusive Framework was an impressive step towards greater engagement with developing countries, large and small.

Nevertheless, many developing nations in Africa, Asia and Latin America favour the UN taking a bigger role. Meanwhile, the EU and the US still want the OECD to maintain its dominant position in setting standards for tax and transfer pricing.

OECD officials may have made history with the two-pillar solution, but pillar one still hangs in the balance. This is a crucial time for international tax policy – and it could also be the last time that the OECD can play such a role unchallenged by other institutions.

"This is a crucial time for international tax policy – and it could also be the last time that the OECD can play such a role unchallenged by other institutions."

To read more about these issues as we head towards a busy autumn period, look no further than the cover story of our latest PDF publication. In it, you can also find other news and analysis updates as well as a range of expert analysis articles and jurisdictional updates from around the world. We hope you enjoy reading everything on offer.

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MEET THE EDITORIAL TEAM

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Commercial editor

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Market insight

Baker McKenzie welcomes Caracas-based partner

Global law firm Baker McKenzie has added a partner to its Venezuela tax team.

Serviliano Abache Carvajal joins from his own practice, Abache – Abogados (formerly Abache Blanco y Asociados), where he had been for more than 15 years. He also serves as a professor in several law faculties in the country.

Abache's work is primarily focused on areas including cross-border transactions, joint ventures, M&A and transfer pricing.

Private wealth expert joins Excello Law in London

Consultancy model law firm Excello Law has snagged an experienced private client practitioner.

Simon Goldring has more than 35 years' experience in the market and joins from McDermott Will & Emery, where he had been for almost seven years and served as a partner and the firm's London head of international tax and private wealth. Prior to that role, he had spent more than three years as the head of private wealth with Trowers & Hamlins, and almost five years with RadcliffesLeBrasseur in a similar role.

Goldring's work covers the full range of private client practices, including capital tax planning. On the corporate side, he also has experience in the tax structuring of companies, both domestic and international, including in tax-efficient exit strategies for business owners.

Andersen welcomes three managing directors in US

Andersen, the American arm of international tax consultancy network Andersen Global, has made three senior appointments across its tax teams.

The first is **Michael Kenehan**, a new managing director of the Philadelphia office, who joins the team from BDO. He had served as a managing director for more than eight years. Previously he had spent six and a half years working with Kelmar Associates as a senior audit manager.

Kenehan's work is primarily focused on state and local tax. He has more than 19 years of combined experience in abandoned and unclaimed property tax-related matters.

The firm has also added a managing director to its team in Dallas.

Brent Snyder joined the firm from PwC, where he had worked for almost nine years, bringing with him more than 16 years' experience in handling tax and business matters. Prior to PwC, he served as the head of tax at Dallas-headquartered law firm Locke Lord.

Snyder's background is in global compliance, tax planning and due diligence, specialising in US federal tax consulting and related tax accounting for multinational corporations reporting under US GAAP.

In a third Andersen announcement, the firm has hired a managing director in the commercial practice of its Seattle office.

Andrew Liu comes over from EY, where he had been for almost 20 years. His work is focused on financial accounting, income tax reporting, tax compliance, and tax planning in complex tax environments for high-profile Fortune 500 companies.

Andersen Global reinforces presence in Europe, South America and Southeast Asia

International tax consultancy network Andersen Global has continued to build on recent expansions with new additions to its group across the globe.

In the UK this has seen it sign a collaboration agreement with Birmingham-based independent valuations advisory firm Touchstone Advisory. Established in 2021 by current managing director **Krekar Kawani**, the company is focused on financial reporting, tax, independent valuation and commercial sectors. Andersen also signed an agreement with global mobility firm Global Tax Network, whose work includes consulting for employers and assignees, tax policy development, tax return preparation and compliance, social security planning and international payroll consulting.

The network also signed a collaboration agreement with French law firm PDGB in Paris. Led by co-managing partners **Philippe Julien** and **Xavier Hugon**, the firm has been present in the market for more than 40 years and provides an extensive range of services to clients, including international, direct and indirect taxation advice.

In Brazil, the group signed a collaboration agreement with Apsis, an independent valuation firm that has locations in Rio de Janeiro, São Paulo and Belo Horizonte. Led by managing partner **Renata Monteiro**, the firm's team of 130 multidisciplinary professionals has more than 45 years of valuation experience.

The network has also expanded its presence in Asia, signing a collaboration agreement with Singaporean full-service law firm CNPLaw. The firm has been in the market for more than 35 years and is led by managing partner **Lisa Theng**.

Castrén & Snellman strengthens tax team with partner hire

Finnish law firm Castrén & Snellman has boosted its tax team in Helsinki with a new partner.

Janne Juusela joined the firm from Borenius Attorneys, where he had been for almost 18 years. Before that, he had worked for KPMG for two and a half years and spent several years as a tax specialist with the Finnish Ministry of Finance.

One of the most experienced practitioners in the market, Juusela brings with him almost 30 years of experience in the Finnish tax space and regularly contributes to national discussions on tax issues. His work is focused on corporate taxation, international taxation, mergers and acquisitions, and tax litigation.

Baker McKenzie announces 16 tax partner promotions

International law firm Baker McKenzie has appointed 16 tax practitioners to the partnership in the latest round of promotions, which comprises 89 individuals.

Those in the tax space include **Sophie Caulliez**, **Johanna Da Costa** and **Jean-Baptiste Tristram** in Paris; **Susanne Liebel-Kotz** and **Caleb Sainsbury** in Zurich; **Andrew Morreale** in Toronto; **Olivier Dal Farra** in Luxembourg; **Roger van de Berg** in Amsterdam; **Jason Liang** in Kuala Lumpur; and **Luis Zhang** in Shanghai. In the US, the list includes **Young-Eun Choi** (San Francisco), **Stas Getmanenko** (Dallas), **Robert Hammill** (Palo Alto), **Drew Hemmings** (Chicago), **Ross Staine** (Houston) and **Sahar Zomorodi** (New York).

Cuatrecasas bolsters tax practice with PLMJ hire

International law firm Cuatrecasas has expanded its Portuguese tax offering with the addition of a partner to its Lisbon team.

Serena Cabrita Neto joined the firm from PLMJ, where she had served as a partner for 11 years, most recently as the head of the tax department since 2019.

Cabrita Neto is a specialist in tax litigation, representing national and international companies in cases before the tax courts, and exclusively focuses on tax litigation.

Blick Rothenberg expands global mobility team with two additions

Tax, accounting and business advisory firm Blick Rothenberg has added two partners to its global mobility team in London.

Matthew Crawford (top) joined the team from PwC, where he was a tax adviser for almost 10 years. He previously had a similar role at Deloitte. His work is focused on employment taxes and tax investigations.

Rehana Earle (bottom) arrives from Vialto Partners, where she had been the global mobility director for almost a year and a half. Prior to that she worked at PwC for almost 17 years, as a senior manager and director, with prior stints at BDO and Deloitte. Her work is primarily focused on technology.

Three directors appointed at Haysmacintyre

Chartered accountancy firm Haysmacintyre has selected three new directors in its London practice.

Sabina Burke (top) arrives from Carter Backer Winter, where she worked for five years, including as a tax director. Prior to that she spent five and a half years with Beavis Morgan. Her work is focused on corporate transactions, SEIS/EIS tax relief, employee share schemes, international tax planning and R&D tax.

Jon Maddison (middle) has been with the firm for more than eight years, having first joined in 2015 as a trainee chartered accountant. His practice is specialised within the creative, media and technology sectors, and he has experience in audits of AIM-listed entities and publicly listed companies, as well as established private companies and scale-up businesses.

Rakesh Vaitha (bottom) has been with the firm for more than seven years, having previously held in-house audit roles with several companies after more than five years as an audit manager and senior consultant with Deloitte. He is the head of the firm's risk assurance and advisory services, and his experience encompasses internal audit, risk management and governance in cyber security, financial modelling and international advisory services.

Elvinger Hoss Prussen promotes tax partner

Luxembourg law firm Elvinger Hoss Prussen has elevated a partner to its tax practice.

Nadège Le Gouellec had served as counsel with the firm for almost two years, having joined the team from Loyens & Loeff in October 2021. Prior to that, she had spent almost 13 years with her previous firm in a range of different roles.

Le Gouellec's work specialises in Luxembourg and international tax law, advising multinationals and private equity funds on their tax structures in Luxembourg. This advice is primarily focused on M&A, project financing, structured finance, corporate reorganisations and real estate.

Brigard Urrutia appoints partner to Bogotá tax team

Colombian law firm Brigard Urrutia has promoted a partner in its tax practice.

Daniel Duque Estévez has been with the firm since July 2018, having previously spent a year and a half as an international tax services manager with PwC after more than three years as a lawyer with Cuberos Cortés Gutiérrez.

Duque Estévez's work is focused on advising national and foreign clients on issues related to local taxes, tax planning, the application of treaties to avoid double taxation, and compliance with formal tax obligations.

TozziniFreire Advogados welcomes litigation partner

Brazilian firm TozziniFreire Advogados has added an experienced litigator to its tax practice in São Paulo.

Fernanda Ramos Pazello joined the firm from Pinheiro Neto Advogados, where she had served as both an associate and partner for 11 and a half years. It was her second stint with Pinheiro Neto, having previously spent nine and half years at the firm, with a three-and-a-half-year spell as the tax litigation manager for General Motors do Brasil in between.

With more than 25 years' experience in judicial and administrative matters, Pazello brings with her a wealth of knowledge and understanding of the Brazilian market.

Tax litigator joins Baker McKenzie in Hong Kong

International law firm Baker McKenzie has hired a tax disputes counsel to its practice based in Hong Kong SAR.

Stefano Mariani comes over from Deacons, where he served as a partner and head of tax and trusts for more than nine years. Prior to that he served as a barrister at the Chambers of John Gardiner KC in London.

According to the firm, Mariani is the only solicitor-advocate with higher rights of audience who actively represents clients in tax appeals before the Inland Revenue Board of Review, the District Court, the High Court, the Court of Appeal in Hong Kong, and at all stages of civil proceedings. His experience covers corporate taxation and group reconstructions, personal taxation, stamp duties and property taxes, with a particular focus on dispute resolution.

Seasoned tax attorney joins Eversheds Sutherland

Global law firm Eversheds Sutherland has appointed a new partner to its tax practice group.

Michael Lebovitz joins the firm's new San Francisco office, which opened earlier this year.

He was previously a partner at Mayer Brown, since 2018, where he was co-leader of the firm's international tax and transfer pricing team.

He has also worked as a partner at White & Case, DLA Piper, Baker McKenzie and KPMG, and was a managing director at PwC from 2016 to 2018.

Lebovitz has provided international tax advice to clients on matters including joint ventures, cross-border mergers and acquisitions, post-transaction integration, international corporate finance, capital market transactions and general international tax planning matters.

Q&A

Accelerating careers for tax Superstars: in conversation with Oleg Rak, managing partner of Mason Rak

***ITR* sat down with the founder and managing partner of Mason Rak, a specialist tax recruitment firm, to discuss what makes a tax Superstar and how to best position top-level professionals for that next big career move.**

Mason Rak, a game-changing global tax recruitment firm, works with the world's leading tax professionals who need a trusted adviser with superior expertise, a global network and the authority required to facilitate reputation-defining career moves.

The company has successfully completed more than 300 tax partner and team moves with a global reach that spans more than 50 jurisdictions.

Mason Rak's mission is to support senior tax professionals so that they reach their full potential and enjoy a career that befits their talents and professional acumen.

ITR: Can you explain your approach to working with senior tax professionals?

Oleg: What sets Mason Rak apart is our bespoke, tailor-made approach to every individual we engage with. We work with the senior echelons of the tax world, and each case is different, so our approach is tailored to the vision and aspirations of each tax professional we work with. We take time to deeply understand their needs and support them at every stage of the recruitment process.

Together, we build a powerful personal brand and a winning business case that stands out from the competition. It's a bespoke approach based on my own experience. Over years we've built a powerful global network, and as a result we have access to key stakeholders and some of the most exciting strategic tax roles.

I've been in tax my entire working life, first at a Big Four firm in London as a tax professional and then as a specialist tax executive search expert. I've experienced first-hand how frustrating recruitment services can be, so our mission is to provide a superior experience and great results for those we work with.

ITR: What kind of professionals do you work with, and how do you add value to them?

Oleg: We're uniquely positioned in the market for purely focusing on strategic tax recruitment. We work with tax partners and teams, supporting them to secure market-defining moves with leading professional services and law firms across the globe. We like to call the professionals we work with "Superstars", and it's all about them realising their worth.

"I've experienced first-hand how frustrating recruitment services can be, so our mission is to provide a superior experience and great results for those we work with"

We add value by leveraging our network and our second-to-none market intelligence and global reach, so we truly have the means to add value. We are results-driven, and tailor our approach to their specific circumstances to realise their personal and professional ambitions. Our global reach means that wherever you are, and wherever you want to be across the world, you're covered.

During our initial face-to-face meeting, in person or via video call, we discuss your unique situation and build a strategy to increase your chances of success. We are genuinely invested in securing the best outcome for every individual we work with and understanding the challenges ahead and how to overcome them.

ITR: What defines a "Superstar"?

Oleg: Those who are already playing in the highest league, typically tax partners or partners-in-the-making, people who want to take their career to the next level. In football terms, we're referring to players like Lionel Messi, whose every move can shake the market and make a difference to a new club. Part of being a Superstar is building and maintaining a winning personal brand, which is something we can help with.

ITR: How is the current tax market encouraging high-level recruitment?

Oleg: Everything is globalised now, and tax is no exception. For example, transfer pricing offers opportunities across the global market because the legislation is applied in quite a uniform way. It gives tax partners the flexibility to work across a range of jurisdictions.

Looking at the Middle East, for example, there is currently a growth in demand for corporate tax professionals due to the introduction of relevant legislation, which is attracting leading tax professionals from emerging markets and advanced jurisdictions. We recently completed the process for a tax partner who moved from London to Dubai, and he is greatly enjoying his new role, as well as benefiting from a significant bump in his compensation.

In Europe, the EU's adoption of BEPS 2.0 Pillar Two rules raises implementation issues across the member states which will require additional tax expertise. Like other jurisdictions, the EU is also growing its tax technology, and we're currently working with a number of clients who are looking to attract tax technology experts to grow this business line.

In the US, recent news from the Biden administration has suggested that the IRS will be making a concerted effort on tax enforcement for big businesses. This, along with the continued flurry of M&A in the market, requires an influx of highly skilled M&A tax experts.

Asia Pacific, and China in particular, has become a key growth market for private clients, as high-net-worth individuals seek to diversify their portfolios. The collapse of Credit Suisse has forced wealthy individuals to consider spreading their investments across new geographies, and with Asia Pacific likely to experience an economic uptick this year, it seems a safe bet. This obviously entails new tax opportunities in the region.

Whether you are considering a local move, or exploring strategic tax opportunities overseas, our team at Mason Rak will be glad to support. Our mission is to help senior tax professionals reach their full potential and enjoy a career which befits their talent and professional acumen.

To read case studies from tax professionals who have worked with Mason Rak and secured strategic tax roles, please visit the Mason Rak website. https://www.masonrak.com/case-studies/

US Supreme Court to hear appeal against TCJA repatriation tax

The *Moore* case could upend US tax policy if the Supreme Court deems the repatriation tax on unrealised income to be unconstitutional.

Josh White

The US Supreme Court is set to hear the appeal of *Moore v the United States*, which concerns the country's repatriation tax, in its upcoming term set to begin in October.

Charles and Kathleen Moore had a stake of 11% in KisanKraft Machine Tools, an India-based farm equipment company. The mandatory repatriation tax of 15.5% cost the Moores an additional tax liability of just $15,000.

However, the Moore legal team argues that the repatriation tax breaches the 16th Amendment of the US Constitution, which grants Congress the power to collect taxes from realised income – but not unrealised income.

Charles and Kathleen Moore invested $40,000 in KisanKraft for an 11% stake in the company in 2006. KisanKraft was profitable but did not pay dividends to the couple, according to the Moores. Charles Moore swore in a 2020 deposition that he never received a dividend.

However, The Guardian newspaper reported that documents suggest Moore sold 23% of his holdings in KisanKraft before filing his lawsuit in 2019.

The Court of Appeals for the Ninth Circuit rejected the case in June 2022 and declined to rehear it. It had found earlier last year that the realisation of income "does not determine whether a tax is constitutional". As a result, the Moores took their case to the Supreme Court.

Although the sums are small, the legal implications of the case could result in significant tax savings for businesses. It could also create legal uncertainty about the US tax base.

If the Supreme Court strikes down the repatriation tax as unconstitutional, taxpayers will be entitled to claim tax refunds for the first five years after the TCJA came into force. This could cost the US Treasury billions in revenue on top of losses for years to come.

TCJA on trial

The Supreme Court announced on June 26 that it would take on the case, but the dispute stems from the Tax Cuts and Jobs Act (TCJA), implemented in 2018.

As part of the TCJA, the Donald Trump administration imposed a mandatory repatriation tax of up to 15.5% under Section 965 of the Internal Revenue Code. It was a one-off levy on foreign earnings brought back to the US.

Although the tax was temporary, the levy required several permanent changes to the US tax code. Congress voted to end the unlimited deferral of taxes on foreign earnings and introduced anti-avoidance rules, as well as a tax deduction for dividends received by US corporations.

Before the TCJA, US companies repatriating profits would face a 35% headline corporate tax rate. As a result, many corporations offshored profits and, in some cases, even inverted their structures to reduce their tax burdens.

By 2015, US companies held an estimated $2.5 trillion in earnings overseas. The

> "If the Supreme Court strikes down the repatriation tax as unconstitutional, taxpayers will be entitled to claim tax refunds for the first five years after the TCJA came into force."

boom in corporate inversions became a political football with everyone from Barack Obama to Trump criticising the practice.

Once in power, Trump rushed through the TCJA to reduce the corporate tax rate from 35% to 21% and to create incentives for US multinational companies to move assets to the US. However, the repatriation tax was designed as a temporary levy as part of the transition to new tax rules.

Companies repatriating foreign earnings face a tax of 15.5% for cash and cash equivalents, while a lower rate of 8% is applied to non-cash assets. At the same time, the TCJA permits a maximum 100% tax deduction on dividends received.

The TCJA also allows companies to pay the repatriation tax in instalments over eight years. The US congressional Joint Committee on Taxation estimated that this tax would raise $340 billion in revenue from 2018 to 2027.

Political influence

The *Moore* case has drawn political support from conservative think tanks and lobby groups seeking to block future taxes and create a precedent for greater tax savings.

Eight conservative organisations, including the Competitive Enterprise Institute and the Manhattan Institute, reportedly lobbied to get the *Moore* case to the Supreme Court. These groups filed simultaneous amicus briefs with the court on March 27 2023.

If the Supreme Court rules in favour of the Moores, the US government may not be able to levy a federal wealth tax in the future because it would apply to unrealised income. The Biden administration has talked up the possibility of a 'billionaire tax'.

The Supreme Court decision could also affect the constitutionality of US tax reform, including the minimum corporate rates introduced as part of the global intangible low-taxed income (GILTI) rules. The Biden administration has raised this minimum rate from 10.5% to 15%.

The loss of GILTI tax revenue could be as high as $352 billion in the next 10 years, according to the Tax Foundation, a think tank based in Washington DC. One extreme outcome would be the Supreme Court striking down all taxes on undistributed earnings, and this would cost an estimated $5.7 trillion in tax revenue.

Meanwhile, the OECD's hopes of securing international tax reform hang in the balance. The US has still not complied with the two-pillar solution, even though it officially supports the agreement. The *Moore* case could bar the US government from implementing pillar two on constitutional grounds.

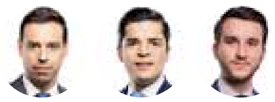
Pillar two includes a 15% global minimum corporate rate with an income inclusion rule (IIR). The latter would be unconstitutional if the Moores win their case. The IIR is designed to allocate a share of taxable income on the subsidiaries of parent companies. This applies whether the income is distributed or not.

Any hopes of further alignment with the OECD on minimum taxation could be shattered by this case. While it's unclear whether the Supreme Court will issue a narrow or a broad ruling on the provisions of the TCJA, the implications will be significant either way.

US Supreme Court, Washington DC

MEXICO

Ritch Mueller



Santiago Llano, Eric Palacios and Alfredo Sampayo

Unconstitutionality of the employees' profit sharing limit provision in Mexico?

Embedded within Mexico's legal framework is the fundamental constitutional right for employees to receive a share of their employer company's profits, commonly known as employees' profit sharing (*participación de los trabajadores en las utilidades de la empresa*, or PTU). Its principal objective is to acknowledge and compensate employees for contributing to a company's prosperity.

In the past, the employees' profit sharing amounted to 10% of a company's taxable profit. However, to mitigate labour-related risks and restrict the payment of the employees' profit sharing, businesses frequently established a separate company that exclusively employed individuals (an 'employees' company). This subsidiary would then provide services to the primary company responsible for generating the majority of the business's profits (the 'profitable' company), charging the costs and expenses incurred, plus a small mark-up.

Reform introduces a cap

In 2021, a reform was introduced to curb abusive or simulated practices that infringed upon workers' rights. Beyond labour-related implications, this reform introduced substantial tax-related considerations, disallowing deductions for income tax purposes and the offsetting of VAT payments made under the aforementioned schemes.

In a nutshell, this reform prohibits companies from subcontracting services that correspond to their main business purpose, as it should be understood that the employees needed for the main business purpose should be hired directly. However, companies are allowed to hire specialised services if labour and tax requirements are met. Lately, labour and tax authorities in Mexico have been very active in scrutinising companies, reviewing if they comply with all the related provisions.

As a result of this reform, many companies in Mexico undertook corporate restructures, including merging the service companies with the profitable company. The impact of the additional PTU was diminished as the reform introduced a cap for the amount of the profit sharing that would be most favourable to the employee. This cap could be:

- A maximum limit of three months' worth of the employee's salary; or
- The average participation received in the last three years.

However, this cap has recently come under constitutional scrutiny.

Recent precedent on constitutionality of the PTU limit provision

According to the public version of a ruling issued by the Eighth District Court in Labour Matters in Mexico City in August 2023, Article 127, Section VIII, of the Mexican Federal Labour Law has been declared unconstitutional. This provision encompasses the limit imposed on employees' profit sharing payments by companies.

The analysis presented in the precedent contends that the imposition of a maximum limit on employees' profit sharing contradicts the Mexican Constitution. Rather than establishing limitations, the Constitution safeguards and guarantees the constitutional right of the workforce to share in the profits of the employer or company, provided those profits are generated.

Furthermore, the precedent underscores the following legitimate constitutional objectives:

- Employees' profit sharing constitutes a crucial obligation in labour affairs for companies, striving to achieve social justice and an equitable distribution of profits. This distribution involves capital and labour, exemplifying a collaborative approach.
- The historical foundation of this right was originally conceived as a form of recompense for workers' contributions to the companies they serve. This notion aligns with fundamental social justice principles by allowing a share of the economic profits derived from their labour while incentivising heightened productivity.
- The provision contradicts the goals of the 2021 reform. While the reform's intent is to prevent employers from evading labour, social security, and tax obligations, the provision fails to meet this criterion. Instead, it appears to foster adverse practices and simulated schemes that exploit workers through inadequate compensation, subsequently sidestepping fair remuneration.

According to the District Court's analysis, secondary regulations must uphold constitutional guarantees, regardless of their subject matter or the substantive or procedural institution they pursue. These constitutional principles set the baseline criteria that secondary regulations must adhere to, ensuring their unwavering compliance. These norms thus serve as a boundary that all authorities, legislative bodies included, are obliged to honour in the execution of their duties.

At the time of writing, the competent tribunals are yet to issue a ruling in the appeals process. Given the considerable economic and social ramifications of the case, the authors expect that the Mexican Supreme Court will review the case and deliver a ruling that comprehensively evaluates the precedent set by the Eighth District Court in Labour Matters in Mexico City.

Moving forward

Considering the potential impact of the ruling, it is important that Mexican companies review if they are compliant with the current labour and tax provisions and follow up on the developments of this case.

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Top tax controversy cases from 2023, so far

The European Commission and the IRS continue to lock horns with some of the world's largest firms over issues including profit-shifting and transfer pricing. Here are *ITR*'s top tax disputes of 2023 so far.

It's been a busy six months for tax controversy with the Internal Revenue Service and the European Commission involved in tax disputes with some of the world's largest companies.

In one case, Apple seeks to preserve a ruling it received at the European General Court in 2020, while the European Commission has set its sights on proving the firm's part in a 'sweetheart' tax deal.

Meanwhile, Meta is embroiled in a potentially ground-breaking VAT investigation in Italy that could change the way non-monetary data transactions are taxed worldwide.

Here, *ITR* gives a rundown of its top controversy cases of the year so far.

Denmark Supreme Court v Danish companies

Denmark's Supreme Court ruled on two of the so-called Danish beneficial ownership cases, which were on remand from the Court of Justice of the EU, on May 4 2023.

The cases concerned whether dividend and interest payments from Danish companies were exempt from withholding tax when the payments were made to companies resident elsewhere the EU, which then made payments to parent companies residing in a third country.

Danish withholding taxes are levied on outgoing dividends, royalty payments and interest payments to affiliated companies in tax havens.

The two cases that were decided on are part of six original cases.

In both cases the Supreme Court decided that after the Danish companies involved had received loans from holding companies, they should have withheld tax at source in connection with interest payments to their parent companies, and that they acted negligently when they did not.

In the first case, Supreme Court determined that the (unnamed) company was obliged to pay withholding tax of DKK369 million ($55 million) on interest paid to a holding company between 2007 and 2009. In the second case, Supreme Court decided that the Danish company (also unnamed) was obliged to pay withholding tax of DKK817 million ($123 million) on interest paid to Luxembourg holding companies between 2006 and 2008.

In both cases this was because the reorganised holding companies were ruled not to be the beneficial owners of the interest.

European Commission v Amazon

US e-commerce company Amazon is fighting a €250 million ($280 million) legal dispute with the European Commission in the Court of Justice of the EU over the company's tax arrangements in Luxembourg.

As *ITR* noted earlier this year, the sum might not sound a lot for such a large company, but the case has the potential to have a much wider impact.

Amazon first won its case in the General Court in May 2021, as the Commission

> The case is the largest of EU antitrust chief Margrethe Vestager's campaign against 'sweetheart' deals between multinationals and EU states that allow for an unfair level of competitive advantage.

was unable to prove that the company had accessed an "undue reduction" in its tax base in Luxembourg.

The Commission refused to accept defeat, and instead doubled down on its 2017 findings and appealed the decision in the CJEU, arguing that the General Court should have based its decision on Amazon's Luxembourg profits rather than its US profits.

Amazon had structured its European operations through a Luxembourg-based subsidiary, Amazon EU Sàrl, to move profits to Amazon Europe Holding Technologies, a limited partnership holding company with no employees, offices or business activities.

Because Amazon EU Sàrl held various intellectual property rights under a November 2003 cost-sharing agreement with Amazon US, it was able to grant an exclusive licence to Amazon EU and receive royalty payments in return.

Amazon continued to argue on March 16 2023, the date of the Commission's appeal, that these transactions were in line with the arm's-length principle, but the Commission has maintained that royalties were inflated to unfairly reduce the company's taxable profits.

European Commission v Apple

The European Commission is trying to overturn a General Court ruling as it attempts to enforce its own 2016 decision and make Apple pay a record €13 billion ($14.6 billion) in Irish back taxes.

The Commission's controversial 2016 decision was annulled by the General Court in July 2020 on the grounds that it had failed to prove that Apple had gained an unfair competitive advantage from its tax arrangements in Ireland.

The Commission appealed the decision to the Court of Justice of the EU on May 23, 2023.

In the 2016 decision, the Commission said that two Irish rulings had artificially reduced Apple's tax burden for more than two decades, reducing it to just 0.005% in 2014.

Apple conducted business in Europe through a double Irish structure, allowing it to send most of its European sales through its head office.

The structure was legal and above board in Ireland, but the Commission is arguing that Irish tax rulings that were granted to Apple between 1991 and 2007 broke EU state aid law.

The case is the largest of EU antitrust chief Margrethe Vestager's campaign against 'sweetheart' deals between multinationals and EU states that allow for an unfair level of competitive advantage.

ExxonMobil v European Commission

US oil company ExxonMobil has sued the European Commission in the General Court over its proposal to levy a fossil fuel windfall tax on major oil and gas producers, the company first stated on December 18 2022.

The lawsuit, which was filed through subsidiaries in Germany and the Netherlands, argued that the right to introduce a tax is reserved for national governments. The EU, it claimed, has overreached its powers.

It also contested the use of Article 122 of the Treaty on the Functioning of the European Union, an emergency measure that allows the European Council to enact the legislation.

The push for a windfall tax comes as energy firms are seeing oil and gas profits soar, while consumers see costs increase dramatically, partly due to supply concerns that arose after Russia's invasion of Ukraine.

In September 2023, European Commission President Ursula von der Leyen announced a plan for major oil, gas and coal companies to pay a "crisis contribution" of 33% on their increased 2022 profits.

The EU stated that the contribution could raise up to €25 billion ($28.1 billion) in public revenue for bloc governments.

ExxonMobil also argued that the proposal is counterproductive as it will lead investors to become discouraged about investing in affordable energy in the future. The firm called the windfall tax "counter-productive".

Ghana Revenue Authority v Tullow Oil

On February 14 2023 oil and gas exploration company Tullow Oil (Tullow) announced that its Ghanian subsidiary, Tullow Ghana Limited (TGL), had filed for arbitration with the International Chamber of Commerce in London over two tax bills amounting to $387 million received from Ghanian local authorities.

The disputed charges relate to income from the period 2010 to 2020 and are on top of taxes it has already paid in Ghana.

Tullow said the tax bills are "without merit", but that it is engaging with the Ghana Revenue Authority to resolve the dispute.

The firm also said that the hearing for a separate international arbitration that was filed in 2021 and concerns a $320 million additional tax bill from Ghana is scheduled for October 2023 with no decision expected before 2024.

The nation is in the middle of a debt overhaul and is receiving help from the IMF.

IRS v Amgen

A pension fund sued US pharmaceutical company Amgen for not disclosing to shareholders that it might owe the Internal Revenue Service $10.7 billion in an ongoing tax dispute with the government agency.

The IRS case, which was consolidated in 2022, concerns $10.7 billion in back taxes that it says Amgen owes from profit and important assets that it allocated to a manufacturing subsidiary in Puerto Rico.

According to the IRS, the structure allowed Amgen to under-report its US taxable income by nearly $24 billion from 2010 to 2015.

Amgen was originally facing an IRS claim of $3.6 billion in back taxes plus interest from 2010 to 2012. However, that was later increased in April 2022 as the IRS added $5.1 billion in back taxes plus $2 billion in penalties from 2013 to 2015.

In August 2022, the pharmaceutical company successfully combined two separate tax disputes with the IRS, resulting in a full tax bill of $10.7 billion at stake.

On March 13 2023, the Detroit-based Roofers Local No. 149 Pension Fund sued Amgen in a proposed class action for waiting too long to inform shareholders of the potential tax bill and therefore artificially inflating its share price.

IRS v Facebook

Progress has been made in the Internal Revenue Service's dispute with Facebook over a potential $9 billion tax bill as a minor settlement has been reached, but there's still a long way to go.

The IRS first challenged Facebook over its transfer pricing arrangements in Ireland in February 2020, but the US Tax Court case has continued into 2023.

The case concerns Facebook's valuation of its intangible assets, specifically the alleged overvaluation of the company's intellectual property.

Facebook moved its IP to Ireland in 2010, before going public in 2012, and valued the assets at $6.5 billion. The IRS argued that the correct valuation would have held the assets at $21 billion and that the company now owes more than $9 billion in taxes on the discrepancy between the two valuations.

The parties have since agreed to increase Facebook's royalties for transferring Instagram property to a Facebook entity in Ireland by about $498 million, in a settlement on June 21 2023 that was obtained by Bloomberg.

It has also been agreed that Facebook won't owe an inaccuracy-related tax penalty along with the royalty increase, and that other types of income should be raised by more than $1.5 million.

Facebook continues to argue that the IRS's $21.15 billion valuation of the company's contributions to the cost-sharing arrangement with an Irish subsidiary was nearly $15 billion too high.

The case represents the first time a major anti-profit-shifting regulatory regime has been challenged in court.

Milan magistrates v Meta

Milan magistrates have launched an €870 million ($979 million) investigation into technology company Meta's unpaid VAT on data acquired from customers, in a case that could set new industry-wide precedents if successful.

The initial assessment is expected to take until the end of the year.

It was first reported in February 2022 that Milan magistrates had launched the investigation at the request of the European Public Prosecutor's Office.

The investigation arises from an Italian audit that claimed user registrations on Meta platforms such as Facebook could be seen as taxable transactions, as they represent a non-monetary exchange where a membership account is paid for with the user's personal data.

The €870 million is only based on consumer data transactions from 2015 to 2021, but if the case is successful, it could set a far-reaching international precedent affecting all non-monetary data transactions.

It would also raise questions regarding how data should be valued for tax purposes.

Earlier this year, *ITR*'s Indirect Tax Forum heard the views of a number of tax professionals who said that the potential ruling could affect the digital economy worldwide.

View of the European Commission building in Brussels

Worlds apart? The UN's challenge to the OECD on tax

The UN could become a rival organisation to the OECD on tax issues with rising powers China and India pushing for greater influence.

Josh White

The UN is challenging the OECD's dominance in global tax matters, but the New York-based organisation must decide what kind of influence it wants to wield.

A global shift may be under way. Many countries outside the OECD, including China and India, favour greater involvement of the UN in tax matters, while the US and its European allies continue to support the OECD's role in shaping global tax standards.

Naturally, OECD member states – from Australia to Japan – do not want the organisation to lose its agenda-setting position in international tax. However, most countries in the world are not a part of the Paris-based OECD.

Even with the Inclusive Framework of almost 140 nations, the OECD is still seen as a very exclusive club. Outside OECD walls, developing countries are becoming more assertive in tax policy, and the possibility of a UN tax convention is partly driven by this.

The Latin American and Caribbean tax summit, the first of its kind, agreed in July to establish a regional tax platform to create a united position on international tax reform. Countries such as Brazil, Colombia and Mexico are supporting these efforts.

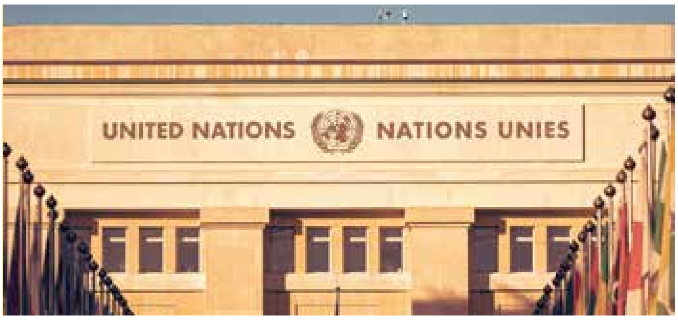
ITR has followed this story since the resolution was drafted and put to a vote in the UN. The UN General Assembly unanimously agreed a resolution in November 2022, granting the organisation a mandate to begin intergovernmental talks on tax.

At the same time, the resolution made the case for a UN convention on tax and the creation of new global tax institutions and cooperation frameworks. The UN General Assembly will decide in the weeks and months ahead what kind of convention it wants.

What the UN wants

UN Secretary-General António Guterres made the case for a new international framework on tax policy in a draft report published on August 8.

“We encourage UN member states to examine carefully how each of the options can usefully fit into the broader global tax ecosystem.”



The entrance to the UN headquarters in Geneva

Guterres proposed three options to expand the UN’s tax policy remit. Option one would be to establish a legally binding UN multilateral convention to regulate tax issues, including setting rules on taxing rights.

This would run in parallel with the OECD’s work to finalise pillar one by the end of 2023 and could create a set of rival international standards. Otherwise, the UN could end up, for example, duplicating OECD profit allocation rules.

Option two would be a legally binding framework for international tax cooperation to create a new system of tax governance. Such a framework could serve as a convention to enable governments to coordinate tax reforms.

Meanwhile, option three would be a non-binding framework for global tax cooperation to allow greater variation in tackling problems such as illicit financial flows. Developed countries may find this more acceptable than option one because it could complement the OECD’s work rather than clash with it.

The International Chamber of Commerce (ICC) responded to the draft report by stressing the need for economic certainty and stability.

“We encourage UN member states to examine carefully how each of the options can usefully fit into the broader global tax ecosystem — and ideally enhance better co-ordination among multilateral institutions working on tax policy issues,” said the ICC.

However, a voluntary, non-binding framework may be too weak to address key issues. Governments with little in common may find it easier to walk away from talks than they would if they had to work together. It may be more effective to make rules legally binding.

All these options are up for discussion at the UN General Assembly, but clear divisions have already formed over the role of the UN in tax.

What the OECD thinks

The OECD has long taken the lead on international tax policy, especially major reforms such as the Common Reporting Standard and country-by-country reporting. So the UN proposals could upend policymaking.

Manal Corwin, director of the Centre for Tax Policy and Administration at the OECD in Paris, said the UN draft report included numerous “inaccuracies and misleading statements”, in comments to the Financial Times (FT).

She told the FT on August 29 that it was “disappointing that the UN had chosen to ignore the positive impact of the most significant changes and concrete results that have been delivered over the last two decades”.

“We’re not saying everything’s perfect. But you have to acknowledge the really significant progress that has been made,” said Corwin.

Corwin referred to the OECD’s support for the automatic exchange of information between tax authorities around the world. This is estimated to have helped tax administrations raise €126 billion ($135 billion) in additional revenue since 2009, including €41 billion for developing countries.

At the same time, Corwin stressed that she did not want to fuel claims of a rivalry between the OECD and the UN. She added that the OECD is focused on results and not “unnecessary competition between organisations”.

In response, Stéphane Dujarric, spokesperson for the UN secretary-general, said the draft report was not about either criticism or competition with any organisation.

“It is about giving all governments, as they have explicitly requested, additional options for making international tax cooperation fully inclusive and more effective,” he said.

This was not the first time that Corwin broke ranks and commented on the UN draft report.

On August 11, she told the International Consortium for Investigative Journalism that the OECD is proud of its record of tax reform. She stressed that these changes have benefitted developing and developed countries alike.

Corwin claimed that the UN had ignored many countries’ favourable assessments of the OECD-led reform process. After all, the Inclusive Framework has significantly expanded the process to bring on board developing countries and not just depend on the G20 and OECD member states.

The Paris-based organisation has secured landmark tax reforms over the last decade and continues to work towards a global minimum corporate tax rate and new profit allocation rules.

Global split

The OECD’s long dominance in tax policymaking could be reduced if the UN can settle on a new framework with a majority of countries participating worldwide.

China and the so-called ‘Group of 77’ have argued that there

“We’re not saying everything’s perfect. But you have to acknowledge the really significant progress that has been made.”

> "The OECD process has never been global. Developing countries have not been able to participate on an equal footing, and the negotiations have been deeply opaque and closed to the public."

is a need for a global forum to discuss tax reform. This group of countries, which include Argentina, Saudi Arabia and South Africa, favour the UN playing this role. China and India could have a much greater influence if this were the case.

Tove Maria Ryding, tax coordinator at the European Network on Debt and Development in Brussels, said on August 9: "The OECD process has never been global. Developing countries have not been able to participate on an equal footing, and the negotiations have been deeply opaque and closed to the public.

"We need global tax negotiations to be transparent, fair and led by a body where all countries participate as equals. The UN is the only place that can deliver that," she stressed.

Alex Cobham, chief executive at the Tax Justice Network in London, also praised the UN talks on August 9: "We now have a real shot at bringing this process into the daylight of democracy at the UN, where all countries will finally get a real say."

The African Group, a bloc representing 54 nations, was instrumental in securing the UN resolution at the General Assembly last year. However, many developed nations still favour the OECD-led process. Both the UK and the US have warned against doubling-up on the OECD's efforts on tax reform.

Several European representatives have suggested the UN should support the OECD-led process rather than duplicate the work on tax because this could create more inconsistency in tax policy.

For example, Germany has made it clear that it does not see the need for an international tax body under UN auspices. Meanwhile, smaller low-tax European countries like Liechtenstein fear that the UN taking on more influence could lead to more fragmented tax rules.

Fragmentation could mean the OECD pushes ahead with its two-pillar solution while the UN ends up creating a forum for most developing countries to make their demands heard. A world with at least two competing sets of international tax norms may be the result.

A view of Manhattan with the UN building in the foreground

Q&A

Senator O'Neill interview: big four 'not above and beyond the government'

In an exclusive interview with *ITR*, Deborah O'Neill says the PwC Australia tax leaks scandal has revealed an industry rife with malpractice and that she's not going to stand for it.

Deborah O'Neill, Labor senator for New South Wales, has gone from schoolteacher to academic to politician – so she certainly knows something about the education that she says Australia's consultancy firms are in desperate need of.

Since first being elected to Australia's Senate in 2013, O'Neill has chaired seven parliamentary groups and committees, ranging all the way from the Parliamentary Friends of Ireland to the Parliamentary Friends of Multiple Sclerosis.

No position in that time has proved more of a challenge than as the chair of the Joint Committee on Corporations and Financial Services, in which she has spent the last few months fighting to draw information from a consultancy sector wrapped in scandal.

The scandal has centred around PwC Australia's leaking of confidential government information, which was first reported in January. But, as Senator O'Neill tells *ITR*: "That's the canary in the coal mine, that's a trigger. It reveals a much broader and deeper culture."

Scandalous beginnings

O'Neill has been listening to evidence from companies and whistle-blowers, fighting to access documents, and calling for action against firms that she says are being allowed to operate outside of the law.

PwC Australia is also the subject of multiple investigations including a criminal probe, an internal investigation, and an outsourced independent investigation headed up by former Telstra CEO Ziggy Switkowski.

It all began on January 23, when Australia's tax industry regulator the Tax Practitioners Board confirmed a report from the Australian Financial Review that it had banned former head of international tax at PwC Australia, Peter-John Collins, from practising for two years.

The ban resulted from evidence that Collins, who was part of an advisory group involved in high-level Treasury discussions, had shared confidential government information via email on future tax avoidance policy within the firm, and later to clients, for commercial gain.

Multinational clients were tipped off on the legislative changes before they were introduced.

At the time, O'Neill lambasted Collins' punishment as a "slap on the wrist".

The senator secured the PwC emails on May 2, revealing that 53 PwC members of staff and 14 clients may have benefitted from the information. She's been scrutinising the company – which she says has forgotten that it has to play by the rules – ever since.

"A partner decided it was okay to steal information from the federal government and take it back and monetise. It was just a scale indicator of how far from the ethical baseline the company had moved, to a point where that was no longer a problem," she tells *ITR*.

It's clear to O'Neill that this is about more than one bad actor. It's a company-wide and industry-wide problem where the type of behaviour exhibited by Collins is encouraged, and where illegally accessed information is seen as a commercial opportunity.

"He knew that when he took it back, he was not only going to find fertile soil but that he was going to be encouraged and work effectively across the globe to grow a money tree on the back of confidential information taken from his own fellow citizens," she claims.

The firm's attitude needs to be addressed, she says, by making sure it pays a price for its actions. However, PwC is not the only party in this scandal that might be made to face consequences.

Spreading the net

O'Neill is also trying to navigate the complicated question of what to do about the companies that received and benefitted from the leaked information.

They didn't steal it, but they did use it.

Uber and Facebook are two of the firms that managed to restructure and sidestep the legislation after receiving confidential information from PwC, doing so before it came into effect in January 2016.

O'Neill adds that those companies, and others like them, pay nowhere near the amount of tax that they should on the enormous gross profit margins that they make in Australia.

So far neither Uber nor Facebook has faced a penalty, largely because they both maintain that they had no knowledge that the information was improperly obtained.

O'Neill tells *ITR*, however, that not everyone is buying that.

"An argument that was put to us is that there's no way they would have put money on the line if they weren't quite confident that the intelligence they had was accurate," she says.

"It is pretty unlikely that people savvy enough to set up transfer pricing tax regimes would not be savvy enough to demand some clarification and assurance that this scheme was actually going to be enacted, which means that they would know that there was confidential information."

She says that the government needs to chase down those companies but that it's unclear exactly what might happen, as is the number of companies that benefitted.

However, she explains that it is important not to fixate on this particular instance. According to O'Neill, this conflict-of-interest case is one example of many within the consultancy industry in Australia and highlights a lack of transparency and accountability.

"It's taking a while for this sector to understand that they operate businesses with people licensed to operate in the country, by agreement from the government. They're not above and beyond the government."

Industry problems

O'Neill has witnessed the Committee inquiry stretch to all corners of the consulting industry and has taken the 'big four' to task over behaviour that she says represents a disregard for rules and regulations.

Speaking about a hearing in July with the Finance and Public Administration References Committee, she tells *ITR* that Deloitte, which was acting as a witness, "provided us with documents in response to questions that showed scant regard for the authority of the parliament. And that's putting it nicely".

"They were worse than PwC in terms of the information that they provided, they just plugged everything in commercial and confidence," she says.

Deloitte was also questioned by the committee over instances of failing to meet industry standards, and, according to O'Neill, showed an unacceptable level of inaction: "I asked them about 121 instances of intervention for failure to meet standards. There was one that they dealt with; the other 120 they just kept quiet and didn't do anything about."

In response to O'Neill's claims, a spokesperson for Deloitte told *ITR* that the company responded truthfully, constructively and in adherence with the terms of reference of the hearing.

"We are supportive of the Senate inquiry. We believe we have an important contribution to make in actively engaging with the committee to enhance transparency, accountability and trust in the way the profession works with government," they added.

O'Neill tells *ITR* that, ultimately, the partnership models adopted by these consultancy firms allow them to reveal nothing of themselves, meaning there is often little way of telling whether conflicts of interest arise when they are interacting with the government.

The lack of transparency also produces a lack of accountability, leaving firms to discipline their own as they see fit – and often not very effectively – according to O'Neill.

Measures of success

O'Neill says that a successful outcome for the committee will start with being able to document how the consultancy industry operates and the way it interacts with the government, because current operations are almost completely untraceable.

"That's the first success because that is piercing the darkness," she tells *ITR*.

After that, she says, the way public procurement and outsourcing is managed needs to be looked at and improved to prevent conflicts-of-interest cases arising. Then, a list of ethical standards needs to be established with a regulatory body that can actually enforce those standards.

Breaking those rules, she says, must come with a serious reputational risk to individuals. "That means some sort of a registration structure that's linked to an individual's capacity to practice."

In the long term, she adds, the entire structure of these firms needs to be addressed and changed, especially if they are interacting with the public sector.

Ring-fencing, by splitting partnerships up to avoid conflicts of interest, is one way to solve some of the industry's problems, she says.

"EY got so close with the Everest project [earlier this year EY attempted to separate its consulting and audit business to avoid conflicts of interest]. It's something that's going on all around the world."

By legislating for the breakup of companies to safeguard against conflicts of interest, Australia has a chance to lead in the way consultancies interact with the public sector.

There's a lot of work to be done, O'Neill says, and more inquiries are needed. The next of those, which the senator will be chairing, will extend to the audit sector where similar issues of structure and transparency are present.

"It will look at the entire structural debacle that has enabled what we've seen to grow and fester; like a cancer it needs to be radically excised and changed."

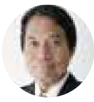
In the meantime, Senator O'Neill says she is attempting to teach Australia's big consultancies an important lesson: that they must play by the same rules as everyone else.

"I think there's a bit of public education going on right now."

This interview was first published on August 7.

INDONESIA

GNV Consulting

Dwipa Abimanyu Dewantara and Hartiadi Budi Santoso

Indonesia tax update: depreciating tangible assets and electronic tax disputes

Depreciation of tangible assets/ amortisation of intangible assets

On July 13 2023, the Minister of Finance (MoF) issued a new regulation, number 72/2023 (PMK-72), regarding the depreciation of tangible assets and/or amortisation of intangible assets. Through this regulation, the MoF has now revoked regulations No. 248/PMK.03/2008, 249/PMK.03/2008, 126/ PMK.011/2012, and 96/PMK.03/2009.

Here are some new salient points taken from PMK-72/2023:

Depreciation of tangible assets

Under the old regulation, permanent buildings should be depreciated over 20 years. However, under PMK 72/2023, the taxpayer now has the option to use the following depreciation methods for permanent buildings which have a useful life exceeding 20 years:

a) 20 years; or
b) In accordance with the actual useful life based on the taxpayer's accounting records, if they are maintained in a compliant manner.

Taxpayers who have already depreciated permanent buildings, which were owned and utilised before the tax year 2022 (according to the 20 years useful life provision), may choose to depreciate based on the actual useful life by submitting a notification to the Directorate General of Taxation no later than April 30 2024.

Amortisation of intangible assets

Like the treatment for depreciation of buildings, for the amortisation of intangible assets with a useful life exceeding 20 years, the taxpayer can choose to use either a straight-line 5% amortisation for 20 years or follow the actual useful life based on the taxpayer's bookkeeping. This can be done by submitting a notification to the tax authority no later than 30 April 2024.

Electronic administration of tax disputes in the Tax Court

On July 21 2023, the head of the Tax Court issued a new regulation, number PER-1/PP/2023 (PER-1), regarding the electronic administration of tax disputes and hearings in the Tax Court. Through this regulation, the head of the tax court has revoked regulation No. KEP-16/PP/2020.

Some salient points taken from PER-1/2023 are as follows:

Account registration

Taxpayers, tax bearers, or attorneys shall apply to be registered applicants electronically by uploading the following documents:

a) Account registration application letter; and
b) Registration certificate/ tax ID number/ identity card/ family card/ passport and attorney license (for legal representatives).

Registered applicants will be given an account activation link to receive administrative and hearing services electronically from the e-tax court to the electronic domicile address.

Appeals and lawsuits

An appeal or lawsuit can be filed by a registered applicant by uploading an appeal or lawsuit letter in electronic pdf or doc/ docx/rtf formats.

A registered applicant who has filed an appeal or lawsuit through the e-tax court will obtain an electronic proof of receipt (BPE). The date stated in the BPE is the date the letter is received at the Tax Court.

Electronic hearings

Appeals and lawsuits which are filed electronically will be heard electronically via video conferencing. However, for appeals or lawsuits that are not filed electronically, the hearings can still be conducted electronically with the consent of the appellant or plaintiff.

In the electronic hearing process, the parties submit electronic documents to the e-tax court in accordance with the period set by the judges. For effective tax dispute examination, the judges may change a hearing from electronic to face-to-face (offline).

Tax Court verdicts

The verdict will be pronounced electronically by the judges. The decision is provided via an electronic copy of the decision with the registrar's electronic signature. The electronic verdict can also be implemented for appeals or lawsuits that are not filed through the e-tax court.

This regulation is effective from July 31 2023.

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CHINA

KPMG China

Lewis Lu

China enhances tax incentives for employment stabilisation

On August 2 2023, China's Ministry of Finance, State Taxation Administration (STA), Ministry of Human Resources and Social Security (MOHRSS), and Ministry of Agriculture and Rural Affairs (MOA) jointly released Notice No. 15 ("Circular 15"). This circular enhances 2019 incentives to stimulate employment, especially tax incentives for enterprises hiring certain underprivileged groups.

Key features of Circular 15 incentives include:

- Each "qualified" employee can generate a maximum of RMB 23,400 (approximately USD $3,300) worth of tax benefits for employers. These tax benefits can be used for up to a maximum of three years, and can be received as refunds or reductions in various taxes including VAT, Urban Maintenance and Construction Tax, educational levy, local educational levy and corporate income tax;
- To qualify, employees need to have employment contracts lasting over a year and have paid social security premiums. "Qualified" individuals include those identified by the national anti-poverty monitoring system or those unemployed for more than six months and registered with the Human Resources and Social Security Department/Public Employment Agency;
- A database that collates the information for "qualified" personnel has been established. The MOHRSS, MOA and STA will facilitate the smooth sharing of this information, including sharing of information from the central to local level; and
- Circular 15 is retroactively effective from January 1 2023, and taxpayers can enjoy the tax benefits until December 31 2027, allowing existing and new employees to benefit for up to three years of their employment.

Circular 15 employment stabilisation tax benefits represent an improvement over previous policies. They encourage employers to hire specific vulnerable demographics, allowing for the development of their skills, and can be seen as ESG-aligned.

Based on KPMG's experience with previous employment stabilisation incentives, it is observed:

- Only a handful of enterprises have set specific hiring criteria to encourage the hiring of "qualifying" personnel. As such, many companies' workforces have been built without considering these tax incentives as a factor in hiring;
- Sample historical data (from a manufacturing enterprise) showed a hit rate of 8% to 14% among the entire employee population. The "hit rate" varies across sectors, regions, and wage levels. Some sectors like IT may have a lower hit rate, while an original equipment manufacturer factory for consumer electronics in Suzhou (i.e., an affluent city in central China) could have a higher one;
- Many tax bureaus lack experience in handling this specific incentive, necessitating education efforts for both enterprises and tax officials; and
- Securing the incentive can be time-consuming (usually two to four months), potentially involving multiple government authorities and the deployment of dedicated resources (both internal and external).

Circular 15 incentives arrive at an opportune time, given that the employment market has been severely impacted by the post-COVID-19 economic environment. With many companies actively seeking ways to support their businesses, deploying resources and planning implementation could lead to substantial benefits for eligible employees.

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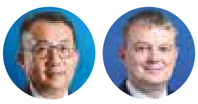
HONG KONG SAR

KPMG China



Lewis Lu and John Timpany

Hong Kong's latest proposals on the tax certainty scheme for onshore equity disposal gains and expanded FSIE regime

The initial proposals

The Hong Kong SAR Government issued the following two consultation papers earlier this year to seek inputs from stakeholders:

1. Consultation paper on enhancing tax certainty of onshore gains on disposal of equity interests (March 2023);
   - To introduce a tax certainty scheme which includes a bright-line test for treating certain onshore equity disposal gains as capital in nature and non-taxable. For more details of the initial proposal on this scheme, please refer to KPMG's publication in March 2023;
2. Consultation paper on refinements to Hong Kong's foreign-sourced income exemption regime for foreign-sourced disposal gains (April 2023);
   - To expand the scope of the existing FSIE regime to cover foreign-sourced gains from disposal of assets (other than equity interests) – see KPMG's publication in April 2023 for more details.

The key changes/clarifications

The Inland Revenue Department (IRD) recently conducted two engagement sessions with stakeholders to provide an update on these two proposed tax regimes:

The proposed tax certainty scheme

- Definition of equity interest – in addition to being interest that carries rights to profits, capital or reserves, the interest must be accounted for as equity in the books of the investee entity;
- The 15% ownership threshold can be counted on a group basis – i.e. equity interest held by the investor entity and its closely related entities (determined based on the "control test") can be aggregated for meeting the 15% threshold;
- Disposal in tranches is allowed but subject to a 24-month restriction – e.g. if the investor entity had held 15% of Co A shares for 24 months and then disposed the shares in three tranches (i.e. 5% for each tranche), provided that the second and third disposals were made within 24 months from the first disposal, the tax certainty scheme can still apply to the second and third disposals even though the holding percentage is less than 15% prior to these disposals; and
- Trading stock is not to be counted for determining whether the 15% ownership threshold is met.

KPMG observations

We are glad that the government has considered several recommendations made by stakeholders during the earlier consultation exercise to make the tax certainty scheme more business-friendly and practicable.

We understand that the IRD will continue to work on a number of issues related to the revised proposal. Based on our observations, some issues for further consideration are:

- If trading stock needs to be excluded for counting the 15% ownership threshold, taxpayers may face an uncertainty on which portion (if any) of the equity interest held by them are regarded as "trading stock"; and
- For disposal in batches, if the 24-month restriction is counted from the first disposal, it would mean holding the equity interest that remains after the first disposal for a longer (i.e. more than 24 months) period would result in the subsequently disposed interest not being eligible for the tax certainty scheme.

For more details, such as an illustrative example on equity interests previously regarded as trading stock for tax purposes, the application on cases involving a change of intention from trading stock to a capital asset, and observations on the proposed exclusions of property development and holding activity, please see KPMG's full article via this link.

The proposed expanded FSIE regime

- The carve-out for disposal gains of traders will apply to both disposal gains on equity interests and other types of assets but not intellectual property assets (where the nexus requirement applies), once the expanded FSIE regime becomes effective (from January 1 2024);
- A trader refers to a person who sells, or offers to sell, property in its ordinary course of trade; and
- Intra-group relief:
  iii. The IRD will consider accepting other means of fulfilling the 75% threshold for association, in addition to via issued share capital; and
  iv. The relief will be revoked if these two conditions are not met: (1) both the transferor and the transferee are within the charging scope of Hong Kong profits tax for six years after the transfer and (2) the transferor and the transferee remain associated for two years after the transfer.

KPMG observations

We welcome the apparent adjustment to the exclusion for disposal gains of traders whereby a reference to "substantial business activities in Hong Kong" is no longer made. While it is understandable for the trader to be within the charging scope of Hong Kong profits tax and for the FSIE regime to apply, the trader must be carrying on a trade or business in Hong Kong. A distinction between carrying on a trade or business in Hong Kong and performing the profit generating activities in Hong Kong suggests it is possible for a MNE entity to qualify for the trader exclusion in one hand, and make an offshore claim on its trading profits from disposal of assets in the other.

We also applaud the government's positive response to the stakeholders' request of considering other means of association for the purpose of the intra-group relief. That would cater for different forms of legal entity used by businesses in the commercial sector.

Next steps

The government plans to introduce the tax bills on the above two regimes to the Legislative Council in October this year, with an aim to enact the bills by the end of this year and for the two regimes to take effect from January 1 2024.

KPMG will continue to provide our comments and suggestions to the government on how to deal with the outstanding issues of the proposed regimes and other possible enhancements to make the regimes more useful and practicable. Business groups that may be affected by the regimes should also take this opportunity to provide their inputs to the government.

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Maintaining the tax base in the US and UK: TP and diverted profits tax

Caroline Setliffe and Ben Shem-Tov of Eversheds Sutherland give an overview of the US transfer pricing penalty regime and UK diverted profits tax considerations for multinational companies.

Caroline Setliffe

Ben Shem-Tov

Transfer pricing is often the largest tax and accounting issue for multinational enterprises with substantial related-party transactions. Taxing authorities around the world are becoming more aggressive in their efforts to examine these types of transactions and enforce adjustments and penalties.

While the laws of each country are different, the intent of TP regimes is similar across borders – to ensure income of MNEs is adequately taxed in the jurisdiction to which it is properly attributable.

The arm's-length principle (ALP) is the international standard on the valuation of cross-border transactions between related parties to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein.

While the US is allocating more resources to maintaining its tax base via TP, complementary anti-abuse measures – purportedly less susceptible to challenge under double tax treaties (DTTs) – are being used in other common law jurisdictions, such as the UK and Australia. The UK is also instituting a stricter TP documentation regime.

US transfer pricing

The arm's-length standard

Section 482 of the Internal Revenue Code governs TP and applies when two or more organisations, trades, or businesses are owned or controlled, directly or indirectly, by the same interests.

The Internal Revenue Service (IRS) standard to determine a controlled taxpayer's true taxable income is the ALP. This standard is based on the principle that income reported by related parties involved in a transaction should be the same as independent parties who engage in the same transaction under the same circumstances.

Whether a transaction produces an arm's-length result is determined by reference to the results of comparable transactions under comparable circumstances. The US Treasury regulations specify a variety of detailed methods for determining what is "comparable" and require the use of the test that provides the most reliable measure of an arm's-length result.

Section 482's TP provisions grant the IRS broad discretion to "distribute, apportion, or allocate gross income, deductions, credits, or allowances" between or among controlled enterprises if it determines that such a re-allocation is "necessary in order to prevent evasion of taxes or clearly to reflect the income" of any of the enterprises.

The IRS's Section 482 determination must be sustained absent a showing of abuse of discretion. Accordingly, whether the IRS abused its discretion is a question of fact that is resolved based on the trial record.

> "The transactional penalty increases to 40% if the reported transfer price is 400% or more, or 25% or less than the arm's-length price."

A taxpayer that challenges a Section 482 adjustment therefore has a "dual burden". First, the taxpayer must show by clear and convincing evidence that any IRS proposed TP adjustment is "arbitrary, capricious, unreasonable amounting to an abuse of discretion".

Second, the taxpayer must show by a preponderance of evidence (greater than 50% probability) the proper arm's-length result.

When a taxpayer meets the threshold burden of proof, the court nevertheless has the authority to determine the arm's-length result independently if the court determines that neither side is correct as to the proper arm's-length result.

This authority can place significant discretion in the hands of the court regarding the selection and application of the appropriate TP method.

The penalty regime

While the US has not adopted a general anti-avoidance rule (GAAR) applicable to corporate income tax (unlike the UK, which has a broad GAAR and a specific diverted profits tax (DPT), the US has a robust TP penalty regime in place.

Recently, the IRS put taxpayers on notice about the importance of these standards, stating in its FAQs for TP documentation that low-quality reporting can invite extensive information requests from the auditor to clarify facts, transactions, and economic analyses, and may not provide penalty protection.

The FAQs are important to review because the TP penalties can be significant. First, a transactional penalty applies to individual transactions in which the transfer price is determined not to be arm's length by the IRS.

The regulations impose a 20% non-deductible transactional penalty on a tax underpayment attributable to a transfer price claimed on a tax return that is 200% or more, or 50% or less than the arm's-length price.

The transactional penalty increases to 40% if the reported transfer price is 400% or more, or 25% or less than the arm's-length price. Where these thresholds are met, the TP penalty will be imposed unless the taxpayer can demonstrate reasonable cause and good faith in the determination of the reported transfer price.

In certain instances, based on the sum of all increases and decreases in taxable income that result from a series of transactions in which the transfer price is determined by the IRS not to be arm's length, a net adjustment penalty may apply.

Second, a 20% net adjustment penalty is imposed on a tax underpayment attributable to a net increase in taxable income caused by a net TP adjustment that exceeds the lesser of $5 million or 10% of gross receipts.

The net adjustment penalty increases to 40% if the net TP adjustment exceeds the lesser of $20 million or 20% of gross receipts. Where these thresholds are met, the TP penalty generally can be avoided if a taxpayer can demonstrate that it had a reasonable basis for believing that its TP would produce arm's-length results.

The taxpayer needs appropriate documentation of the analysis upon which that belief was based at the time the tax return was filed and turned over to the IRS within 30 days of a request. The principal focus of the TP regulations is on these documentation requirements that must be met if a taxpayer is to avoid the assessment of a net adjustment penalty.

Under this penalty regime, it is entirely possible that a taxpayer could be assessed for a transactional penalty but no net adjustment penalty at one end of the spectrum, or could be assessed for a net adjustment penalty but no transaction penalty at the other.

However, only one penalty, at the highest applicable rate, will be applied. The same underpayment in taxes will not be penalised twice. Hence, developing comprehensive TP documentation mitigates the risk of significant penalties for non-compliance and facilitates compliance with Section 482.

Economic substance doctrine

While the IRS has focused on Section 482 in the past, it may also attempt to invoke the economic substance doctrine in future TP disputes. The economic substance doctrine is an anti-abuse doctrine under which a court may deny the tax benefits of a transaction if the transaction either does not have a non-tax business purpose or the transaction does not change the taxpayer's economic position in a meaningful way.

The IRS recently pursued an economic substance argument in addition to a TP argument under Section 482, in *Perrigo v United States* (2021), and may attempt to invoke the doctrine in future cases.

There is no reasonable cause and good-faith penalty defence for economic substance penalties. A 20% penalty is imposed with respect to tax benefits that arise from a transaction that is found to lack economic substance. This penalty is increased to 40% if the transaction was not disclosed on the taxpayer's US federal income tax return.

The UK diverted profits tax

Origin, design and calculation

As with the US, the UK has domestic TP rules. These are based on the OECD ALP and are found in Part 4 of the Taxation (International and Other Provisions) Act 2010.

Naturally, they have fundamental interaction with UK corporation tax and income tax, requiring certain adjustments to tax returns and computations where triggered in order to ensure reflection of the ALP in the given taxpayer's overall UK tax position.

In addition to the UK's TP rules and general anti-avoidance legislation, most notably the GAAR, which covers (among other taxes) corporation tax and income tax, the UK has a DPT.

This came into force in respect of 'diverted profits' arising on or after April 1 2015 (the relevant legislation can be found at Part 3 of, and Schedule 16 to, the Finance Act 2015 and Schedule 6 of Finance Act 2019).

> "In 2014 and 2015, there was a great deal of UK policy focus and debate on the practice of MNEs 'diverting' their UK-generated profits outside of the UK (perfectly legally)."

The DPT rules adopt many TP principles, but go a step further than the UK's basic TP rules and in many respects present like an earlier, UK domestic-focused stab at what is shaping up to be the global base erosion (GloBE) top-up tax rules under the OECD's two-pillar solution.

In 2014 and 2015, there was a great deal of UK policy focus and debate on the practice of MNEs 'diverting' their UK-generated profits outside of the UK (perfectly legally), thereby eroding the UK tax base and not paying their 'fair share' of UK tax.

In that context, the UK government of the day introduced the DPT. In essence, it is intended as a rather large 'preventative' stick to make MNEs reconsider the use of contrived related-party arrangements to reduce the amount of UK tax that they would otherwise be paying.

The DPT carries a main rate of 31%, meaning a 6% punitive elevation above the main rate of UK corporation tax. The rate is yet higher for certain banking and oil sector profits.

Broadly, the DPT applies in two circumstances. First, where there are related-party arrangements (involving either UK-resident or non-UK-resident companies) which lack economic substance that enable the exploitation of tax mismatches.

Second, where there is avoidance by a non-UK-resident company of a UK-taxable presence (an avoided permanent establishment) so that the total tax derived from its UK activities is significantly reduced.

The amount of DPT payable on 'taxable diverted profits' depends on various factors and there are slightly different calculations applied depending on the applicable trigger (lack of economic substance or avoided PE).

In nearly all circumstances, the calculation involves, very broadly, a comparison between the transaction which was actually implemented and the alternative transaction that it is just and reasonable to assume would have been entered into if tax had not been a relevant consideration for any of the parties at any time. Essentially, TP principles (profit attribution, the ALP, etc) are applied and there is re-characterisation where necessary.

For example, with respect to the lack of economic substance trigger, there should be no 'taxable diverted profits' (and so no DPT charge) if the actual transaction has been correctly priced, or, despite being incorrectly priced, the relevant company has made transfer pricing adjustments that put it in the same tax position as if arm's length pricing had been used.

While the DPT rules allow credit to be given on a just and reasonable basis to reduce a charge where corporation tax or foreign tax (or a relevant controlled foreign company charge) has already been paid on the same profits, it is not guaranteed that another jurisdiction will give (domestic, unilateral) credit against a domestic tax charge in that jurisdiction for a DPT charge on the same taxable profits.

In this context it is important to note that DPT is a separate, standalone UK tax charge on 'diverted profits' and not a penal rate of UK corporation tax. This appears to have been an intentional policy decision when introduced.

It is on this basis that HM Revenue and Customs (HMRC) has historically considered that it is not a 'covered tax' for the purposes of the UK's wide double taxation treaty (DTT) network.

This has given rise to a real risk to MNEs (depending on the non-UK jurisdiction involved) of double taxation, absent a successful challenge under the mutual agreement procedure (MAP) of an applicable DTT.

Recently, MNEs have started looking to use the MAP process under relevant DTTs with the UK as a means of contesting the position historically taken by HMRC, in order to seek relief from what they consider to be (UK) taxation not in accordance with the DTT. This is on the basis that the DPT should be considered a tax covered by the relevant DTT where that DTT includes wording to the effect that it covers identical or substantially similar taxes to those taxes listed as covered in the relevant DTT (e.g. corporate income tax) that are imposed after the entry into force of the DTT (the US-UK DTT being one such example).

This process should now become somewhat easier in view of a 2022 legislative change in the UK which allows relief against the DPT to be given where doing so is necessary to give effect to a decision reached in a MAP.

The change was made to ensure that the UK meets its commitments under DTTs, the subtext being that there was increasing pressure from other jurisdictions to roll back an essentially unilateral charge that they consider, in certain circumstances, to be outside the spirit, if not the letter, of bilateral tax conventions.

In view of this legislative change, a consultation launched by HMRC on June 19 2023 on how to reform the DPT, transfer pricing and permanent establishment rules to make them clearer and easier to use (which, interestingly, includes a proposal to bring the DPT into the UK corporation tax regime).

It will be interesting to see how the practical application of the DPT evolves in view of this legislative change, a consultation launched by HMRC on June 19 2023 on how to reform the DPT, TP and PE rules to make them clearer and easier to use (which includes a proposal to bring the DPT into the UK corporation tax regime), and the introduction of the GloBE rules

Conclusion

MNEs should thoroughly review the TP regimes in the countries in which they operate. Although the laws of each country vary, generally, developing comprehensive and contemporaneous TP documentation mitigates the risk of significant penalties for non-compliance and accuracy-related penalties, and further facilitates compliance with local requirements, including under both the US and UK TP regimes.

Companies need to carefully evaluate their inter-company agreements, the economic substance of underlying transactions, current trends in TP cases, and examine all available avenues for DTT relief (including in respect of the UK DPT where necessary).

Transparency and speed are key to EU withholding tax reform

A drive for speed and efficiency defines the European Commission's proposal for streamlining how EU member states deal with withholding tax reclaims. Ralph Cunningham reports.


Ralph Cunningham

By September 4, the European Commission had already received 227 items of feedback to the two-month public consultation on its proposal for a new EU system for the avoidance of double taxation and prevention of tax abuse, named Faster and Safer Relief of Excess Withholding Taxes (FASTER). The consultation closed on September 18.

So far, the majority of respondents have been individual investors – with Spanish taxpayers being particularly enthusiastic participants – urging EU officials to streamline and harmonise the process as much as possible throughout the bloc.

Some wrote that withholding tax (WHT) should be 0% in the country of origin to avoid the bureaucracy of reclaiming it. Perhaps without fully understanding the Commission's proposal, others argued the EU should go towards the US system where, annually, non-US individuals and entities submit a form to the Internal Revenue Service to certify their foreign status.

This allowed such taxpayers to claim a reduced rate or exemption from WHT on income earned in the US. This is similar to the digital tax residency certificate that the European Commission is proposing.

Others have written that they have invested in jurisdictions, such as the UK, that do not charge dividend WHT because the refund process in the EU is so lengthy and awkward.

BSH Hausgeräte, Europe's leading manufacturer of home appliances, is one of the few companies to have responded so far. The author of its submission expressed a frustration that was common to many other submissions, writing: "I propose to extend this initiative also to withholding taxes on royalties/license fees. According to our experience it is very bureaucratic and takes a very long time to get the application of the double taxation treaties granted and excess withholding tax refunded."

FASTER and faster

One could be forgiven for thinking that the European Commission unveiled the FASTER proposal on June 19 as a direct attack on scandalous cum-ex and cum-cum share-trading schemes.

These schemes saw banks and investors use the rapid buying and selling of company shares to make multiple claims for dividend WHT refunds where only one amount of tax was paid.

However, while its announcement of its proposal for a new directive on June 19 referred to how the cum-ex and cum-cum schemes showed how convoluted WHT procedures in different EU member states could be abused, the EU (and other multilateral organisations) have wanted to create an efficient and speedy cross-border WHT refund system for some years.

For example, the OECD's Treaty Relief and Compliance Enhancement initiative allows the claiming of WHT relief at source on portfolio investments through its Authorised Intermediary system. Financial institutions can report information about taxpayers eligible for relief to tax administrations, while tax authorities exchange information with their counterparts in other jurisdictions.

The EU's proposal for a new directive is based on three policy options:

1) A common digital tax residence certificate (eTRC) plus common reporting that would allow "investors with a diversified portfolio in the EU to need only one digital tax residence certificate to reclaim several refunds during the same calendar year" and a common reporting standard where every financial intermediary throughout the financial chain would report a defined set of information to the source member state.
2) Relief at source, where member states would have to establish a system that allowed for the application of reduced rates in double tax treaties or domestic rules directly at the moment of the payment; and
3) A quick refund system within a set timeframe and/or relief at source where the reclaim is handled within a pre-defined timeframe: "Member states shall process a refund request … within 25 calendar days from the date of such request or from the date reporting obligations under this directive have been met by all relevant certified financial intermediaries, whichever is the latest."

Each member state will have to implement a fully automated system for issuing eTRCs within a day of one being requested. Though an eTRC is primarily for WHT efficiency at the moment, the Commission envisages that one could be used for other purposes; the proposal allows for other information to be added to it.

New CFI regulation

Member states will also have to set up a national register of certified financial intermediaries (CFIs) so investors can access the services of legitimate providers. Large institutions will have to enroll as CFIs in the member states where securities issuers are located or where their investors have invested. For other organisations, joining a CFI register will be voluntary.

CFIs will have to report if their clients' investments take place in a member state that has a national register of CFIs.

According to the proposal, the aim is to ensure that "the recipient of the full reporting, either the source tax administration or a WHT agent designated on its behalf, will have all the information needed to reconstruct the financial chain of the transaction from the investor to the securities' issuer".

The proposal aims to stop WHT abuse by requiring that CFIs report information about the holding period of underlying securities. Buying securities within two days of the ex-dividend date was a feature of cum-ex schemes.

CFIs will also have to report financial arrangements linked to the securities for which the taxpayer is requesting tax relief. Such arrangements could show possible links to a cum-cum scheme.

In 2021, Professor Christoph Spengel and colleagues from the University of Mannheim Business School in Germany, along with Correctiv, the cross-border investigative journalism network, which first brought the cum-ex and cum-cum scandals to global attention in 2017, put a "conservative" estimate of €150 billion ($163 billion) on the losses suffered by national revenue authorities in 10 countries from fraudulent dividend tax reclaim schemes between 2000 and 2020.

Speaking to *ITR*, Martin Phelan, head of tax at Simmons & Simmons in Dublin, says he supports the Commission's proposal: "Anything that can make interacting with states simpler is a good thing.

"The idea of a digital tax residency certificate is fabulous," he adds. "I can't believe it's taken until now. If you think about it, there was no hassle in producing digital COVID certificates for everybody."

Tax returns

However, Phelan foresees that some EU member states will find some of the details of the proposal to be problematic. He says it may explain why the Commission has set a date of January 1 2027 for member states to transpose the final directive to their national legislation.

"I think the 25 days [that member states will have to refund WHT under the quick refund proposal] is going to cause problems" he says. "I think that will cause challenges for some countries who probably collect a lot of withholding tax and don't particularly want to give it back as fast, so I think they're giving them until 2027 to get their act in order."

These new proposals are part of a series of efforts in recent years by the European Commission to tackle tax abuse. These have included DAC (Directive on Administrative Cooperation) 6, 7 and 8, covering mandatory disclosure by tax practitioners of cross-border tax arrangements, and reporting for digital platform operators and crypto-asset providers; and ATAD (Anti-Tax Avoidance Directive) 1, 2 and 3, the latter more commonly known as the Unshell Directive, at the moment in draft form, which seeks to deny tax benefits to entities with minimal or no substance.

National action

Member states are also taking their own action against the risk of tax abuse. For example, the Ministry of Finance in Germany sent the draft Growth Opportunities Act (Gesetz zur Stärkung des Wirtschaftswachstums und der Zukunftsinvestitionen), which includes changes to national and international tax law provisions, out for consultation with German industry in July.

"There are some rules in there which are good for business," Jens Schoenefeld, a partner of Flick Gocke Schaumburg in Bonn, tells *ITR*. "But the draft also extends DAC 6 from cross-border situations to purely domestic situations."

Cross-border links

The EU proposals also come at a time when international standards of tax transparency and information exchange between tax administrations have probably never been greater. Extra reporting requirements have also given officials unprecedented insight into the tax arrangements of companies and financial institutions.

Schoenefeld believes the EU needs to turn its attention in another direction to help the region's economy.

"It's my personal opinion but I think it's not necessary to implement more rules," he says. "We now have rules which make sure that tax abuse is no longer possible and tax structuring is hard to do. I think now it's time to start a discussion about how we can change the mindset to be open minded for businesses to come to Germany and to Europe overall.

"The US has a totally different mindset. They are positive about any investor. In Europe, it's the opposite: any kind of business is always dangerous, and you have to regulate it."

EGYPT

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Nouran Ibrahim, Hana Khalil and Noura Moawad

Avoiding tax pitfalls by understanding the interaction between TP adjustments and taxes in Egypt

Transfer pricing adjustments are common mechanisms used by companies to adapt to changes in market conditions, deal with data limitations, respond to changes in performance, and ensure their adherence to global policies. Multinational corporations operating in Egypt, especially in the current economic environment, need to monitor the impact of transfer pricing adjustments.

This article outlines the effect of transfer pricing adjustments administered before year end on direct and indirect taxes in light of recent tax audits.

Types of adjustment implementation

Companies may administer transfer pricing adjustments in a number of ways to achieve a desired arm's length outcome. They can be grouped based on their effect on a company's profit and loss account as follows:

- Profit adjustments, which for the purposes of this article refers to adjustments made at the operating profit level. Their objective is for the company to achieve a margin that is within an arm's length range of comparable companies. Profit adjustments are often recorded as separate line items such as other revenues/other expenses. These adjustments may not be linked to a particular product or service and are focused on adjusting the overall results of a company. Profit adjustments may also occur within the revenues/cost of goods or services sold; however, for simplicity, these will be considered within the following type of adjustment.
- Price adjustments, which adjust the price charged for particular goods or services transferred between related parties. The main drivers for price adjustments are usually errors, or changes in the cost of production or market prices. Price adjustments are typically recorded directly within the revenues/cost of goods or services sold.

These adjustments can be made as upward adjustments, increasing the taxable income of the company, or as downward adjustments.

Impact of TP adjustments

Transfer pricing adjustments are often cause for debate as they can materially change the amount of taxable income that a company reports. Accordingly, the impact of an adjustment must be evaluated from a number of angles, most importantly:

- Transfer pricing audit outcomes – given there is no specific guidance on the treatment of transfer pricing adjustments within Egyptian tax law or transfer pricing guidelines (with the exception of those made in an advance pricing agreement context), adjustments are cause for attention, and tax authority assessments are made on a case-by-case basis;
- Possible deductibility challenges – Egyptian tax law specifies conditions for deductibility and a deduction of cost is denied for tax purposes if these are not met;
- Triggers for withholding tax – usually correlated with the characterisation of the payment made and whether it may be classified as dividends, interest, a royalty, or services; and
- Indirect taxes – while companies typically consider transfer pricing adjustments as primarily a corporate income tax issue, such adjustments can also have a large impact on VAT and customs.

The impact is different depending on the nature of the adjustment and its direction; upwards or downwards. Accordingly, it is important for companies to evaluate the possible scenarios prior to administering an adjustment.

Upward adjustments

Upward adjustments increase the profit of the company. An upward price adjustment results in an increase in revenue or a decrease in cost of goods or services sold, while an upward profit adjustment results in an additional revenue line item in the income statement of the company, beyond gross profit, such as support payments or subsidies.

From an Egyptian perspective, the impact of an upward adjustment may have an effect on the transfer pricing assessment made upon audit, and on indirect taxes – depending on the characterisation of the adjustment.

TP audit outcomes

In cases where the upward adjustment is not clearly linked to the core operations of the company or its goods or services,, the tax authority may initially dismiss the adjustments from the operating profit calculation, and then may offset them later (depending on the case) against profit adjustments calculated by the tax authority at the time of the audit. This essentially means that, if not carefully characterised, there is a risk that company results would fall out of range despite the presence of the upward adjustment, which may still result in an added tax liability.

VAT and customs

Where the upward adjustment has caused a decrease in cost of goods sold, this may mean that the company is entitled to a customs and/or VAT refund.

Where the upward adjustment has caused the introduction of additional revenue, the company may be considered to have exported a service. Ordinarily, an exported service is subject to a 0% VAT post meeting certain service classification requirements. The most relevant requirement is where the services are deemed to be ultimately benefiting the Egyptian market, in which case the upward adjustment may be subject to VAT.

Downward adjustments

Downward adjustments decrease the profit of the company. A downward price adjustment results in a decrease in revenue or an increase in costs of goods or services sold, while a downward profit adjustment results in an additional cost line item in the income statement of the company, beyond gross profit, such as a residual payment. From an Egyptian perspective, the impact of a downward adjustment may have an effect on the transfer pricing assessment made upon audit, as well as on deductibility, withholding tax, and indirect taxes – depending on the characterisation of the adjustment.

TP audit outcome

A downward adjustment is consistently challenged, particularly when not clearly linked to a good or service that is provided by the overseas counterpart. It is generally regarded by the authorities as a reduction in profits generated in the Egyptian market and facilitated by its conditions.

Deductibility

The Egyptian income tax law has conditions for approving the deductibility of costs for corporate tax purposes, as follows:

- The necessity of the cost for the performance of the company's activities; and
- The costs being real, and supported by documents.

On that basis, downward price adjustments that are more directly linked to certain services/goods, and are therefore regarded as real, are easier to justify for deductibility. On the other hand, downward profit adjustments are more difficult to justify if not characterised and linked to the core operations of the business.

VAT and customs

The VAT and customs impact may differ depending on the way the downward adjustments are booked within the income statement. Where the downward adjustment has caused an increase in cost of goods sold, this may mean that the VAT or customs originally paid will be impacted and the company may need to settle additional taxes.

With downward profit adjustments which would result in documentation of the adjustments as separate cost line items, the downward adjustment could be subject to VAT depending on the nature/characterisation. The invoice received by the Egyptian company may be considered an imported service benefiting the Egyptian market and subject to VAT. Payments that may have an intellectual property component may be subject to customs as well as VAT.

Withholding tax

In most instances, true down adjustments will not explicitly represent dividends, interest, services, or royalties. However, practically speaking, it is likely that in a tax audit the authorities would still seek to impose withholding tax on those payments with the purpose of retaining taxing rights on exit from Egypt.

Key takeaways

Regardless of the driver to perform transfer pricing adjustments, companies need to take into consideration the impacts they might have from the transfer pricing, indirect tax, deductibility, and withholding tax angles to avoid pitfalls, such as recharacterisation, disallowance, and adjustments during audit.

Transfer pricing adjustments can be complex to navigate; however, by carefully considering the potential impacts and by accurately documenting and supporting the adjustments, companies can mitigate a large number of risks and remain consistent with their global policies.

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ITALY

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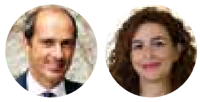

Paolo Ludovici and Marlinda Gianfrate

Multilateral instruments from BEPS 1.0 to BEPS 2.0

Introducing model tax convention amendments into all existing bilateral tax treaties requires a bilateral negotiation and the process can take several years to complete. A quicker and more agile way to adopt changes would be through multilateral negotiations and a multilateral instrument.

A multilateral tax instrument is a tool included in both pillars of BEPS 2.0.

On July 11 2023, 138 members of the OECD/G20 Inclusive Framework on BEPS (IF) agreed on an outcome statement that reports the package of deliverables developed to complete the two-pillar solution. Among others:

- The package on Amount A of pillar one, which allows jurisdictions to reallocate and exercise a domestic taxing right over a portion of residual profits of defined multinational enterprises (MNEs) to market jurisdictions, includes the text of a multilateral convention (MLC); and
- The Subject-to-Tax Rule (STTR), together with its implementation framework consisting of a multilateral instrument (MLI) and an explanatory statement, will enable developing countries to update their bilateral tax treaties to restore taxing rights on certain outbound intra-group income where such income is subject to low or nominal taxation in the other jurisdiction involved.

The MLC on Amount A of pillar one

As Amount A of pillar one is not consistent with existing bilateral tax treaties, it requires an MLC to come into effect.

Under the MLC of Amount A of pillar one, jurisdictions will be allowed to reallocate and exercise a domestic taxing right over a defined portion of the largest and most profitable MNEs' residual profits that meet certain revenue and profitability thresholds and that have a special purpose nexus to the markets of the relevant jurisdictions. These taxing rights are allocated across jurisdictions based on the market shares of MNEs to overcome the issue of companies operating in jurisdictions without physical presence.

The agreed rules on Amount A are being translated into provisions for inclusion in an MLC. The MLC will establish the legal obligations of the parties involved to implement Amount A consistently.

In addition to the operative provisions of Amount A (for example, scope and the mechanisms for relieving double taxation), the MLC will contain provisions requiring the withdrawal of all existing digital service taxes (DSTs) and relevant similar measures with respect to all companies, including those not in the scope of Amount A. The MLC will also include a commitment not to enact DSTs or relevant similar measures.

The IF will publish the text of the MLC once it has been prepared for signature. The MLC will be opened in the second half of 2023 and a signing ceremony will be organised by year end. The aim is to enable the MLC to enter into force in 2025.

Only companies that are headquartered in a jurisdiction that signed the MLC can be covered. Therefore, to assess the consequences in terms of the revenue potential of Amount A, it is necessary to focus on who ratifies and effectively implements the reform: the MLC would require ratification by a significant number of jurisdictions to come into effect as it involves the participation of all countries in which MNEs declare significant income.

The MLI for the implementation of the STTR

The STTR, as part of pillar two, is a treaty-based rule that applies to intra-group payments (interest, royalties and other defined payments) from source states that are subject to low nominal tax rates in the residence state (less than 9%).

The document Tax Challenges Arising from the Digitalisation of the Economy – Subject to Tax Rule (Pillar Two): Inclusive Framework on BEPS was published on July 17 2023.

The MLI implementing the STTR is expected to be released and open for signature from October 2 2023. It will amend the bilateral tax treaties of lower-income countries with other countries.

The STTR is presented as a separate treaty article to make it easier to manage its interaction with other treaty provisions and it is consistent with the structure of, and terminology used in, the OECD Model Tax Convention on Income and on Capital.

The draft does not preclude the flexibility to make amendments in the context of a bilateral tax treaty as the MLI will provide one possible option for implementation of the STTR. Jurisdictions are free to include the provision in their tax treaties on a bilateral basis. The form of the provision included in the MLI will contain adaptations so that it is modified to existing treaties that might conform to the UN Model Double Taxation Convention between Developed and Developing Countries as there are divergences between the OECD and the UN model.

Background: the BEPS MLI

The OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the BEPS MLI) is a mechanism to amend several bilateral tax treaties at one time. It was adopted to transpose BEPS 1.0-related changes into more than 2,000 existing bilateral tax treaties. It modifies bilateral tax treaties of pairs of countries and applies only where the two countries agree to apply it to a bilateral treaty and only to the extent that they agree.

The MLI was signed on June 7 2017 and entered into force on July 1 2018.

Based on OECD data, 100 jurisdictions have joined the MLI; out of which, 81 jurisdictions have ratified or approved the BEPS MLI, and it covers around 1,850 bilateral tax treaties. Around 650 additional treaties will be modified once the BEPS MLI has been ratified by all signatories. The BEPS MLI requires a complex matching process to identify which bilateral tax treaties will be amended.

In June 2023, an improved version of the database supporting the application of the MLI was released and it is a useful tool to verify the implementation and application of the MLI as it offers the 'matching results' under the MLI in respect of each covered tax treaty.

A few years after its adoption, the BEPS MLI has not yet had its full effect because a third of the bilateral tax treaties still need to be amended and among these, Italy is continuing to be delayed.

The path of Amount A of pillar one is still evolving and for it to be effective, it is necessary for the US to ratify the MLC (most of the MNEs in scope are American) and for the MLC to be ratified by a number of countries representing a significant percentage of covered MNE groups.

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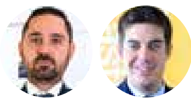

Federico Vincenti and Alessandro Valente

The Public Country-by-Country Reporting Directive arrives in Italy

The Italian government, through the European Delegation Law 2022–2023 (*Legge di delegazione europea 2022–2023*) that was approved on June 16 2023, has been delegated to implement European directives and other acts of the EU into the Italian legal system. Directive (EU) 2021/2101 of November 24 2021 (the Public Country-by-Country Reporting Directive), which amends Directive 2013/34/EU concerning the disclosure of income tax information by certain companies and branches, will also be incorporated into Italian legislation.

Directive (EU) 2021/2101 introduces an obligation for multinational companies to disclose their taxes paid in each EU country.

The directive's goals

The main aims of the directive are to:

- Increase tax transparency and fight corporate income tax avoidance;
- Enhance public scrutiny over corporate income taxes paid by multinational companies operating in the EU; and
- Promote an informed debate on the level of tax compliance of certain multinational companies operating in the EU and the impact of tax obligations on the real economy.

Enhanced financial reporting transparency will lead to broader involvement on multiple levels; for example, workers will be better informed, and investors will be less risk averse. Also, companies will benefit from this initiative as it improves relations with stakeholders, resulting in increased stability, easier access to financing thanks to clearer risk profiles, and a better reputation.

The fundamental purpose is to enable anyone to examine all the activities of a group of companies when the group includes certain types of entities established within the EU. In the case of groups conducting activities within the EU solely through subsidiaries or branches, these subsidiaries and branches should publish and make accessible communication from the parent company.

If such information or communication is not available, or if the parent company does not provide the required information to the subsidiaries or branches, the latter should prepare, publish, and make available a communication containing all the information they have obtained, along with a statement certifying that their parent company did not provide the necessary information.

The Public Country-by-Country Reporting Directive enables governments, citizens, and other stakeholders to better understand how multinational enterprises (MNEs) organise their activities and fulfil their tax obligations through tax payments. This helps to prevent aggressive, abusive, and evasive tax practices.

For these reasons, the directive stipulates that it is the member states' responsibility to establish effective, proportionate, and dissuasive sanctions for companies that fail to comply with the obligations of publishing the required information.

Entities within scope

According to the amendments to Directive 2013/34/EU under Directive (EU) 2021/2101, the following entities are obligated to undergo public reporting:

- EU-based MNEs which total consolidated revenue exceeding €750 million (about $824 million) for each of the last two financial years and that are active in more than one jurisdiction; and
- Non-EU-based MNEs which total consolidated revenue exceeding €750 million for each of the last two financial years and controlling:
- A medium-sized or large subsidiary "governed by the national laws" of a member state of the EU; or
- A qualifying branch in any member state.

In general, the reporting requirements for the above entities are lifted when their total revenues at the end of the financial year are less than €750 million for each of the last two consecutive financial years, as evident from the consolidated financial statements.

Information to be reported

The obligation of the aforementioned companies is to make public certain information regarding the activities carried out by each company, according to Directive (EU) 2021/2101; above all, that involving certain "third-country tax jurisdictions which pose particular challenges". This includes information related to all consolidated subsidiaries for the relevant financial year, including:

- A brief description of the nature of the business;
- The number of full-time equivalent employees;
- Revenues;
- The pre-tax profit or loss;
- Taxes accrued and paid; and
- The amount of undistributed profits for each member state.

For all other third-country operations, the information should be given on an aggregate basis, unless the undertaking wishes to present more detailed information.

The safeguard clause

Considering the sensitivity of the information and to ensure that the disclosure of such information does not harm a company's commercial position, the directive allows member states to include a safeguard clause that enables multinational companies not to disclose commercially sensitive information for five years.

The increased financial and tax transparency required by Directive (EU) 2021/2101 could also impact the company's strategy, as the disclosed information will be available to the public, competitors, and investors. This could influence the perception of the company among its stakeholders and affect access to financing or commercial partnerships.

The impact on MNEs

Overall, the implementation of Directive (EU) 2021/2101, not only in Italy but across all EU member states, will have a significant impact on multinational companies operating in the EU in terms of the allocation of human and financial resources and the responsibilities of CEOs and CFOs.

Companies will need to be prepared to make new investments to update their compliance models to meet the required obligations.

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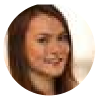

Rebecca Hammer

Proposed changes to the Norwegian interest deduction limitation rules

Financial leasing

As of today, the definition of financial lease for accounting purposes is, in certain situations, wider than the definition of financial lease for tax purposes. Consequently, not all financial lease payments have been considered as interest under the Norwegian interest deduction limitation rules.

The Ministry of Finance now proposes that the accounting definition shall override the tax definition. Hence, when calculating net interest expenses for interest deduction limitation purposes, the finance cost element related to financial leasing shall be the same amount as set out in the company's annual accounts prepared in accordance with the Norwegian Accounting Standard (*Norsk RegnskapsStandard*) 14 (NRS 14). If no finance cost element has been recognised in the financial statements, the company would have to assess whether the calculation of the interest element is in line with the principles in NRS 14. In the event of different treatment, the company may have to keep a "shadow accounting" determining the finance cost element in line with NRS 14.

For taxpayers with a financial lease, the proposed change may lead to increased net interest expenses being denied deduction for tax purposes or the taxpayer having to decide to limit the interest deduction. The proposal will also lead to increased compliance costs for taxpayers.

Special limitation rule for interest expenses to related parties

The Norwegian interest deduction limitation rules contains a specific limitation on net interest expenses to related parties that fall outside the definition of the same "group" under the interest deduction limitation rules.

It has been possible to circumvent this rule by incorporating an intermediary Norwegian holding company and using back-to-back shareholder loans. By doing so, the Norwegian holding company with interest expenses to a related party outside the group, would have zero in net interest expenses, and thus not have any net interest expenses subject to the special interest limitation rule.

The Ministry of Finance now suggests introducing a special anti-avoidance rule tracing the interest payment as if the interest payment was paid directly to a related party outside of the group.

Group contributions and calculation of the interest deduction cap

Under the current rule, group contributions received from a company that applies the equity escape rules shall not be included when calculating the interest deduction cap (25% of taxable EBITDA). The Ministry of Finance states in the proposal that the current rules may be circumvented by transferring group contributions via a third company that does not use the exemption rule.

The Ministry of Finance proposes that group contributions via a third company may be traced back as if received directly from a company applying the equity escape rules. It is also proposed that group contributions from financial institutions and companies falling within the scope of the Petroleum Taxation Act that are exempt from scope of the interest deduction limitation rules, are not to be included in the calculation of the interest deduction cap.

Summarising comments

The proposed changes will add further complexity to the Norwegian interest deduction limitation rules, which are already complicated. The Ministry of Finance has estimated that the proposed change to the definition of financial leasing will have a tax revenue effect of about NOK 30 million. When weighing the limited tax revenue effect up against the increased complexity of the rules, one may question whether the proposed change is necessary.

The second proposal will stop certain interest deduction limitation planning, however the proposal will at the same time also impact wholly-owned Norwegian structures with commercially driven financing structures. The proposal goes therefore broader than the purpose behind the rules, which is to limit base erosion within multinational groups by placing a higher level of debt in high tax jurisdictions.

Regarding the third proposal, it may also be questioned how widespread the problem with group contributions indirectly originating from companies that have invoked the equity exemption rule is in practice.

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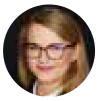
POLAND

MDDP



Agnieszka Krzyżaniak

How to manage financial transactions – TP aspects in Poland

In the current economic situation, the importance of intragroup financial transactions has been growing. Companies are increasingly borrowing from a related party instead of financing from an external financial institution. This approach is triggered by lower creditworthiness of lenders or less activity of the banks. This approach was confirmed in a report prepared by the National Bank of Poland entitled "Credit Market Situation." In Q4 2022 an increase was reported in the margin for higher-risk loans and a decline in demand for long-term loans to entrepreneurs. One of the reasons for the latter decline was the increase of intragroup financing for companies from their own resources.

Intragroup financial transactions

From a TP perspective, intragroup financial transactions not only cover loans. Group financing can also take place through issuing bonds, providing a deposit, or participating in a cash-pooling system. Financial transactions also include group guarantees or insurance services, factoring services, hedging services and other currency transactions.

Intragroup financial transactions often bring benefits to related parties, for example, by obtaining additional financing, which can be used to conduct investments or develop business activities. By receiving a group guarantee, the company can achieve the bank financing or improve the terms of bank financing. In addition, receiving a guarantee can be a requirement for entering a tender or contract, whereas participation in a cash pooling system allows the day-to-day management of funds in capital groups. The entity engaged in management of the cash pooling structure allocates the financial surpluses to those entities that have cash shortages.

The attractiveness of intragroup financial transactions is also confirmed by published statistics of the Polish Ministry of Finance. About 43% of all reported intra group transactions for FY 2019 in the TP-R declaration (a dedicated tax return for TP purposes in Poland) referred to financial transactions. Moreover, in practice, the values of intragroup financial transactions in terms of loans capital are high, therefore the value of potential reassessment of the value of interest could have a material impact on the settlements of the companies.

Benchmarking analysis based on reliable data is crucial

An important factor affecting the valuation of financial transactions with related parties is the changing economic environment in which related parties operate. From a TP regulations perspective it is crucial to defend the arm's length level of interest rate by possessing a valid, reliable, high-quality benchmarking analysis for financial transactions.

To confirm the arm's length level of interest rate it is not sufficient to pursue just any analysis. For example, in the judgment of the Polish Supreme Administrative Court of June 29, 2022, it was indicated that a valuable benchmarking analysis should be carried out based on the element of comparability analysis indicated in the Polish TP regulations.

The comparability study for financial transactions should include:

- The period under review;
- Description of the related parties and the economic environment;
- Analysis of functions, assets, risks, and selection of the tested party (if any);
- Internal comparability analysis (if possible);
- In case of lack of internal comparables, identification of available external comparables;
- Selection of the most appropriate method and financial indicator for the application of the selected TP method;
- Analysis of available comparative data;
- Comparability adjustments; and
- Calculation of the financial results.

In the opinion of the Supreme Administrative Court, the benchmarking analysis for loans presented by the tax office did not cover the obligatory elements of comparability study specified by Polish TP regulations. The tax office's analysis was limited to a brief description of the company, and a description of the loans and queries to the banks, which included interest rates and commission rates for loans granted to commercial companies. In this manner the identification and verification of comparable terms and conditions established by independent entities was completed, including:

- The currency of the loan;
- The amount of financing;
- The purpose of the financing;
- The term of the loan;
- The presence of collateral;
- The type of interest rate applied; and
- The amount of the bank's commission.

The Supreme Administrative Court observed that in the presented benchmarking analysis, the authority did not analyse the loan transactions comprehensively. The analysis covered only the loans themselves without considering the purpose of the loan (financing of a specific investment). Therefore, the analysis did not cover all the relevant comparability factors, including the assets and risks incurred within the transaction. The tax authority in its enquiries to the banks did not include significant information about the company, i.e. its credit rating, the market in which it operates and the types of collateral used, which was not applied in the pricing received.

The Polish Supreme Administrative Court is not alone in questioning the appropriateness of using bank offers to prepare benchmarking analyses. In the newest version of the OECD guidelines, it is indicated that bank bids should not be used as comparative data, because these data must reflect the conditions under which unrelated parties enter transactions. Bank bids do not meet this requirement, because they do not reflect the conditions of actual transactions, since they may be the subject of negotiations at a later stage. Furthermore, before granting a loan, the bank conducts a relevant credit rating analysis, which precedes the formal loan offer. Therefore, such bank bids are generally not considered as evidence to confirm the arm's length level of interest rates in the financial transactions.

Therefore, possession of high-quality benchmarking analysis for financial transactions reduces the possibility of its questioning by tax authorities during an inspection. It also limits the possibility of a potential reassessment of income. It should also be emphasised, that if a taxpayer has a benchmarking analysis, the tax authority must question it before preparing its own analysis. Therefore, the higher the quality of the benchmarking study, the more difficult it will be for the tax authority to question it.

Macroeconomic factors

According to Polish TP regulations, the benchmarking analysis prepared for financial transactions should be updated at least every three years, unless a change in the economic environment significantly affects the prepared analysis and justifies a more frequent update.

The current economic situation in the borrower's country or in its industry can directly affect the level of remuneration in financial transactions carried out between related parties. In recent years, dynamic changes in the economic situation caused by, among other things, the COVID-19 pandemic, high inflation, changes in interest rates and the war in Ukraine should have affected the conducted analyses. Among the factors that are important to analyse for financial transactions are: credit rating, type of interest rate, currency and the impact of the group support. It is important to consider whether the benchmarking analysis for financial transactions prepared a year or two ago will still be relevant in view of the market changes since 2021.

To determine if an update of the benchmarking analysis is required, each financial transaction should be analysed individually. One of the key factors that should be verified is the borrower's credit rating. If it changes, a benchmarking analysis update should be considered.

As good practice, it is recommended to review annually whether market factors or intra-group changes in arrangements have affected the remuneration applied in financial transactions. Based on such an analysis, it can be concluded whether an update of the benchmarking analysis is necessary. The above approach to the verification of the arm's length nature of the transfer price was also confirmed by the individual interpretation issued on March 24 2021 by the Polish Director of National Fiscal Information (PDNFI). Doubts raised by the taxpayer concerned whether the interest rate should be adjusted, in the event that the adopted interest rate level (determined at the time of concluding loan agreements) in loan transactions concluded historically, deviates from the results of the updated benchmarking analysis.

The PDNFI indicated that it is the taxpayer's responsibility to monitor the terms and conditions of the transactions on an ongoing basis and to adjust them if unrelated parties would do so. Moreover, if the interest rate terms of a previously granted loan were market-based, but became non-market-based due to, for example, a significant changes of circumstances, the parties should adjust the transfer prices to a level consistent with the arm's length principle from an updated benchmarking exercise.

In conclusion, the changing economic situation and the tightening credit policies of banks towards companies changes the terms and conditions of financing provided between unrelated parties. Therefore, the interest rate levels in financing transactions conducted between related parties should also be updated to reflect the market conditions. Accordingly, the taxpayer should verify whether ongoing market changes affect the terms of financial transactions conducted with related parties. If so, it is important to adjust the terms of this transaction to the market conditions.

Moreover, the changing economic environment may force the taxpayer to conduct a new benchmarking analysis, considering the changing terms and conditions. This is because it is the taxpayer's responsibility to conduct financial transactions with related parties on the terms that unrelated parties would have agreed. Therefore, the best solution is to regularly analyse the terms and conditions of financial transactions concluded in the market and, if necessary, adapt them to those between related parties.

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SPAIN

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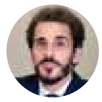

Fernando Matesanz

CJEU decision emphasises need for harmonisation of the special VAT scheme for travel agents

The Court of Justice of the European Union (CJEU) recently issued a judgment (Case C-108/22, *C.sp. zo.o.*) on the complex and controversial special VAT scheme for travel agents.

The crux of the case

The case concerned a Polish entity which carries out its economic activity as a 'hotel services consolidator'. This entity has no accommodation facilities of its own and therefore purchases, on its own behalf and for its own account, accommodation services from other VAT-able persons and resells them to its customers. In a few cases the resale is carried out with ancillary services such as consultancy services or assistance with travel arrangements.

The question referred to the CJEU asked whether the special scheme for travel agents can be applied to such an activity (a mere resale of accommodation services).

In this respect, the court pointed out in its ruling on June 29 2023 that if the general place of supply rules applied to the activities usually carried out by travel agents, the VAT management would become practically impossible. The services usually provided by such entities (accommodation, transport, events, etc.) have very specific place of supply rules that would mean that VAT would have to be paid in different member states, which could be unmanageable in practice.

Avoiding this type of difficulty is precisely what the special scheme for travel agents seeks to do. According to the CJEU, the activities involved in reselling accommodation services are identical, or at least comparable, to those carried out by a travel agent or a tour operator. For this reason, it would not be correct to exclude them from the special VAT scheme on the sole ground that they are supplied without being accompanied by other services.

The court argued that the geographical diversity of the hotels which are the subject of such services causes practical difficulties for the management of VAT that must be avoided.

Clarity and controversy

The CJEU has thus provided clear reasoning on an issue that is recurrently raised by companies involved in this type of activity. It seems to be a pronouncement with a clear practical sense that aims to facilitate, in some way, the VAT management of entities operating in this sector.

However, it is likely to have created controversy in certain member states where, in order to be able to apply the special scheme for travel agents, there is a requirement to be dealing with a truly complex service. That is, according to the legislation of some member states, the transaction carried out by the taxable person should involve a bundle of several supplies.

For example, in the case of Spain, the VAT regulations state that for the application of the special regime, 'travel' means accommodation or transport services provided jointly or separately and, where appropriate, with other services of an ancillary nature. Therefore, it is not fully clear whether an activity consisting of the mere resale of accommodation services fits entirely within this definition. The same may happen with other member states.

In fact, the VAT Directive refers to this special scheme as applicable to transactions carried out by travel agents that deal with customers in their own name and use supplies of goods or services provided by other taxable persons, in the "provision of travel facilities". It is, again, unclear whether a resale of accommodation services is a provision of travel facilities.

A pressing need for action

All of the above means that the revision and harmonisation of the special regime for travel agents at EU level is becoming urgent. This issue has been on the European Commission's agenda for some time, but its discussion has been postponed.

The truth is that the special scheme presents a number of inconsistencies that are creating concerns for operators in the sector and should be addressed. These inconsistencies relate mainly to the scope of the special scheme as it is not entirely clear to which type of activities it should apply (only travel, congresses, events, etc.). They also concern the place of supply rules for these services, as the current VAT regulation seems to benefit third-country operators to the detriment of EU operators, and the definition of certain concepts that are affected by the special scheme.

As is seen above, and although it may seem surprising, there is no common position within the EU on what should be understood by the term 'travel'.

The CJEU´s judgment, which seems to make important practical sense, reminds us that there is an urgent need to return to this issue as it affects an industry of paramount importance in the EU. Moreover, the current regulation is beneficial to non-EU operators to the detriment of EU companies. Every day that goes by without modifying this aspect is a lost opportunity that we cannot afford.

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Opinion: Republicans risk more than they realise by opposing OECD

Conservative US politicians are building a narrative against the OECD's two-pillar plan for international tax reform, but they have no serious alternative vision.

Josh White

Many leading Republicans are drawing the fault lines over US support for the OECD's two-pillar reform. By framing the deal as a 'tax surrender', the Republicans can appeal to the patriotism of many American voters who fear the country has gone to the dogs.

West Virginia Representative Carol Miller even wrote an op-ed for Fox News on Thursday, July 20, lambasting the OECD reforms as a "global socialist agenda".

This is very funny for anyone aware of the OECD's history and its left-wing critics, who accuse the organisation of only representing rich countries. What's less amusing for tax stakeholders is the possibility of international reform being derailed by US opposition.

Meanwhile, the Democrats have not made a strong case for a global deal on tax reform, preferring to keep the focus on domestic social issues instead. This may mean the Republican Party will win on blocking tax reform even if they lose the next election.

Leaving America behind

The Joint Committee on Taxation (JCT), a non-partisan congressional body, has estimated that the US stands to lose $122 billion in tax revenue because of pillar two alone. However, the JCT analysis finds it likely that the US may not enact pillar two in 2025, while most of the rest of the world goes ahead.

If this happens, the US would be the biggest international outlier in a very small club of nations – including Kenya, Nigeria, Pakistan and Sri Lanka – and the only major developed economy to reject the reforms.

Many Republicans appear more concerned about a short-term political victory by stopping reform, but it wasn't long ago that the Republicans were not so opposed to the OECD plans to solve digital taxation.

The Trump administration worked with the OECD, just as the Biden administration has done, because reform was a way of ending the wave of unilateral tax measures levied on US businesses.

US tax reform was partly the model for the global minimum corporate tax rate, even though the two-pillar solution goes further. The Tax Cuts and Jobs Act introduced minimum tax rates on inbound and outbound investments. OECD officials saw an opportunity in building on this.

It's less clear what the Republicans will do on this front in 2024 if they win back the White House. They might just scrap the deal and refuse any further agreement, but the risk of this would be countries levying digital taxes on US companies.

Trade wars are one alternative to international tax reform. Some Republican politicians may be quietly thinking they can win fights with the EU over digital taxes without an OECD deal, but this would mean more unilateralism, not less.

All it takes is one major country to refuse to back down on digital tax and we are back to square one. This could take many more years to resolve and end up with similar solutions in the end.

> "Some Republican politicians may be quietly thinking they can win fights with the EU over digital taxes without an OECD deal, but this would mean more unilateralism, not less."

Trouble in DC

Right-wing institutions in the US are also trying to build opposition to the OECD's two-pillar solution. The Cato Institute, a libertarian think tank based in Washington DC, has become increasingly critical of the plans.

Adam Michel, director of tax policy at the institute, told the Ways & Means Committee last week that the OECD "no longer serves the interests of the United States". He even argued that the US should withdraw from the OECD over the reforms.

This is shocking because the OECD was set up to administer the US Marshall Plan to rebuild Western Europe after the Second World War. As an institution, the OECD is a part of the core of European-US relations.

Nevertheless, Pennsylvania Representative Mike Kelly, who chairs the Ways & Means Sub-committee on Tax, criticised the OECD-brokered two-pillar solution for its cost to the US.

"It's $120 billion in US tax revenues to foreign countries. This makes absolutely no sense," said Kelly.

The Republican congressman went on to claim that the OECD tax work is effectively controlled by Europe.

"Europe controls one third of the seats on the Steering Committee, and the broader Inclusive Framework includes over 30 tiny former European colonies," said Kelly.

"The bottom line is the deck is stacked against America at the OECD," he argued. "That is why it has never made sense for Treasury to negotiate behind closed doors with a group of 140 nations on a 'one-country, one-vote' basis."

At the same hearing, Georgia Representative Drew Ferguson said: "We are not about levelling the playing field with the rest of the world. We're about being number one day in and day out.

"We're either going to be number one in the world or we're not," he added.

The timing of all of this couldn't be worse for the OECD. This is a critical juncture for the work on pillar one; the Paris-based organisation hopes to finalise an international agreement by the end of the year.

Losing US support for the deal at this point wouldn't necessarily kill off the two-pillar solution, but it would create the need to continue working on it until the US eventually supported it. Otherwise, it's a matter of the world leaving the US behind.

Congress, Washington DC