NEW YORK CITY BAR

Thursday, February 22, 2018 | 6:00 p.m. – 8:30 p.m.

Tax Planning for Brexit & Beyond

Navigating the New European Landscape

Sponsoring Association Committee
Taxation of Business Entities Committee

Co-Sponsoring Association Committee
European Affairs Committee

Co-Sponsoring Organizations

LOYENS & LOEFF

CIOT Chartered Institute of Taxation

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Speakers

- **Gary Ashford**
  Harbottle & Lewis/CIOT
- **Stuart Chessman**
  Vivendi
- **Anne Fairpo**
  Temple Tax Chambers/CIOT
- **Stefano Grilli**
  Gianni, Origoni, Grippo, Cappelli & Partners
- **Jennifer Stevens**
  Laura Devine
- **Lawrence Feld**
  Law Office of Lawrence S. Feld
- **Mélanie Staes**
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  Gide Loyrette Nouel LLP

Moderators

- **Alan Appel** *Professor of Law, New York Law School*
- **Stanley Ruchelman** *Ruchelman P.L.L.C.*
- **Elizabeth Zanet** *Ruchelman P.L.L.C.*

Brexit

Where Are We Now? What Planning Options Are Available?

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United Kingdom

Stuart Chessman *Vivendi*
United States

Jennifer Stevens *Laura Devine*
United States/United Kingdom

Stanley C. Ruchelman *Ruchelman P.L.L.C.*
United States (Moderator)

EU Jurisprudence & the UK Post-Brexit

Current Position

- EU ***Directives*** require implementation into UK law in order to have effect
  - Therefore now part of UK domestic law
  - Brexit doesn't change that – only Parliament can change it
- EU ***Regulations*** rely on the principle of direct applicability
  - Apply without incorporation into domestic law
  - Post-Brexit …
- Court of Justice of the European Union is the highest court in Europe and final arbiter of EU law

Divorcing the EU

General Legislation

- European Union (Withdrawal) Bill
  - Repeals EU law …
  - … and incorporates it all into UK domestic law to the extent that it isn't already incorporated, including the Regulations
  - UK domestic law to continue be interpreted in accordance with the wording and purpose of relevant directives
  - no right of action in UK domestic law after exit day if fail to comply with any general principles of EU law
    - courts will have no power to quash or disapply any enactment, rule of law or conduct on the basis that it is incompatible with any general principles of EU law.

Divorcing the EU

Tax Legislation

- Customs & VAT dealt with further in the Taxation (Cross-BorderTrade) Bill
  - basic framework … delegates virtually all decisions to Ministers
  - disapplies EU VAT legislation (most is in domestic law anyway)
  - but principal EU VAT Directive may continue to be "relevant for determining the meaning and effect of the law relating to Value Added Tax"

European Courts & Case Law

- EU (Withdrawal) Bill – pre-Brexit decisions of the European Court of Justice to be equivalent to Supreme Court decisions
- CJEU likely to have jurisdiction over the withdrawal agreement and during transition
- Post-Brexit – no direct jurisdiction for CJEU
  - No capacity to refer questions to CJEU from UK courts
  - Likely still to be influential over areas of law (especially VAT) where the UK domestic law is the same as European law
  - Possible continuing jurisdiction over rights of EU citizens in the UK (likely time limited)
- Taxation (Cross-border Trade) Bill – "abuse of rights" doctrine of EU VAT case law (the *Halifax* principle) is preserved

Practicalities

- UK law likely to look still European-influenced for a long time after Brexit
  - A few tweaks likely on VAT rates, and in some areas of corporation tax where UK has been forced to follow EU rules
- But: companies looking to trade in the EU still have to comply with EU laws such as EU competition rules, regulations and standards
  - Impact and effect therefore likely to continue: EU is 50% of UK's export market (at the moment …)
- Any transition period will require UK to follow EU directives, regulations and case law

The Foreign-Owned Multinational & Brexit

Entertainment

- Music and videos
- Intellectual property and its protection is a major issue
- Relatively little distribution of manufactured products: focus on digital distribution (some increase in vinyl)
- Streaming impact on music industry
- Concentration of assets in US and UK but spread out over world

Brexit

- Main areas potentially adversely affected at this point seem to be non-tax (*e.g.*, customs)
- Need to monitor consequences for payments to UK (royalties); loss of EU protections on withholding tax
- Potential tax advantages in the UK offset by new restrictive tax legislation (diverted profits tax)

Other Issues: US Tax Reform

- Of greater concern are developments such as US tax reform; EU digital taxation initiatives; state aid decisions
- Application of BEAT to businesses that have historically received and pain cross-border royalties (no off shore IP transfers, cost sharing or inversion)
- No grandfathering of existing structures or inquiry into how they arose

Digital Tax Initiatives

- EU Targeting of (primarily US) companies selling into EU
- "Equalization tax"
- New PE concepts
- OECD digital tax report coming
- Meanwhile, Italian and UK initiatives
- US: expanding scope of state and local nexus concepts
- Major decision on nexus may be coming
- Planning complexity as digital (and online sales) increase

"State Aid," etc.

- One more contributing factor to growing international tax uncertainty
- Can rulings, audit settlements etc. still be relied upon?
- Tax war between the EU and the US? Tax reform vs BEPS, State Aid and

Post-Brexit Immigration

Free Movement Rights – Eligibility

EEA Nationals may exercise treaty rights as:

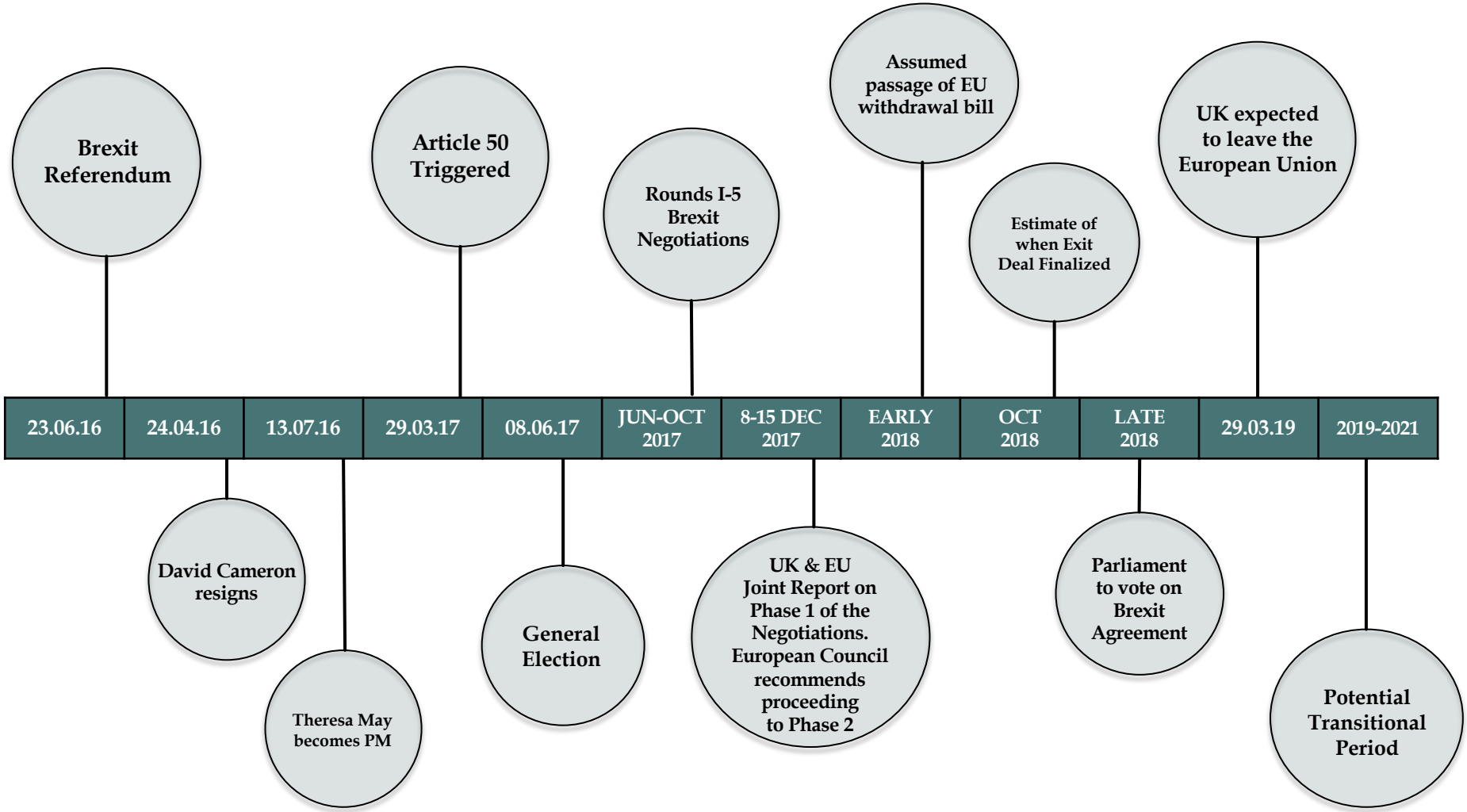
- worker
- self-employed
- self-sufficient
- student

Family members of EEA nationals

- Spouse/civil partner
- Children/descendants under 21 or dependent
- Parents/ascendants who are dependent

Extended Family members of EEA nationals

- Durable relationship partner (2 years of cohabitation)
- Other family members of household who are dependent


Brexit Referendum
Article 50 Triggered
Rounds I-5 Brexit Negotiations
Assumed passage of EU withdrawal bill
Estimate of when Exit Deal Finalized
UK expected to leave the European Union
23.06.16
24.04.16
13.07.16
29.03.17
08.06.17
JUN-OCT 2017
8-15 DEC 2017
EARLY 2018
OCT 2018
LATE 2018
29.03.19
2019-2021
David Cameron resigns
Theresa May becomes PM
General Election
UK & EU Joint Report on Phase 1 of the Negotiations. European Council recommends proceeding to Phase 2
Parliament to vote on Brexit Agreement
Potential Transitional Period

Categories of Right Holders

after "specified date" of 29 March 2019

Individuals Eligible for Permanent Residence

- EU or UK citizens legally resident for a minimum of five continuous years on the specified date
- Those who already have a permanent residence document
- In the UK, this status will be referred to as '**settled status**'

Individuals Eligible to Remain

- Those in-country, but who don't have five years continuous residence, will be permitted to stay under a '**temporary status**'
- After total of five years, they will be allowed to apply for permanent residence

Individuals Not Covered under the Withdrawal Agreement

- Individuals who meet neither criteria will **not be covered under the Withdrawal Agreement**
- Should they wish to stay, they must apply under their host State's future immigration laws.

FAMILY MEMBERS

Certain family members will be permitted to remain in the host State or join EU/UK national rights holders after 29.03.19

FAMILY MEMBERS NOT RESIDENT ON A SPECIFIED DATE

but who were related to the EU/UK national rights holder on the specified date, and continue to be related to the individual, will be permitted to join them

FAMILY MEMBERS INCLUDE

- Unmarried Partners
- Children under 21
- Child dependents
- Dependent parents
- Dependent grandparents

Those **LEGALLY RESIDENT** in the UK or EU27 Member State on the specified date permitted to remain

CHILDREN BORN OR ADOPTED AFTER THE SPECIFIED DATE TO:

a parent who is covered by the Withdrawal Agreement, and who has joint or sole custody of the child, will be permitted to stay

CHILDREN BORN OR ADOPTED AFTER SPECIFIED DATE TO:

(1) parents who are both covered by the Withdrawal Agreement;

or

(2) one parent who is protected by the Withdrawal Agreement and the other is a citizen of the host State, will be permitted to stay

EU & UK Process

EU/UK Agreement Principles

- Only necessary and proportionate requirements;
- Avoid unnecessary administrative burdens;
- Short and simple applications;
- Help applicants and give opportunity to correct;
- Proportionate response to missing deadline;
- Allow two years to apply for status; and
- Commit to residence documents being free of charge or low-cost

UK Technical Note

The Government's Technical Note details plans for a streamlined application system in 2018.

Proposed Digital Application System

- Require minimal applicant documentary evidence;
- Government will draw on existing data wherever possible; and
- Fees would be kept at or below the cost of British passport (presently £72.50 and for a child £46.00)

Driving Change
US & UK Programs to Incentivize Tax Compliance

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Gary Ashford *Harbottle & Lewis*
United Kingdom

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United States (Moderator)

United States Tax Prosecutions of Foreign Banks, Bankers & Advisers

Enforcing the Commitment to Tax Transparency

The Charges

- Conspiracy (18 U.S.C. § 371):
  - To defraud the United States by impeding the IRS in the ascertainment, computation, assessment and collection of income taxes
  - To willfully aid, assist in, procure, counsel and advise in the preparation and presentation of false income tax returns to the IRS
  - To evade U.S. income taxes
  - To aid and assist U.S. taxpayers in evading their obligations to file FBARs.

Other Potential Charges

- Mail/wire fraud charges (18 U.S.C. §1341 and §1343) in tax cases, and as predicate acts for money laundering
  - Department Of Justice, Tax Division Directive No. 128 (October 29, 2004)
  - *Pasquantino v. United States*, 544 U.S. 349 (2005)

Bank Prosecutions

Convictions

1. Wegelin & Co
2. Credit Suisse AG
3. Cayman National Securities, Ltd.
4. Cayman National Trust Co. Ltd.

Deferred Prosecution Agreements

1. UBS
2. Bank Leumi
3. Bank Julius Baer & Co., Ltd.

Bankers and Advisers

Convictions

1. Bradley Birkenfeld
2. Renzo Gadola
3. Andreas Bachmann
4. Joseph Dorig
5. Peter Amrein
6. Michele Bergantino
7. Daniella Casadei
8. Fabio Frazetto
9. Susanne D. Ruegg-Meier

Bankers and Advisers

Acquittals

1. Raoul Weil
2. Shokrollah Baravarian
3. Stefan Buck

Developments in UK Criminal & Civil Tax Penalties

Topics Covered

- Recent Offshore Developments
  - Failure to Prevent Facilitation of Tax Evasion
  - Strict Liability Personal Offence
  - Other Civil Penalties in Area of Offshore Non-Compliance
  - New Penalty for "Enablers" Where There is a "Defeat" of Aggressive Tax Planning

Failure to Prevent Facilitation of Tax Evasion

- Part 3 Criminal Finances Act 17
- Effective from 30 September 2017
- Two offences
  - Failure to Prevent Facilitation of UK Tax Evasion
  - Failure to Prevent Facilitation of Foreign Tax Evasion

Failure to Prevent Facilitation of Tax Evasion

- Failure to Prevent Facilitation of UK tax evasion
  - A relevant body (B) is guilty of an offence if
  - A person commits a UK tax evasion facilitation offence when acting in the capacity of a person associated with B

Failure to Prevent Facilitation of Foreign Tax Evasion

- A relevant body (B) is guilty of an offence if
  - A person commits a foreign tax evasion facilitation offence when acting in the capacity of a person associated with B; and either
  - B is a body incorporated, or a partnership formed, under the law of any part of the United Kingdom;
  - B carries on business or part of a business in the United Kingdom;
  - Any conduct constituting foreign tax evasion facilitation takes place in the United Kingdom

Failure to Prevent Facilitation of Tax Evasion

- A relevant body guilty of an offence under this section is liable to an unlimited fine
- It is not a defence for B to prove that B had in place such prevention procedures as was reasonable, or it was not reasonable to expect B to have any prevention procedures in place

Failure to Prevent Facilitation of Tax Evasion

- HMRC draft guidance designed to be of general application and is formulated around six guiding principles:
  - Risk assessment
  - Proportionality of risk-based prevention procedures
  - Top level commitment
  - Due diligence
  - Communication (including training)
  - Monitoring and review

Strict Liability Personal Offence Offences Relating to Offshore Income, Assets & Activities

- 166 FA 16
  - A person who is required to
    - give notice of being chargeable to income tax or capital gains tax
    - to make and deliver a return

    commits an offence if…by reference to offshore income, assets or activities [**Absence of Mens Rea]**
  - It is a defense for a person accused of an offence under this section to prove that the person had a reasonable excuse
  - Threshold is to be not less than £25,000
  - The offence from any jurisdiction signed up to CRS (US?)
  - The offence became effective in November 2017

Strict Liability Personal Offence Offences Relating to Offshore Income, Assets & Activities

- A person guilty of an offence is liable on summary conviction
  - In England and Wales, to a fine or to imprisonment for a term not exceeding 51 weeks, or to both

Other Civil Offshore Penalties

- Increased penalties for offshore non-compliance; maximum 100% increased to 200% from 2011
- Offshore "move" penalties (moving assets to avoid, for example, CRS, FATCA) increased by 50%, from 2015
- Penalties for "enablers" of offshore evasion and non-compliance from 2016
- Increased minimum penalties for offshore non-compliance, minimum increased by 10%, from 2016
- Asset based penalty equal to 10% of asset value, rather than tax liability, from 2016

Penalties for Enablers of Defeated Tax Avoidance

- Where a person has entered into abusive tax arrangements, and incurs a defeat in respect of the arrangements, a penalty is payable by each person who enabled the arrangements
- [Tax avoidance] arrangements are where having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements
- Tax [avoidance] abusive arrangements are where the entering into or carrying out the arrangements cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances

Penalties for Enablers of Defeated Tax Avoidance

- A "defeat" takes place where either
  - The relevant tax advantage has been counteracted and the counteraction is final, or
  - HMRC has made an assessment to counteract the tax advantage and the counteraction is final

Penalties for Enablers of Defeated Tax Avoidance

- The penalty is the total value of the relevant consideration received by the enabler
- A penalty cannot be imposed without a final decision or an opinion of the GAAR Advisory Panel

BEPS
The US & European Divide

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Anti-Tax Avoidance Directives I & II

2016/1164/EU
Amended by 2017/952/EU

SUBJECT	DIRECTIVE	BEPS
Interest Limitation Rule	Article 4	Action 4
Exit Taxation	Article 5	-
General Anti-Abuse Rule	Article 6	Action 6
Controlled Foreign Company Rule	Articles 7-8	Action 3
Hybrid Mismatches	Articles 9, 9(a) and 9(b)	Action 2

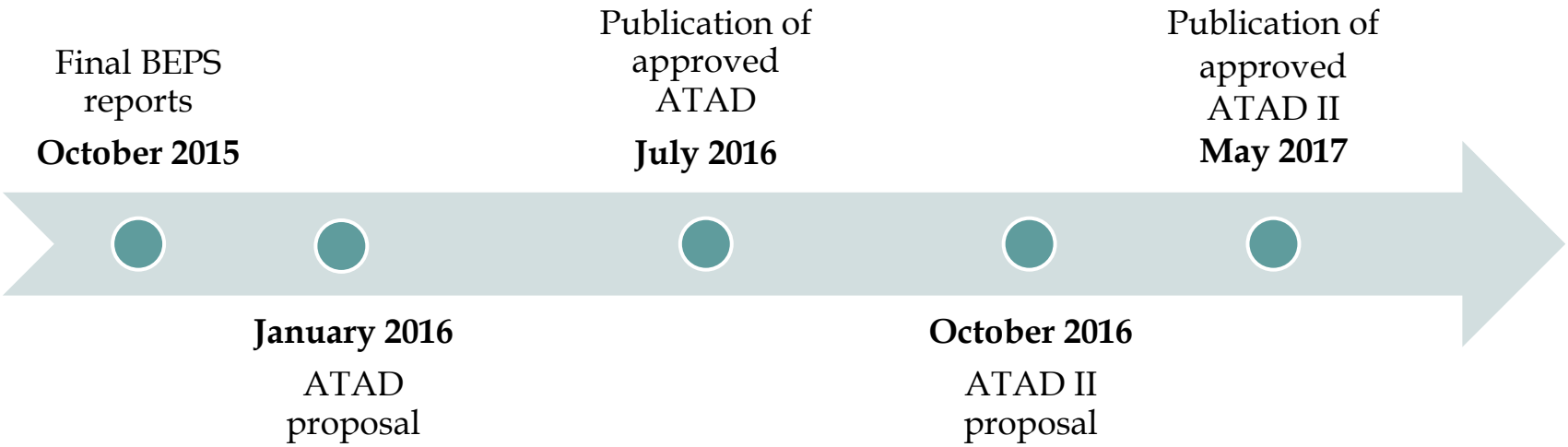
I. Object & Purpose Of The Directive; Timeline

- The objective of the Directive is to ensure a coordinated and coherent implementation at EU level of the OECD's recommendations regarding base erosion and profit shifting (BEPS), which would enhance the single market by introducing a harmonized minimum standard.
- The current political priorities in international taxation highlight the need for ensuring that tax is paid where profits and value are generated (Preamble # 1)
- Furthermore, only a common framework could prevent a fragmentation of the market and put an end to currently existing mismatches and market distortions (Preamble # 2).
- It is necessary to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market (Preamble # 3).

I. Object & Purpose Of The Directive; Timeline

- As these rules would have to fit in 28 separate corporate tax systems, they should be limited to **general provisions and leave the implementation to Member States** (Preamble # 3).
- This objective could be achieved by creating a **minimum level of protection** for national corporate tax systems against tax avoidance practices across the Union (Preamble # 3). (See also Art. 3)
- *"This Directive **shall not preclude** the application of domestic or agreement-based provisions **aimed at safeguarding a higher level of protection** for domestic corporate tax bases."* (Art. 3)

I. Object & Purpose Of The Directive; Timeline



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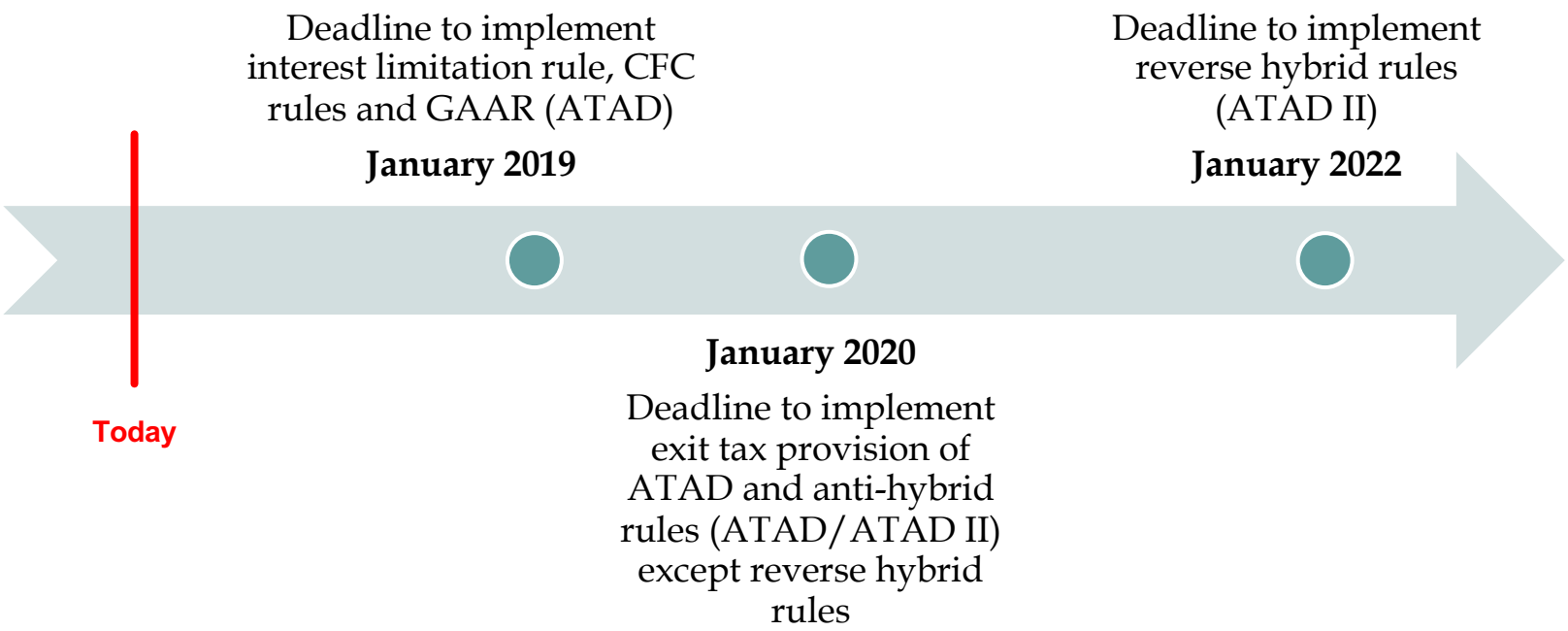


II. Interest Limitation Rule (Art. 4)

- **Aim of the Interest limitation rule** → Prevent base erosion through the use of interest expenses

PROVISION	DIRECTIVE	BEPS
Fixed ratio rule net interest/EBITDA ratio	Up to 30%	Within a corridor of 10%-30%
***De minimis* monetary threshold**	Yes (optional)	Yes (optional)
Group ratio rule	Yes (optional)	Yes (optional)
Carry forward and/or carry back	Yes (optional)	Yes (optional)
Targeted rules to support general interest limitation rules and address specific risks	Yes (optional)	Yes (optional)
Specific rules/exclusion to address issues raised by the banking and insurance sectors	Yes (optional)	Yes (optional)

II. Interest Limitation Rule (Art. 4)

Main Features

- Exceeding Borrowing Costs ("**EBC**") shall be deductible in the tax period in which they are incurred **only up to 30 percent of** the taxpayer's **EBITDA ("Interest Capacity")**.
- Tax exempt income shall be excluded from the EBITDA of a taxpayer
- The rule applies to interest related to either **intra-group and/or third party debt regardless of the Country of residence of the creditor**
- **Optional Provisions**: (i) *De minimis* rule Euro 3 Million (computed at the group level - if applicable) (ii) Stand Alone Company (*i.e.*, taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment)
- A **carry-forward/carry-back** rule of (i) the EBC in excess and/or (ii) the Interest Capacity may be provided by Member States

II. Interest Limitation Rule (Art. 4)

Optional Rules

- Member States could **decrease the ratio** or **place time limits** or **restrict the amount of unrelieved borrowing costs that can be carried forward** or **back** to ensure a higher level of protection (preamble #6);
- **Alternative measure** referring to a taxpayer's earnings before interest and tax (EBIT) as long as it **is equivalent to the EBITDA-based ratio** (preamble #6);
- Member States could in **addition** to the interest limitation rule provided by this Directive also use **targeted rules against intra-group debt financing**, in particular **thin capitalization rules** (preamble #6);
- **Grandfathering clauses** (loans existing as at 17 June 2016)
- **Intra-EU Loans for Long-term Public Infrastructure Project** → violation of the free movement of capital(?);
- **Optional exclusion of Financial Undertakings**.

II. Interest Limitation Rule (Art. 4)

Optional Rules for Groups

- A member State may allow a taxpayer belonging to a group to fully deduct its EBC if it can demonstrate that the **ratio** of its **equity over** its **total assets** is **equal** to (≥ 98%) or **higher** than the **equivalent ratio of the group**
- A member State may allow a taxpayer belonging to a group to deduct EBC at an amount in excess of what it would be entitled under the "ordinary rule" (30% EBITDA) in accordance with the **Group Ratio** computed as follows:
  - first, the *group ratio* is determined by dividing the EBC of the Group vis-à-vis third-parties over the EBITDA of the group; and
  - second, the *group ratio* is multiplied by the EBITDA of the taxpayer.

II. Interest Limitation Rule (Art. 4)

Country Specifics

PROVISION	ITALY	LUXEMBOURG
Fixed ratio rule net interest/EBITDA ratio	30%	Nothing for now; only informal rules
***De minimis* monetary threshold**	NO	Nothing for now
Group ratio rule	Yes	Nothing for now
Carry forward and/or carry back	Only Carry Fwd	Nothing for now
Targeted rules to support general interest limitation rules and address specific risks	NO	Nothing for now
Specific rules/exclusion to address issues raised by the banking and insurance sectors	Yes	Nothing for now

III. General Anti-Abuse Rule (Art. 6)

"1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the ***main purpose or one of the main purposes*** [subjective element] *of obtaining* ***a tax advantage that defeats the object or purpose of the applicable tax law*** [objective element], *are* ***not genuine*** ***having regard to all relevant facts and circumstances****. An arrangement may comprise more than one step or part.*

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as ***non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality*** [carve-out clause for genuine economic activities].

3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law."

III. General Anti-Abuse Rule (Art. 6)

- The GAAR is designed to cover gaps that may exist in a country's specific anti-abuse rules against tax avoidance.
- The GAAR reflects the CJEU case-law on abuse and "wholly artificial test" (*ex multis* Case C-255/02 Halifax, C-196/04 Cadbury Schweppes, Case C-425/06 Part Service).
- **Features**
  - One or more arrangements;
  - "Non-genuine arrangement" definition;
  - Main purpose or one of the main purposes of obtaining an undue tax advantage;
  - Tax treatment → Substance over form approach;
  - Scope of the provision (Domestic/intra–EU/EU-Third States).

III. General Anti-Abuse Rule (Art. 6)

- The GAAR is largely similar to the Principle Purpose Test ("**PPT**") laid down in BEPS Action 6.
- **BEPS PPT**

  "Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income ***if it is reasonable to conclude****, having regard to all relevant facts and circumstances, that obtaining that benefit was* ***one of the principal purposes*** *of any arrangement or transaction that resulted directly or indirectly in that benefit, unless is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."*

  - **EU Recommendation on Treaties C(2016) 271** final suggests to implement the PPT in a form compliant with the ECJ case law → inserting a carve-out clause for genuine economic activities to the treaty GAAR proposed by BEPS Action 6
  - **EU GAAR**:
    - Main purpose or one of the main purposes;
    - Carve-out clause for genuine economic activities.

IV. CFC Rules

- To be implemented as of 1 January 2019
- CFC if a taxpayer holds (alone or together with associated enterprises) a (direct or indirect) **participation of more than 50%**; *and*
- The non-distributed income is **not subject to an adequate profit tax** in the CFC jurisdiction, *i.e.*, effective tax rate is lower than 50% of the shareholders effective tax rate.
- OECD BEPS Actions and US tax reform helpful in managing CFC rules to be implemented

IV. CFC Rules

Methods of Implementation

Method A

Tainted income approach: taxpayer needs to include in its tax base **specific types of non-distributed income** of a CFC as defined in the ATAD.

CFC-income =

- Interest
- Royalties
- Dividends
- Capital gains on shares
- Leasing income
- Insurance income
- Banking income
- Income from invoicing companies

Exceptions

- If CFC has a substantive economic activity which is supported by relevant staff, equipment, assets and premises
- 33.33% or less tainted income

Method B

Transactional approach: taxpayer needs to include in its tax base **non-distributed income of CFC arising from non-genuine arrangements** which have been put in place for essential purpose of obtaining a tax advantage.

CFC-income =

- Income from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage
- Income (assets/risks) only taxed as CFC income because of significant people functions of the controlling company which holds the CFC

Optional exceptions

- CFC's accounting profits and non-trading income is limited to EUR 750,000 respectively EUR 75,000; or
- CFC's accounting profits are not more than 10% of operating costs

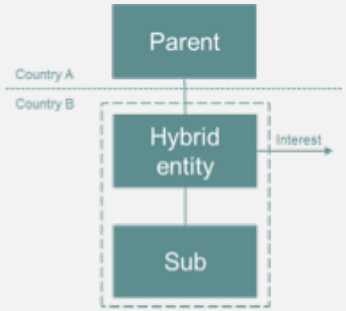
V. Hybrid Mismatch Rules

- Without these rules: mismatches in legislation lead to double double-dip situations. Purpose: eliminate "unfair" **double dips**
- Hybrid mismatch arrangements that give rise to double deduction or deduction/no-inclusion situations, are dissolved:
  - **deduction without inclusion**: the Member State of the payer shall deny the deduction of such payment.
  - **double deduction**: the deduction shall be given only in the Member State where such payment has its source.

V. Hybrid Mismatch Rules

Overview

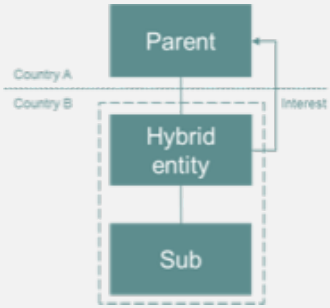
1. Double Deduction



Transparent for Country A tax purposes, but not transparent for Country B tax purposes.

ATAD: *Intra-EU*: deny deduction in A.
***With third countries*: deny deduction in A (if A is MS), or deny deduction in B (if B is MS).**

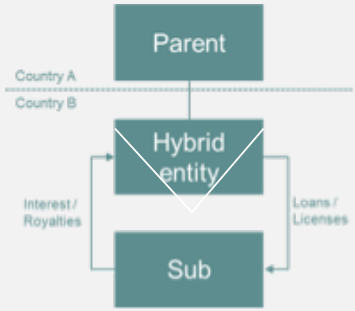
2. Deduction / No Inclusion



Transparent for Country A tax purposes, but not transparent for Country B tax purposes.

ATAD: *Intra-EU:* deny deduction in B.
***With third countries*: inclusion in income A (if A is MS), or deny deduction in B (if B is MS).**

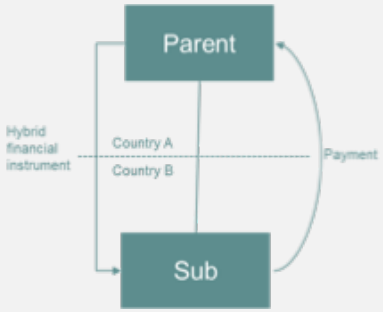
3. Reverse Hybrid



Not transparent for Country A tax purposes but transparent for Country B tax purposes.

ATAD: *EU Hybrid* : hybrid entity regarded as resident of B and taxed. *Other cases*: deny deduction in B (if B is MS) or inclusion income in A (if A is MS).

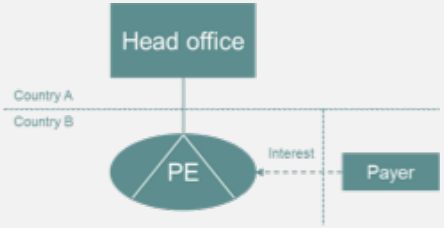
4. DNI / Financial Instrument



Financial instrument is treated as equity for Country A tax purposes and as debt for Country B tax purposes.

ATAD: *Intra-EU*: deny deduction in B.
***With third countries*: inclusion in income A (if A is MS), or denial deduction in B (if B is MS).**

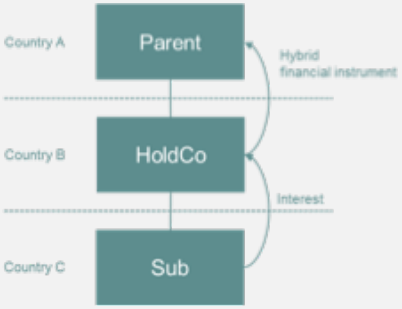
5. Disregarded PE



Arrangement treated as a PE for Country A tax purposes, but not for Country B tax purposes.

ATAD: Include income attributed to the PE in income A.
***Head office in third country*: Deny deduction in C (if C is MS), or inclusion in income of B (if B is MS).**

6. Imported Mismatch

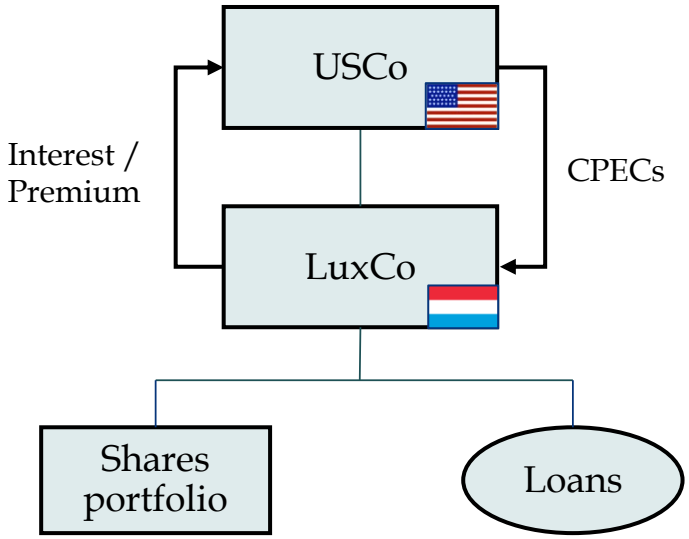


Financial instrument is treated as equity for Country A tax purposes and as debt for Country B tax purposes.

ATAD: deny deduction in C.

V. Hybrid Mismatch Rules – Impact Assessment

Luxembourg (C)PECs



Current Situation

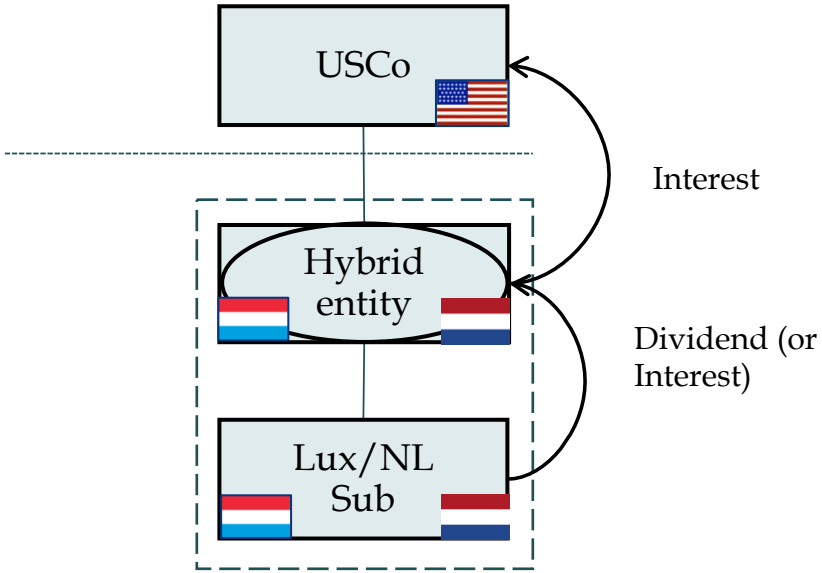
- Luxembourg: CPECs return in principle deductible if at arm's length (except if related to exempt income)
- US: deferral (?)

Post ATAD II

- Luxembourg will have to deny deduction
  - Except if inclusion in US "within reasonable period of time" or 12 months
  - Otherwise shift of taxing rights from US to Luxembourg (additional Lux CIT credited on US CT)?
- Withholding tax and net wealth tax not affected

V. Hybrid Mismatch Rules – Impact Assessment

Check-the-Box Entity



Current Situation

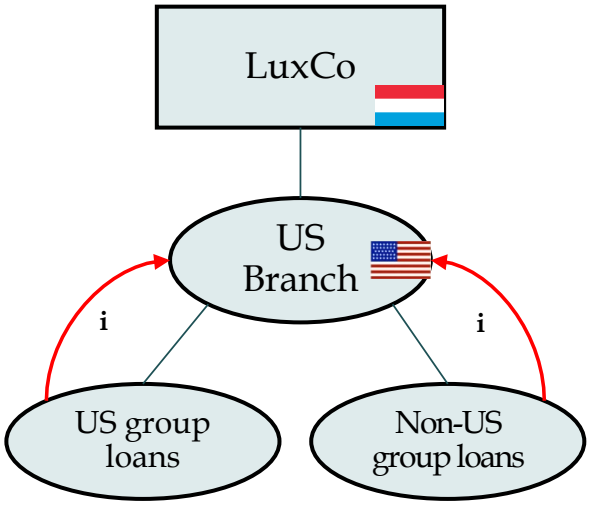
- Lux/NL: Hybrid is ordinarily taxable → interest is deductible (offsets most of Sub's taxable income in context of fiscal unity)
- US: hybrid is disregarded (checks the box) → interest payment not recognized

Post ATAD II

- Lux/NL will have to deny deduction
- Withholding tax and net wealth tax not affected

V. Hybrid Mismatch Rules – Impact Assessment

US Branches



Current Situation

- Lux: PE recognised in US
  → exempt under tax treaty
- US: Branch not recognised to constitute a trade or business / no ECI
  → no tax on interest income

Post ATAD II

- Luxembourg to tax income of US Branch?
  - Art.9(5) ATAD 2: tax treaty prevails.
  - Interaction with contemplated amendment to US-Luxembourg tax treaty

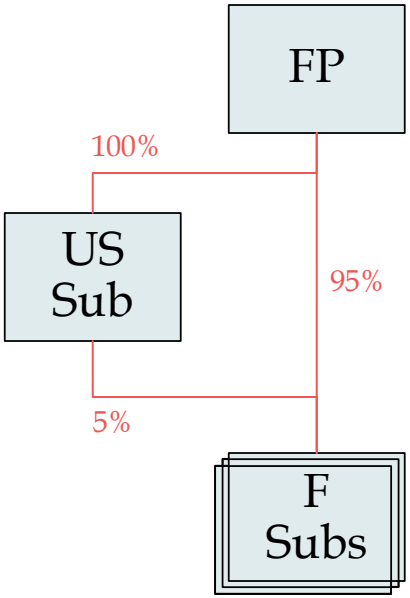
US Tax Reform

International Provisions and EU Concerns

Agenda

- **Highlights of U.S. Tax Reform International Provisions:**
  - Expanded CFC Rules: More CFCs
  - GILTI: More Anti-Deferral, More Phantom Income
  - FDII: Patent Box or Not?
  - Modified Participation Exemption: Now You See It, Now You Don't
  - The BEAT: A Minimum Tax
  - Anti-Hybrid Rules: No Double Dipping
  - Interest Expense: More Restricted Limitation
- **Highlights of EU Reaction:**
  - European Concerns
  - Is Europe Countering or Collaborating?

Expanded CFC Rules: More CFCs



- 10% U.S. shareholder expanded to now include 10% ownership by value
- New downward attribution of stock owned by a foreign person to a U.S. person
  - Foreign parented groups with even one U.S. sub will see all foreign subs classified as CFCs
  - Potential for unexpected 5471 reporting obligations and Subpart F inclusions
- Section 956 requiring current inclusion of CFC earnings invested in U.S. property remains – and therefore so too do limitations on CFC guarantees and pledges of CFC stock on debt financings

GILTI: More Anti-Deferral, More Phantom Income

- GILTI (*global intangible low-taxed income*) regime applies to CFCs as an anti-deferral complement to the Subpart F regime
- Virtually all non-Subpart F income is in the scope of GILTI
- GILTI is income earned by a CFC in excess of an "ordinary" 10% return on tangible assets
- The excess is deemed attributable to intangible assets, and classified as GILTI
- Like Subpart F income, GILTI is taxable currently to 10% US shareholders whether or not distributed
- For 10% US corporate shareholders:
  - the ETR on GILTI is about 10.5% due to a 50% deduction (increasing to 13.125% after 2025 when deduction reduces to 37.5%)
  - Foreign tax credits are possible up to 80% (meaning if GILTI is subject to foreign tax of at least 13.125% generally no additional US tax applies)
- 10% non-corporate shareholders do not benefit from any deduction or foreign tax credit

FDII: Patent Box or Not?

- FDII is a US corporation's "*foreign derived intangible income*" defined as gross income less:
  - Subpart F
  - GILTI
  - associated deductions (including taxes), and
  - 10% of the US tax basis in tangible business assets.
- The ETR on FDII is about 13.125% due to a permitted 37.5% deduction (increasing to 16.406% after 2025 when deduction reduces to 21.875%)
- FDII, is designed to keep intangibles in the US even when exploited overseas and thus functions like a patent box though without any explicit nexus or substance requirements
- A corresponding expansion of outbound penalties makes it even more costly to transfer outbound a wider range of intangibles, now including goodwill, going concern value, workforce in place, etc.
- The GILTI rules are meant to reduce any benefit to US taxpayers from operating in foreign tax havens, while the FDII rules are meant to incentive taxpayers to center their international operations in the United States

The Modified Participation Exemption: Now You See it, Now You Don't

- Applies to 10% (by vote or value) U.S. corporate shareholders of foreign companies
- 100% dividends received deduction for foreign source portion of dividends
- 1 year holding period for eligibility
- No foreign tax credit for DRD-eligible dividends
- However, DRD does **not** include:
  - U.S. source portion of dividends
  - Dividends from PFIC
  - Subpart F earnings
  - GILTI earnings
  - Hybrid dividends from CFCs

The BEAT: A Minimum Tax

- Base Erosion Anti-Abuse Tax (**BEAT**) is a minimum tax (5% in 2018, 10% 2019-2025) on large U.S. corporations to curb outbound base eroding payments to 25% related foreign parties (**RFP**)
- Applies to a modified taxable income calculated as taxable income less the tax benefits from base erosion payments to RFPs (*i.e.*, income with deductions added back)
- Base erosion payments include:
  - interest, royalties, certain service and reinsurance payments, and some COGS
  - Deductions from depreciable or amortizable assets acquired from RFPs
- Limited to corporations with average receipts of $500M over 3 years and a "base erosion percentage" of 3% or more – creating a cliff effect
- No foreign tax credits!

Anti-Hybrid Rules: No Double Dipping

- No deduction for related party (**RP**) (50% connection) interest/royalties if the amount:
  - is not included in RP's taxable income, or
  - generates an RP deduction

  AND the amount is:
  - paid pursuant to a hybrid transaction (*i.e.*, treated as interest/royalties under US tax law but not under the RP's tax law), or
  - paid to, or by, a hybrid entity (*i.e.*, transparent for U.S. tax law but not under RP's tax law, or vice versa)

Interest Expense: More Restricted Limitation

- Lower limit and lower base:
  - Annual business interest deductions limited to 30% (down from 50%) of adjusted taxable income (**ATI**)
    - Through 2021, ATI = EBITDA
    - From 2022, ATI = EBIT (no add back of depreciation or amortization deductions)
  - Applies to all interest - related party and unrelated party
  - No debt/equity safe harbor
  - Unlimited carry-forward of disallowed interest
  - Applies at partnership level with carry-forward allocated among partners
  - No grandfathering of existing debt
- Not applied to taxpayers with average gross receipts of $25M or less over prior three year period

U.S. Tax Reform: European Concerns

- Bilateral Tax Treaty Violations?
  - GILTI – is there conflict with US treaty permanent establishment/business profits provisions because GILTI taxes CFC business profits that may not be attributable to any PE?
  - BEAT – is there conflict with treaty provisions that already govern taxation of interest and royalties?
  - Are Anti-Discrimination provisions triggered where US vs. foreign related parties are treated differently?
  - What about spirit of bilateral and multilateral approaches to global tax issues?
  - **BUT,** Savings Clause affords U.S. full discretion to tax its own residents … and U.S. does have constitutional authority to override U.S. treaty commitments with new laws…
- Legitimate counter measures to Base Erosion or Unfair Protectionism?
  - Is BEAT's cross-border deduction limitation a discriminatory incentive for US companies to operate within the US, and a disincentive for foreign businesses to operate in the US?
  - Are FDII and GILTI regimes an export subsidy, possibly subject to challenge under WTO rules?
- Contradicts BEPS principles?
  - Does FDII regime align with BEPS Action 5 recommendations for IP incentive regimes regarding nexus, substantial activity, and limiting benefit to patent/copyright income?

U.S. Tax Reform: European Countermeasures or Collaboration?

- Countermeasures in play?
  - EU digital tax rules possible - a temporary equalization tax focused on large internet companies, legislation set to be proposed by EC in March
  - Effectively would be a tax on large U.S. internet companies and could launch a tax war without cooperation
  - EU countries could deny deduction for FDII payments on the basis of those payments being preferential income in the U.S.
  - WTO litigation over export subsidy?
- Collaboration underway?
  - International Compliance Assurance Program (**ICAP**)
  - IRS working with OECD to launch a global tax risk assessment program based on BEPS country reports
  - Pilot project involves 8 MNCs and 8 countries (US, Australia, Canada, Italy, the Netherlands, Japan, Spain, and the UK)
  - Will such a multilateral approach be possible going forward?

Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.

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