International Fiscal Association

2019 London Congress

report

Summary of Proceedings

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Summary of Proceedings
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Permanent Scientific Committee (PSC)

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INTERNATIONAL FISCAL ASSOCIATION (IFA)

The International Fiscal Association (IFA) is a leading, non-governmental, international organisation devoted to the study of international tax law. As a non-profit organisation, IFA provides a neutral and independent platform where representatives of all professions and interests can meet and discuss international tax issues at the highest level.

Its objects are the study and advancement of international and comparative law in regard to public finance, specifically international and comparative fiscal law and the financial and economic aspects of taxation. IFA seeks to achieve these objects through its annual Congresses and the scientific publications relating thereto as well as through scientific research. Although the operations of IFA are essentially scientific in character, the subjects selected take account of current fiscal developments and changes in local legislation.

IFA was founded in 1938 and is headquartered in the Netherlands. IFA has more than 13,500 members worldwide deriving from more than 110 countries, with 72 Branches.

More information about IFA, the Branches, the annual Congresses and IFA's publications is available on the IFA website: www.ifa.nl.

Table of contents

The 2019 London Congress of the International Fiscal Association

Themes and Variations

"International taxation" as we have understood that term to describe the reconciliation of countries' intersecting tax claims is fundamentally simple and profoundly difficult at the same time. There are ever only three key questions. The first two are: where was a taxpayer "present"when it earned income, and where did the taxpayer conduct activities to generate the income it earned? As a result of the internationalisation of business models and activities, these first two questions, which are rooted in the 1920 policy of the League of Nations, have recently become of utmost relevance. The OECD/G20 BEPS multilateral initiative has attempted to respond to some of these challenges by increasing attention on substance, coherence and transparency requirements. As this contemporary shift to fiscal multilateralism is still being absorbed, a more fundamental third question, latent nevertheless in work of the League and international taxation notions more generally, has however emerged in the meantime with a more acute focus: was it necessary for the taxpayer to be "present" where the activities to generate income occurred? The debate began with the challenges raised by digitalisation but has now proven to possibly have much wider implications on the future of the international tax system. In fact, as this note goes to press the latest OECD's proposal for a "Unified Approach" has been discussed at the G20 Finance Ministers meeting in Washington and will continue to trigger important discussions in the coming months.

In the middle of this intense and ongoing international tax conversation, the International Fiscal Association (IFA) occupies a place of choice as a unique forum for neutral, constructive and forward-looking inspiring discussions on the future of "international taxation" between all stakeholders. In that connection, the Permanent Scientific Committee of IFA (PSC) is faced with the stimulating challenge of planning the scientific work of IFA years in advance while, at the same time, ensuring that major international tax policy developments are being debated as they unfold.

The London Congress was no different. Within the framework of the two Main Subjects and a variety of seminars, fundamentally what the Congress tested were the three questions noted above, sometimes in ways that would not appear obvious and approached from various intentionally converging perspectives. The Main Subjects on interest deductibility and investment funds concern basic questions about where income originates and ought to be considered earned, who owns it and whether intermediation of various kinds ought to influence jurisdiction to tax. The seminars on Space and Sharia law at their heart relate to familiar international tax issues about the parameters of tax jurisdiction and the intersection of private law regimes that see and configure equivalent economic outcomes according to different legal constructions for various reasons, raising also implications of hybridity and the increasing deference to "substance" which were addressed by seminars on these subjects. These are familiar notions but exposing them through novel points of reference shines a light on underlying considerations that may too often be taken for granted. In a similar vein the indirect tax seminar was fundamentally concerned with how transactions are defined with reference to the parameters of tax jurisdiction, as was also the seminar devoted to hybridity. The seminar on transparency discussed the challenges raised by the visibility of taxpayers' affairs. The seminar on treaty override presented the opportunity to revisit a fundamental topic previously discussed at IFA but which has recently gained increased attention as tax treaty obligations are at tension with the proliferation of unilateral measures adopted by certain states with a view to expand their taxing rights.

As always, the IFA/OECD, IFA/EU and recent developments seminars were key highlights of the Congress. The focus of IFA/OECD was naturally the current work on digitalisation and its broader implications. The IFA/EU seminar discussed most recent European tax policy changes which are also of relevance beyond the internal market such as the DAC6 Directive relating to reportable cross-border arrangements. Moreover, attention was also paid to the recent judgments of the Court of Justice (CJEU) in the area of directive shopping. The CJEU's findings may indeed be considered as an important contribution to the discussion on international abuse prevention around the globe. The recent developments seminar discussed, on the one hand important court decisions and, on the other hand, picked up some most recent developments and added the perspective of the International Monetary Fund.

In the past, IFA has not memorialized the Congress proceedings; only the Cahiers were a written record of the Main Subjects and even then, not of the panel discussions about the general reports and the branch report tributaries.

This report marks a change. Summaries have been prepared of the panel discussions of the Main Subjects and the principal seminars. These are to be read as points of reference for discussions that otherwise would not be documented, to be used as reminders for those who attended the discussions of what was said and in any event an informal way for interested readers to follow up on topics or with persons who are interesting to them. These are the record of rapporteurs; they are not scholarly treatises; they are not footnoted. The reports are meant to be able to be read quickly and easily. It is another way in which IFA is present and an interlocutor in the international tax conversation.

Robert Danon
Chair PSC

Scott Wilkie
Vice Chair PSC

Subject 1: Interest deductibility: the implementation of BEPS Action 4

Report by: Mirna S. Screpante, Susi Baerentzen, Benjamin Malek
General reporters: James Gadwood (USA) Paul Morton (UK)
Chair: Yash Rupal (UK)
Secretary: Sandra Martinho Fernandes (Luxembourg)
Panel members: Bernd-Peter Bier (Germany),
Pierre-Henri Durand (France), Karishma Phatarphekar (India),
Adam Zalasiński (EU)

1. Introduction

Interest deductibility and its relationship with the implementation of BEPS Action 4 triggers the following key points:

- the overview of the main results of the general report;
- the evolution of thin capitalization rules;
- the building blocks of interest restriction;
- the transfer pricing aspects;
- the economic double taxation of interest; and
- the evaluation of the interest restriction and forward thinking.

2. Overview of the main results of the general report

One of the main goals of the general report was to determine which countries adopted BEPS Action 4 in substance. Actually, there was a meaningful convergence in the EU since the majority of Member States has adopted a fixed ratio rule and some countries supplemented it with a group ratio rule, whereas non-EU countries have mostly adopted non-fixed ratio rules. In addition, carry forward rules are more taxpayer favourable in the EU than outside the EU. However, some jurisdictions did not implement any of the two rules mainly due to time constraints but also because similar rules are already in force. Nonetheless, more convergence is expected in the future since it is an area that rapidly evolves.

As regards the approaches to deductibility of interest, besides the business approach, it is also common to find a mechanical, transfer pricing approach or a combination of both. The intention is to seek a best practice rather than a minimum standard. For that purpose, it is necessary to identify the points where convergence has successfully occurred. In connection with the deductibility of interest, the following options are considered:

- if the interest expense is a business expense, the deduction should be allowed;
- if the interest expense is allowed at the level of the payer, the interest should be taxed at the level of the recipient (assurance of symmetry); and
- if there is any kind of abuse of interest deductibility.

With respect to the qualification of interest, it is first necessary to determine what the meaning is of interest and whether interest is an ordinary expense, or a different and separate rule. So far, there is no universal definition of interest. Actually, it is more a commercial term which triggers deductibility not only based on accounting rules but also on general presumptions or purely territorial approaches. As regards recharacterization of interest, in some countries where the thin capitalization rule is applied, there is no recharacterization whereas where transfer-pricing rules are applied, the non-qualifying interest might be subject to recharacterization.

3. The interest restriction: an evolution of thin capitalization rules?

The main reason for the complexity of interest deductibility lies in the unbalanced taxation of interest and dividends. Basically, interest payments are deductible from taxable income, whereas dividend payments are not. Within a context where change is highly needed, drivers for that change have been identified such as fear of base erosion, CJEU case law, the need for more harmonization and reduction of competition.

Interest restriction rules evolved to the extent that there was a shift from principles (e.g. arm´s length principles, safe harbour approach, etc.) to mechanical rules based on BEPS Action 4 and ATAD article 4 (e.g. earnings cap/asset ratio, worldwide debt ratio of group, mechanical base protection rule = general cap on interest deductibility). These rules are of diverse nature: (i) interest allocation rule: aligning interest deductions with taxable economic activity; (ii) revenue-raising measure/safeguard: to ensure that an appropriate level of tax is collected from investments in the source country; and (iii) measures to counteract so-called “low tax loans” and discourage artificial debt arrangements designed to minimize taxes. However, it remains questionable whether these goals can actually be achieved with an earnings cap since it is not clear whether it is an objective measure, or merely a blunt tool.

4. Building blocks of the interest restriction

As regards the addition that ATAD is to BEPS, the main point is that whereas BEPS is considered a best practice on a world-wide scale (no minimum standard), ATAD pursues a uniform and binding implementation amongst Member States, which ensures compliance with a defined minimum standard for all companies with EU taxable presence. It is notable when comparing the expectations for the BEPS compared to the EU approaches, that the EU is an economic Union of the member states which carries with it a measure of mutual institutional accommodation (“union”) of regulatory regimes and their application including tax systems, even without a common tax base or homogeneity more generally, that is not the case more broadly for and among countries affected by BEPS. With respect to which taxpayers are covered by the rules, BEPS Action 4 covers all entities that are parts of a multi-national group, while ATAD covers all EU CIT taxpayers (including PEs of entities resident in a third country). Moreover, under ATAD, Member States may exclude standalone entities, and tax consolidated groups can be treated as a single taxpayer. Interest is defined by BEPS Action 4 as all forms of debt, whereas in ATAD article 2 the definition is the same as in BEPS with an explicit reference to the domestic laws of Member States.

As interest cap and thresholds, BEPS Action 4 provides a 10% to 30% EBITDA limitation, whereas ATAD - article 4 provides up to 30% of “tax EBITDA” limitation. Both contemplate safe harbours and optional carry forward. Emphasis has been given to the ATAD meaning of EBITDA which is a definition that refers to the tax and not the accounting concept of EBITDA. In principle, all income items subject to corporate income tax should be included in EBITDA. This may include items such as fair value and gains and losses on derivatives. It is important that tax EBITDA should cover solely amounts subject to corporate income tax, as this is the scope of the ATAD.

Also highlighted was the optionality of ATAD rules with focus on maximum scope (all CIT taxpayers, 30% or lower cap (EBITDA) on net interest) and on minimum obligatory scope (taxpayer exclusions, substantive exclusions and carry-forward and carry-back rules). Moreover, there is an option for deferred transposition offered by the ATAD in the case of equally effective rules. The "equally effective" criteria was evaluated taking into account the legal similarity or economic equivalence to other rules. The national measures were considered as equally effective to article 4 ATAD for five Member States: Greece, France, Slovak Republic, Slovenia and Spain.

Remarkably, there are additional limitations in connection with anti-abuse measures. While BEPS Action 4 suggests the introduction of a GAAR, in ATAD a GAAR is mandatory (article 6). Both BEPS Action 4 and ATAD recommend introducing TAARs such as thin capitalization rules, and it could be the case that Member States may keep the old rules if they are compatible with the treaty.

Another point of discussion was the interplay of BEPS Action 2 with BEPS Action 4 and whether BEPS Action 2 overrides BEPS Action 4. As a result, Action 2 applies first before Action 4 because conversely it is possible to end up with a disproportionate calculation considering the hybrid instrument.

5. Transfer pricing aspects

Transfer pricing and BEPS Action 4 have several differences. Essentially, BEPS Action 4 is based on group ratio rules and targeted rules, whereas transfer pricing rules follow the arm´s length principle. In addition to that, interest deductibility under BEPS Action 4 encompasses related and unrelated parties, whereas transfer pricing rules only cover related parties. As regards the interplay of transfer pricing rules with BEPS Action 4, interest payments made to related parties would have to satisfy the ALP test as well as the BEPS Action 4 rule. The main question in this regard is which rule prevails SAARs or GAARs.

6. Economic double taxation of interest

The OECD/EU recognized that (economic) double taxation is a significant issue which should be mitigated by unilateral measures. For example, carry-back/forward rules could transform a permanent double taxation into a temporary one, however they have a negative cash flow effect. The question that followed was whether mitigation of (economic) double taxation could be achieved by DTTs. In this regard, it has been concluded that there cannot be much relief for the following reasons: (i) article 1(3) DTT does not necessarily prevent double taxation since a state's power to tax its own residents remains unaffected by treaty provisions; (ii) article 9 DTT obliges to analyse the issue within the arm´s length principle and not as an interest barrier; and (iii) article 24(4) DTT offers little additional protection compared to constitutional law and EU law. In addition, *inverted linking rules* and a *gateway test* could mitigate double taxation in some cases but cannot resolve the general problem (i.e. disruptive industries, costs of litigation, start-up financing and volatility of earnings).

7. Evaluation of the interest restriction and forward thinking

The question is whether interest restrictions could effectively address the BEPS main concerns as well. The major concerns include groups putting high levels of third-party debt into high tax jurisdictions, groups using intra-group loans to generate deductions in excess of actual third-party interest expense, or groups using interest to finance production of exempt or deferred income, increasing harmonization and reduction of market distortion, and simplification and raising revenue. At EU level a high degree of convergence has been observed, which could lead to a decrease of market distortion unlike outside the EU where little convergence has been detected. With respect to the simplification of the tax system from an overall point of view, the outcomes are not successful. For example, the UK has 16 targeted anti-avoidance rules for interest limitations. One potential reason for this could be that governments just want to secure a minimum tax base and raise revenue.

As regards the practical effects of ATAD in the EU, the interest barrier is an effective tool in aligning interest deductibility with real economic activity in the vast majority of EU Member States. Actually, it is more effective than a thin capitalization rule with a safe harbour debt-to-equity ratio. Concerning ATAD article 4 and its relationship with EU law there is one major point of concern. According to article 115 of the TFEU, the right to change direct taxation regulations only exists in exceptional cases on the request of harmonization of the common market. In other words, ATAD should rule against tax avoidance practices that directly affect the functioning of the internal market. However, there is no consensus whether ATAD article 4 is an anti-tax avoidance regulation or just an element for simplification. Another key point that still needs to be properly addressed is whether ATAD article 4 complies with the freedom of establishment.

With respect to the evaluation of interest restrictions from an OECD´s perspective, a more mechanical approach has been chosen since it has fewer complications than the arm´s length or the withholding tax approach. In fact, the arm´s length principle is time and resource consuming with uncertain outcomes. The withholding tax still offers BEPS opportunities if applied at a lower rate than the corporate income tax rate, so there is a risk of double taxation and its use is constrained by double tax treaties and EU law.

8. Conclusion

A fundamental reform is needed to reduce the gaps and mitigate frictions. For example, as regards the CCCTB, it is uncertain whether it is included in a future reform, although it is included in the Commission's agenda. In addition to that and from a more general perspective, it has been highlighted that all the challenges posed to interest deductibility, are intimately related to tax competition. It is a fact that jurisdictions are competing with each other and tax policy is part of that competition. Jurisdictions try to foster investment and tax policy is a clear driver for that purpose. Even though we try to achieve harmonization there will always be competitiveness. Most likely, in ten years' time there will be a new version of BEPS Action 4.

Subject 2: Investment funds

Report by: Benjamin Malek, Susi Baerentzen
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Panel members: Delphine Charles-Péronne (France),
Roland Hummel (Germany), Nigel Johnston (Canada),
Floran Ponce (Switzerland)

1. Introduction

When analysing the tax issues related to investment funds, various fundamental international tax questions arise which require answers. Above all, it must be determined what constitutes an investment fund, itself and in relation to its members or other interested parties. Then, the question as to why these often differently constituted funds are established invariably arises, followed by questions on the different investment strategies as well as the categories in which funds can be classified and the implications of these determinations for how tax regimes apply to them and those interested in them and, further, how those tax systems interact with each other in a coherent way. The major distinction to be made, which will also be addressed in the section about the general report, is that between public/retail funds (mainstream funds), private funds (such as hedge funds) and real estate funds.

Several persons intervene in investment funds, and the funds can be self-managed or managed by a company (management company). The three main functions of funds – portfolio management, sales, and IT and support – can all be delegated to various extents; the dissociation of certain services can have VAT and transfer pricing consequences. One particularity of investment funds and related management companies is the control which auditors and Financial Markets Authorities have over them. Moreover, a depositor must check that management decisions comply with the fund's prospectus. All in all, several issues arise in relation to taxation of investment funds, and in the sections below a selection of these will be addressed.

2. Presentation of the general report

There has been a significant growth of assets under management, which have tripled in 15 years (as of 2017). Another change is the emergence of new types of funds, for instance those focusing on environmental credits, carbon taxes, cannabis or crypto currencies. These new models challenge the previous standard economic arrangements made in traditional equity funds.

The objectives of the general report were to survey the state of taxation of investment funds in different jurisdictions (42 branch reports were provided) and to examine assumptions and challenges associated with prevailing policies and theories that have driven the evolution of the taxation of funds as well as investors in and managers of those funds.

The main findings of the general report may be summarized as follows. Importantly, the taxation of investment funds is rapidly evolving and is not uniform across countries. Moreover, regulatory rules have a greater impact on taxation of investment funds; this impact is more important on funds which qualify for preferential tax regimes. According to the survey of the 42 branch reports, the taxation of mainstream funds appears to follow tax neutrality as a key tax policy consideration. However, there is no consensus on a definition of this "tax neutrality". In contrast, real estate funds seem to be subject to an opposite objective, i.e. the preferential treatment of domestic entities.

The general report also found that tax neutrality is generally not implemented in a systematic and coordinated manner. Moreover, most states opt for both horizontal tax neutrality (i.e. the fiscal treatment of funds being comparable to direct investment) and vertical tax neutrality (i.e. the elimination of double economic taxation). However, tax policy considerations seem to limit the achievement of tax neutrality. This is namely the case when resident investors invest in foreign funds, and even more so when the latter are residents of low tax jurisdictions. Investment funds which focus on real estate face the same difficulties. Some of the issues mentioned are domestic managers or advisory entities of offshore funds or management companies qualifying as permanent establishments (PE). Some states have addressed the PE qualification, either by legislating to exclude such a qualification for advisory entities, or by legislating to exclude the PE qualification in these situations. Other states have enacted safe harbour rules tailored for investment managers.

Another key finding of the general report is that in low tax jurisdictions most investment funds are set up for genuine investment reasons. It was for instance mentioned that the Cayman Islands are a common investment fund location because it is possible to set up funds there at lower cost and because the local legal system is similar to the systems in the US and the UK. The choice of jurisdiction is also driven by the need to achieve tax neutrality or to obtain preferential, yet legal, tax treatment.

3. Taxation of funds and investors

Regarding tax neutrality or market neutrality, two policy objectives are mentioned: first, avoidance of double taxation, i.e. if funds are taxed as corporate entities this may result in economic double taxation, more broadly taxation not coinciding with the "ownership" of the assets or income and could entail tax where none otherwise is due; and second, taxation of investors in a manner equivalent to direct ownership of the underlying assets. Real estate funds tend to follow different regimes, as some jurisdictions provide for preferential regimes, where the tax treatment is more favourable than in the case of direct ownership.

A major distinction is whether the fund is considered to be opaque, i.e. the fund itself is taxed, or if the fund is transparent, i.e. the investors are taxed. Investor taxation can be achieved through three models: pure pass-through, modified pass-through or upon distribution/sale of shares (deferral). In practice, pure pass-through is not workable for all funds because of the unlimited number of investors. In opaque funds, the taxation of the fund is often a surrogate for investor taxation. If fund taxation is preferred by a jurisdiction, exemptions or a reduced tax rate as well as a deduction for distributions made, are advisable.

Several mixed regimes also exist, mostly depending on the nature of the income or the legal form of the investment fund. The qualification of income may depend on numerous factors, such as the structure of the fund, entity qualification, residency of the investor or of the investment fund, and elections regarding the opting-in or opting-out of tax transparency.

The question of withholding taxes was also addressed. Most funds are in jurisdictions where no withholding taxes are levied, and some jurisdictions will levy withholding taxes depending on the type or source of the income or based on the residence of the investor. From a policy perspective, it was argued that withholding taxes act as a deterrent for investment in a country. It is however generally sensible for states to levy withholding taxes if an investment fund is investing in domestic securities, and should the fund get a withholding tax waiver, the system could be exploited to circumvent withholding taxes applicable to direct investors.

Under EU law, discrimination based on residency between EU taxpayers is prohibited. Moreover, free movement of capital is also applicable to third state investors. Two relevant CJEU cases were mentioned. In the *Aberdeen* case (C-303/07), the Court held that a dividend cannot be taxed at a higher rate if it is paid to a Luxembourg fund, as opposed to a Finnish fund. The same treatment was confirmed regarding Polish dividends paid to a US Fund in the *Emerging Markets* case (C-190/12).

Another importance issue for investment funds in practice is compliance and administration. Apparently, tax neutrality is better served by systems which put the obligations on individuals, whereas compliance and administration are better served by systems that impose these obligations on firms.

4. International aspects

Although tax havens levy no taxes on investment funds, they lack treaty access which creates a source taxation liability. Investors will not be able to credit withholding taxes levied on distributions made to the fund.

For funds, another issue related to treaty access pertains to conditions thereof. Before the 2010 OECD report on Collective Investment Vehicles (CIVs), few treaties mentioned investment funds. Normally, to obtain treaty benefits, a fund must be (i) a person, (ii) a resident of a contracting state, (iii) meet the beneficial ownership requirement when interest, dividends or royalties are at stake, and may need to fulfil LOB requirements.

One possibility for funds is to rely on intermediate vehicles. However, these entities are problematic with regard to substance and beneficial ownership. In this context, the CJEU Danish beneficial ownership cases were mentioned. Pursuant to this recent case law, intermediate companies lacking beneficial ownership cannot avail themselves of the Parent-Subsidiary Directive or the Interest and Royalties Directive; the foregoing is also applicable to DTT benefits.

Several policy issues are raised by CIVs: treaty shopping, the treatment of equivalent beneficiaries, the fact that economically similar funds can be treated differently because of their legal form, deferral, and the loss of preferential benefits for funds established for special purposes (e.g. pension plans).

Source state concerns are namely that funds are used for treaty shopping, i.e. people who lack access to treaties can invest in funds. Another issue is deferral of tax, as relief is granted on the premise that taxes are paid in the residence state. Before distribution, no taxes are levied, so the source state will generally require that the fund itself is subject to tax. Moreover, there are concerns that funds may have access to lower withholding taxes, which ultimately benefit domestic investors.

In turn, investment funds have concerns on clarity as foreign taxes affect the calculation of net asset value of the fund. Another challenge is establishing that investors are entitled to treaty reliefs; in many cases the investors do not deal directly with the fund manager, who may not know the identity of the investors or their tax residence.

In 2010, the OECD Committee on Fiscal Affairs adopted, with some modifications, the report on CIVs prepared by the Informal Consultation Group (ICG). The report led to amendments of the OECD Model Convention and Commentary. The report determined the extent to which CIVs and their investors should be entitled to treaty benefits and suggested best practices when granting and claiming treaty benefits through intermediated structures. The report defined CIVs as funds which must be widely held, dispose of diversified portfolios and be subject to investor-protection regulations in its country of establishment. Private equity funds and hedge funds are excluded of this definition. Moreover, the OECD advised treaty negotiators to expressly address CIVs even if it appears that they would be entitled to treaty benefits in both states. There is however a consensus that CIVs should be defined in domestic law.

This 2010 Report's definition of CIVs can be criticized because the fact that a fund is widely held does not mean that it cannot be used for treaty shopping. It is however unclear to what extent this happens. A publicly traded fund is supposedly not adequate for treaty shopping because investors have no control over transactions and distributions. Moreover, it was agreed that a CIV not subject to tax in its jurisdiction, could easily serve as a treaty shopping vehicle.

A global investment fund will typically be set up to have residence in a jurisdiction with no taxes at CIV level and no withholding taxes. In such a situation, a source state will generally not want to grant full benefits. Possible solutions suggested in the 2010 Report include: a provision treating the CIV as a resident of the state it is established in - thus entitling it to treaty benefits, and a variation of this provision under which treaty benefits are granted only to the extent that beneficial interests are owned by "equivalent beneficiaries" or residents of the residence state, which leads to a proportionate claim of benefits by the CIV. This is particularly useful in situations where investors could lose the equivalent beneficiary because they do not invest directly, typically for pension funds. Thresholds are also possible: once a certain threshold of treaty-entitled investors is reached, treaty benefits are granted in full to the investment fund. According to businesses, this threshold should be granted when 51% of the fund is held by treaty-entitled investors; states consider that 90-95% is a more suitable threshold. However, there remains a commercial issue in allocating treaty benefits to only 30% of the investors. This is realistically not feasible, and all investors would benefit from the proportionate benefit. Finally, a conduit or look-through treatment may be adopted. Under this system the CIV is not a resident but may claim treaty benefits on behalf of entitled investors. The issue with this system is that ownership of shares may often change and that in intermediation, fund managers may not directly deal with investors, thus ignoring their identities or residence.

Examples of the implementation of pragmatic solutions include: the Germany-Luxembourg DTT (2012), which allows CIVs to claim treaty benefits on a pro-rata basis; the Germany-Ireland DTT (2011) which provides for an equivalent beneficiary clause: once a 95% threshold is reached, full treaty entitlement is granted to the fund, and a pro-rata basis is granted under that threshold; the France-Luxembourg DTT (2018) also provides for an equivalent beneficiary test.

The Final report of BEPS Action 6 states that there is general support for the 2010 CIV report. A similar conclusion is not made for private equity funds and hedge funds; treaty shopping remains problematic for these entities. The introduction of the Principal Purposes Test (PPT) coexists to some extent with the LOB provision – the latter can serve to deny treaty benefits when residence is not substantiated enough. Risks relative to the language used in the PPT were mentioned, as tax authorities may deny treaty benefits when they identify a tax motive, irrespective of valid economic reasons for an arrangement or structure. The OECD Commentary on article 29, paragraph 182, example D, was also mentioned. In this example a CIV is widely held in state R, most investors are also residents of state R. Distributions are made on an annual basis. Moreover, 15% of the CIV's portfolio are shares of companies headquartered in state S. The CIV considers tax treaty benefits. However, the strategy is not driven by the tax situation. The example concludes that in these circumstances the PPT would not lead to a denial of treaty benefits. There was concern that such a restrictive example was used to show a CIV's compliance with the PPT, as this example does not reflect the situation of most investment funds.

There have been recent initiatives to use blockchain technology to address issues with investor residency. The TRACE (Treaty Relief and Compliance Enhancement) project of the OECD, which is not limited to funds, allows authorized intermediaries to make claims on behalf of investors on a pool basis. This project, which is yet to be implemented, replaces tax residency certificates with self-declaration forms. It has been noted that there are some similarities with the Common Reporting Standard (CRS, 2017). Finland announced that it would introduce TRACE in 2021. TRACE is arguable facilitated by the Foreign Account Tax Compliance Act (FATCA, 2014) and the CRS.

Investment funds which have their units held through a clearing system by a financial institution, i.e. in the custodial account of the investor, are deemed compliant and will have no FATCA or CRS obligations. However, if the fund is considered a participating foreign financial institution (PFFI), the management company must register with the IRS and perform due diligence. This is generally delegated to the custodian, but legal responsibility remains on the fund.

5. Taxation of fund managers

This issue is mostly discussed in alternative funds. In traditional funds, income will normally be taxed. Private equity funds, venture capital funds and activist hedge funds tend to make long term capital gains. There are different types of compensation for managers in those funds: management fees, performance fees after preferred return and capital gains on co-investments. Fund managers can be organized as corporations or partnerships, which impacts their taxation.

There is a policy debate on the taxation of carried interests, with some jurisdictions accepting to consider such income as capital gains. The debate arises because by means of a "carried interest", that is an interest in the performance of investments they manage, managers essentially realize the outcome of their investment services in the form of profits from the managed assets rather than from fees paid for their services by the funds they manage. Capital gains are usually taxed at preferred rates or exempted. But fund managers provide labour to the fund, on the other hand if they organize the fund as a partnership it could be considered that this qualification should be respected, thus capital gains will be realized only at the fund level and the character of managers' "compensation" will be according to how compensation, or services fees, typically would be taxed.

With regard to the taxation of hedge fund managers, two questions arise. First, does the retention of an onshore investment advisor create a tax exposure for the offshore fund? Most countries consider that this will not be an issue. Countries with a well-developed financial industry have safe-harbour rules. Second, does the use of an offshore fund manager create a tax exposure for the onshore investment managers or for the onshore investment advisor? The issue is more complicated in this situation and the answer will generally depend on the applicable factual circumstances. In this regard, an alignment between structure and economics is key.

VAT is probably the most expensive tax for the fund industry, namely for fee invoices. Directive 2006/112/EU exempts management fees of investment funds from VAT. The exemption is subordinated to two conditions: the service must be qualified as a funds management and the service must be rendered to a special investment fund. However, this Directive allows EU Member States to enact legislation to charge VAT on exempt services.

A current challenge concerns brokers who provide research and execution services. Before MiFID II entered into force research was VAT exempt. This new directive has implemented that there are now two different types of services rendered by brokers: Brokerage which is not subject to VAT and research for which the VAT status is under discussion; it should mainly depend on how the research is qualified (essential or not).

6. Conclusion

It was concluded that investment funds are generally not used for tax avoidance motives but for genuine business reasons. Therefore, funds should be scrutinized under 'lighter' conditions where tax issues are concerned. There is a tendency towards uniformity as far as funds are concerned. Finally, it is anticipated that technology will have a major impact on investment funds in general, including on the field of taxation.

Seminar A: Tax and Sharia instruments

Report by: Susi Baerentzen
Chair: Osman Mollagee (South Africa)
Secretary: Carolina Descio (UK)
Panel members: Peter Barnes (USA),
Monia Naoum (Morocco/Qatar), David Saleh (UK)

1. The fascinating world of Islamic financing

Just like any other legal system, Sharia law includes rules and principles for financing. What makes the rules of Islamic financing special is that ultimately Sharia law is a legal system based on Islamic law and jurisprudence, which means that the Sharia finance instruments are based on four key principles:
1. *Riba* - the prohibition of interest or unacceptable profits;
2. the assumption and sharing of risk in the sense that risk-free participation is not accepted;
3. *bayu al-gharaar* - no excessive uncertainty or speculation;
4. no investments in unethical goods / activities (gambling, alcohol, porn, conventional interest, arms).

These principles necessitate instruments for finance transactions that are compliant with Sharia law, which is referred to as Sharia finance, Islamic finance and Sharia-compliant finance.

A principal tax challenge lies in reconciling the Sharia legal system, which like legal systems generally establishes the features of legal relations among parties to them and to which any tax system is accessory, with other legal systems in which parties to affected transactions are also subject and into which it is necessary to "translate" Sharia legal relations or at least be sensitive to them and their distinguishing characteristics. Fundamentally, respecting Sharia as a legal system, this is a familiar exercise even in more typical settings when different legal systems are engaged by arrangements that may have similar or even the same economic and financial outcomes but be framed quite differently according to applicable law; of course, the enforceability and effectiveness of the arrangements meant to convey those outcomes depends on compliance with the law. This is a recurrent theme of "international taxation" in so far as countries' legal systems are not and cannot be expected to be uniform or homogeneous. We see that, for example, in more mundane ways in the work of the OECD's BEPS project, for example in the attention paid to "hybrids" and the "accurate delineation" of transactions to reflect manifestations of "substance" in a transfer pricing setting. Hence, in a manner of speaking, this panel investigates one of the most enduring and important questions in international taxation, namely the reconciliation of legal systems on which tax outcomes depend.

The solution for how Sharia law addresses financial arrangements is provided by specific transactions mostly used for property, and these transactions include a multiple of additional transfer taxes when compared with traditional finance arrangements, which in return poses a number of tax challenges. Most property transactions will involve a form of rent or lease-buy-back to ensure it complies with Sharia law, and as interests are unacceptable and profits are prohibited, no documents or contracts are allowed to refer to interest. However, for tax, the 'rent' is often equal to interest when applying tax treaty benefits.

Even though there is a general consensus on underlying roots and fundamental principles (which date back to the 12th century), there are different interpretations on what is considered a Sharia-compliant instrument. In fact, there is no single authority in these matters. In practice, each bank will appoint a Sharia board or recognized Sharia expert to supervise the compliance of these transactions to Sharia law.

There are numerous uncertainties regarding the tax treatment of the Sharia transactions. The fact that the borrower pays "rental" income and not "interest" makes it unclear whether the restrictions on "interest" deductibility (interest barrier, thin capitalization rule, anti-hybrid rules, etc.) are applicable or not. Furthermore, it is not certain whether the "interest" withholding tax rules are applicable in these situations. More importantly, under tax treaties, do we need to apply article 6 (income from immovable property) or article 11 (interest)? The same doubt exists in the case of the transfer of property as to whether or not article 13 is relevant.

2. An exponentially growing baby dragon

While Sharia financial instruments may have their own unique features, they are becoming increasingly relevant. In fact, the current value of investments in sharia-compliant instruments is estimated to be around USD 2 billion while the value of the so-called *sukuk* bonds (financial certificates evidencing an ownership interest in underlying assets rather than an obligation – a debt – of the certificate issuer, which nevertheless provides a flow of payments to the holder in relation to a Sharia compliant financial accommodation made by the holder which comprises a return of the amount of the accommodation and a return in relation to it, but manifest via the ownership of the underlying assets) issued on a yearly basis is estimated to be around USD 800 billion including *sukuk* issued by the UK government. The big issuers include General Electrical, Goldman Sachs and the UK government, and for those players there is a wish to be able to access the market. Furthermore, issuers want to signal an interest in Muslim-depositor markets and the market goes beyond the Middle East to include Malaysia, Singapore, Indonesia, Morocco, and others. Again, the challenge posed by the configuration of financial transactions according to Sharia law in relation to how other legal systems may perceive them, is in each case for parties familiar with Sharia law and other relevant legal systems to see the affected arrangement or event through the lens of the other, and then through transaction design and even, possibly legislation devised to be sensitive to this reconciliation, to achieve commercial outcomes respectful of all relevant law and practice.

Several governments are trying to access this financial market in both Muslim and non-Muslim countries, and currently, approximately 6% of global finance is invested through Sharia-compliant instruments. Therefore, there is a need to access more Sharia-compliant customers and capital, to attract interest in Muslim-depositor markets and to build expertise for the future on those instruments.

Unfortunately, the tax community is largely under-informed and unprepared to handle the legal issues and tax challenges revolving around those instruments, as will be analysed below.

3. Lack of expertise and guidance

Sharia finance transactions are often domestic, but as more countries enable a legal structure for these transactions, cross-border transactions will happen and will become far more complex, which will exacerbate the current issues.

Therefore, there is a notable need to develop global guidance, which can ensure certainty and avoid the risk of transfer pricing disputes emerging when tax authorities question the benchmarks used or the application of the arm's-length principle. Put into the context of today's tax world, it is not difficult to envisage how revenue authorities in the functional analyses of the employees of the bank could be asking: so, how do you benchmark this? Do you see yourself as being in the business of buying and selling properties? How do you determine your return? Can you show me the CVs of the guys who really know about property? Equally, it is not hard to see these kinds of questions as being typical of the fundamental inquiry into the effects of private law on tax outcomes, which entails not only narrow tax analysis but also, always, an informed appreciation of the legal parameters and principles that establish the features of the arrangements and events to which tax rules, then, apply.

The lack of expertise and guidance is distinct in the US even though this is where the big issuers like Goldman Sachs and General Electric reside. There is no information whatsoever on the Internal Revenue Service (IRS) website about how to treat "Sharia finance, even though the transactions are clearly taking place. On the other hand, countries like the UK have realized the financial potential in this area and have developed thorough guidelines on how to handle the legal issues and tax issues surrounding them, as will be described in the section below.

4. The Sharia-compliant contracts and their features

The Sharia-compliant contracts vary in nature and prevalence, and include the following:
1. *Murabahah*, which is a s form of cost-plus credit sale
2. *Musharakah*, which is a form of partnership
3. *Ijarah*, which is a rent-to-buy contract, and
4. *Sukuk*, which are investment bonds.

When comparing these transactions to their equivalent conventional transactions, it is apparent that the traditional financial transactions have Sharia-compliant counterparts. What is also apparent is that the more complex the traditional transaction is, the more complex the Sharia-compliant counterpart is as well.

As mentioned above, the UK is one of the countries which has developed guidelines for handling the tax issues related to Islamic financing. The UK experience with Sharia instruments focuses on *Ijarah*, which is structured in a way that is similar to the conventional financial instrument of sale and lease back. Under traditional finance, there will be a sale between the seller and the buyer and a loan agreement between the buyer and the bank with a guarantee as a security for the repayment of the principal/interest in the form of a mortgage. Accordingly, the buyer will bear the transfer tax and make an interest payment to the bank. However, *Ijarah*, will be undertaken in several transactions where the bank will acquire the property and then let it to the lessee with the possibility for that lessee to buy the property from the bank at the term of the lease. Accordingly, under *Ijarah*, rent is paid instead of interest and the principal amount is advanced and re-paid under property sale transaction. A specific issue arising from this construction is that the word "interest" is not mentioned under *the* agreement, so tax practitioners need to determine how these contracts are reported properly for tax purposes including for withholding tax purposes.

5. Conclusion

Considering the vast number of practical issues relating to Islamic financing, there is a great risk of multiple transfer taxes as those instruments include numerous transactions compared to traditional finance. If countries adopt a formal approach to Islamic financial instruments, these problems are very likely to get exponentially bigger. With this in mind, avoiding guidance and specific rules as practiced by the US seems very counterproductive for promoting investments in Islamic banking. For the taxpayers, Sharia-compliant transactions are already likely to be more expensive than traditional transactions, and if an increased tax burden (stamp duties and transfer taxes) is added, then this will also hinder the growth in this market.

At this point, neither the OECD nor the UN are extensively engaged in locations where Sharia-compliant finance is most significant, and this is likely part of the explanation as to why it is not addressed by either of them. If an effective solution is going to be found, it mightbe beneficial for taxpayer groups (including financial institutions and businesses) to create a coalition to identify the key issues related to Islamic finance and encourage the development of uniform and harmonized legal and tax guidance. In this context, they could also address BEPS issues and suggest solutions to cover various "mismatches" in cross border treatments.

Cross-border Islamic finance transactions have features that arise naturally from Sharia law and not unlike transactions formulated under any particular legal system may, in result, be or seem to be far more complex than domestic situations of transaction counterparties whose commercial relations are usually not conducted according to or even with reference or a sensitivity to Sharia law. However, again as with any case where different legal systems intersect in the tax context, there is definitely a need for cooperation to reach viable solutions that achieve parties' objectives including respectful compliance with applicable law.

Seminar B: Form and substance

Report by: Mirna S. Screpante
Chair: Tony Pagone (Australia)
Secretary: Melissa Elechiguerra (Spain)
Panel members**:** Richard Collier (OECD),
Robert Desax (Switzerland), Michael Lang (Austria),
Philip Martin (France), Lionel Nobre (Brazil)

1. Introduction

"Substance" and "form" are problematic to define though they are bandied about in contemporary tax discussions as if they were clear normative terms of art in taxation. Therefore, their meaning, or the meaning to be attributed to them in any particular setting and how those meanings are to be established, and their application is complex but critical not only for the administration of tax but also for the rule of law – the general law that informs the characteristics of persons, events and value transfers that are taxable with reference to their legal connotations. In recent days, both concepts have become increasingly relevant in three broad contexts: (i) in the area of avoidance and abusive transactions – themselves elusive notions; (ii) as a result of BEPS developments, in particular in relation to hybrids; and (iii) in the area of transfer pricing where the "accurate delineation" of transactions may or may not involve considerations aside from what those transactions "are " under applicable law, informed by the conduct of the parties to them.

2. Form and substance from recent case law perspective

For a better understanding of the notions of form and substance three case law studies are explored. The first case illustrates the possible difficulty in distinguishing debt from equity in relation to and the tax effects associated with each within a tax system. The case is about a bank located in country one which sets up a subsidiary (ACorp) also in country 1 (moderate tax jurisdiction). ACorp sets up a second subsidiary (BCorp) in country 2 (low tax jurisdiction). After that, ACorp sells some of the shares to several corporate investors (Xcorp, Ycorp, Zcorp, etc), however control remains at the level of the bank. ACorp invests in BCorp and BCorp invests in bonds abroad. Fundamentally, the tax planning relies on dividends being exempt from tax domestically and when they are paid across a border while interest is taxed. The idea behind the structure is that interests should be arranged to be taxed in the low tax country, and then the amounts so received distributed as tax exempt dividends to the moderate/high-tax jurisdiction. The court took issue with the structure and applied the domestic GAAR from county 1 determining that the structure was artificial. The main reason for that conclusion is the tax-driven purpose to characterize and allocate the taxable income (i.e. interest from investments funds) in an interposed company resident in a low-tax jurisdiction (BCorp) instead of being transmitted directly to and being taxed in the moderate/ high tax jurisdiction at the level of ACorp in country 1.

The issue of substance can be understood from two perspectives. Either it can be understood according to economic or alternatively to legal standards. Whereas economic substance refers to the economic aspect of the transaction from a business perspective, for example whether real activity does exist or not, legal substance typically is understood to refer to the legal structure used to carry on the business activity. Therefore, in cases where debt and equity are involved, a tax administration should use a two-step reasoning based on the existence of economic *and* legal substance. First, it should analyse how to characterize these financial instruments and what are the normal tax consequences and tax treatment for them based seemingly on economic outcomes (i.e. economic substance). Second, the tax administrations should analyse the legal elements of the structure and determine whether those instruments have been used abusively within the tax planning, taking account of whether the parties' conduct corresponds to the legal means they have adopted to implement their transactions (i.e. legal substance).

The second case study aptly illustrates reliance on and the manipulation of thresholds in the law that condition different outcomes. On the one hand, there are positive thresholds that trigger favourable tax regimes, and on the other hand there are negative thresholds which might trigger the application of anti-avoidance rules. The case concerns a company that wants to benefit from a parent subsidiary regime which requires a 10%- participation threshold to secure the desired outcome. The parent (ACorp) holds 7% of BCorp so to reach the 10%-threshold, ACorp buys an additional 3%. The key issue refers to the purchase of the additional 3% to reach the 10%-threshold. The case raises two questions: (i) the purpose of the transaction, and (ii) potential substance problems.

As regards the first issue, it is questionable whether the behaviour of the taxpayer is against the purpose of the law, if the intention was to reach a bright line threshold created by the legislator. With respect to the substance issue, some indicators of potential abuse of law should be considered. For example, issues to consider might include the short timing between purchase and sale of shares, or manipulation of the share price if the threshold is not a percentage but a value of the shares (e.g. artificially lowered price). In this regard, attention should be paid to the reason *why* income has been passed and not *when* it has been passed. If the concern is to decide whether the whole transaction is abusive, it is crucial to analyse the reason for undertaking the transaction and not, or not merely timing issues. With respect to substance, what fundamentally matters is whether ACorp "really" owns those additional 3% or if there are other collateral obligations or extenuating considerations, for example with respect to the sellers, that must be fulfilled like a re-purchase of the shares so as to suggest that the purchase by ACorp was merely temporary and pre-arranged to "unwind". If the formal owner is indeed the "beneficial owner", it should not be relevant if 3% has been acquired to reach the threshold because that requirement was not relevant when the legislator put that percentage. Essentially, this a problem that arises from working with legal fictions, and illustrates the singular importance of understanding and testing the reliability, in relation to taxpayers' conduct, of the private law constructions to which tax law is accessory, i.e., it is the private law that determines the nature of organizational forms and entities and the nature of transactions even where legally distinct kinds of transactions may have the same or equivalent overall financial and economic outcomes.

The third case study deals with substance and form in relation to capital gain versus dividends transactions. The key issue in this case was to determine whether an additional adjusting payment made in the year following a transaction from a subsidiary BCorp (resident in country 2) to a parent company ACorp (resident in country 1) as a consequence of an amendment to reflect a fair market value from a sale price of shares in year one, should be classified as a capital gain or as a dividend. According to the Supreme Court the second agreement (year two) was not necessarily a consequence of the first agreement so the second agreement was made *causa societatis* based on the ownership relationship. Even though from a civil perspective the transaction was an amendment of a sales contract, from a tax perspective in substance the court found that this was not a capital gain but effectively a deemed dividend distribution from BCorp to its parent ACorp. The unfortunate side of this case is that ACorp would have been able to benefit from participation relief if the full payment had been made in year one. Given the way that participation relief works, the supplemental payment was fully taxable income to ACorp. This case raises the question of what comes first: (i) the correct calculation of the capital gain in year one since it is the initial and real transaction, (ii) or the recharacterization of the payment that appears in year two as an isolated payment. However, either one or the other seems disadvantageous for the taxpayer.

3. Form and substance and transfer pricing rules after BEPS

Finally, as regards the relationship between form and substance and the arm's length principle there has been a significant shift in thinking over the years. In the OECD's 1995 Transfer Pricing Guidelines it was directed to follow the actual transactions, except in two particular circumstances where disregarding the transaction as formulated by a taxpayer might justifiably occur. First, where economic substance differed from a transaction's form, it was said that substance prevailed. Second, where the form and substance of the transaction were the same, it nevertheless was to be considered that the arrangements viewed in their totality as formulated by a taxpayer and its non-arm's length counterparty, differed from those which would have been adopted by independent enterprises behaving in a commercially rational manner. Now, BEPS has seemingly recast the first test (i.e. form and substance test); what used to be an exceptional circumstance seemingly has become an integral part of the way a transaction is to be construed ("accurate delineation of the transaction") in the OECD's 2017 Transfer Pricing Guidelines. In other words, what was an exceptional circumstance became part of the everyday practice of transfer pricing.

Under this "new" approach there is a mandate given to the tax authorities to look behind contracts to see what is thought to be the real arrangements between the parties regardless of the manner in which those arrangements have been formally cast under applicable legal conventions. If there are inconsistencies between contractual arrangements and reality – where reality is taken to mean how the parties have actually conducted themselves in relation to each other - it is the actual conduct that prevails. The contract is respected only if it is aligned with the conduct of the parties. It would be fair to wonder whether despite the prominence of "economic" substance in the OECD's thinking, this approach simply reflects an evidence-based testing of parties' contracts – an inherently legal analysis – to determine what their legal arrangements really are, not merely appear to be taking account only a description of the form they have adopted.

As regards the second test, i.e. commercial rationality test, which is retained by the restated OECD 2017 transfer pricing guidance in paragraph 1.122, there is an attempt to constrain or police the fact that associated enterprises have an ability to enter into a much greater variety of arrangements than third parties with economically or financially equivalent outcomes. The non-recognition does not apply when a comparable third-party transaction can be observed. However, the test does not resolve the issue when there is a transaction that associated parties would do but third parties would not do. The practical tension is not just for the tax authorities but for everybody to judge the commercially rationality.

An assessment of a factual situation may be controversial in any context where legal interpretation is relevant. In other words, facts matter because facts – evidence – inform the essential features of legal relations between parties which, in turn, necessarily have economic outcomes. A question in this area is whether the analysis works, or should work in the other direction, that is from an economic outcome then to select a particular legal description of arrangements capable of giving rise to it. The reliance of the OECD on the assessment of facts does not contribute much since there is no big difference between transfer pricing and other fields of tax law, or for that matter legal construction generally. Actually, as the panel considered, interpreting and applying the law requires the same procedures for transfer pricing as for tax law in general. Only two different levels need to be distinguished; the assessment of the facts, and the interpretation of the rule. First, there is a need to understand the rule and depending on the context of the law the factual situation giving rise to interpretation questions. Looking behind what is written as a transaction to evaluate its compatibility with how the parties to it have conducted themselves - what has really gone on and therefore what may be inferred from that analysis is the terms of the transaction - is part of the factual and legal assessment. In fact, the OECD talks about the assessment of the facts in relation to what indeed is an interpretation of a rule.

The commercial rationality test is a powerful tool for a tax administration because the lack of formal definitional standards allows room for broad interpretations of what it might mean. The tax administration could end up taxing something which does not correspond to reality as an evidenced based legal analysis otherwise justifiably would require according to a test of what is considered for other reasons to be commercially rational when it is the intention of tax law to tax reality as it can be determined by both the legal constructions adopted by the parties and evidence of their conduct in relation to them.

After BEPS, fundamental issues have arisen about the use or concept of substance in tax matters. Substance is an unclear requirement which is codified by the courts. Therefore, tax administrations are often tempted to challenge certain transactions when they do not like the tax result by trying to disregard the transaction that seems to be suspicious. However, it is the responsibility of the judiciary to establish the way in which this concept is used including the standards by which disregarding or recharacterizing transactions is acceptable as an outcome of legal analysis and a legal proceeding. For example, in French law there are three levels for substance:

(i) (plain) characterization: for the characterization of a transaction the French courts considers:
    - high consideration of foreign civil or commercial law;
    - medium consideration of accounting rules; and
    - no consideration of foreign law;
(ii) recharacterization of a transaction when there is no abuse of law. It occurs when the form used, is apparently correct for the transaction but what happens in reality belays the apparent form (there is lack of legal substance); and

(iii) disregarding (setting aside) a transaction occurs when there is abuse of law. Such is the case when the form and the reality are disconnected because there is lack of economic substance.

In short and more importantly in a GAAR context, the behaviour of a taxpayer is conclusive. Essentially, the analysis is centred on whether a rational taxpayer would have done the transaction for economic purposes. However, in a transfer pricing context the scenario is quite different because one has to look at how other companies behave in similar circumstances and not what might have been done hypothetically.

As regards abuse and disregarding of transactions, there is a need to distinguish carefully between the level of the facts and the level of the law because the outcomes are not the same. If a tax system or a tax treaty allows disregarding a transaction based on the facts, a legal basis is needed for that. The assessment of the facts is to understand reality neither, the form nor the substance, since it is reality that eventually counts.

4. Conclusion

The notions of form and substance are fundamental to tax law at every level, but it must be taken into account that only the form regulates the taxable outcome and not the substance. In fact, income tax law can only tax the substance from a transaction through the legal forms used. There are constitutional reasons why that is so, therefore why taxation has to be imposed by parliament having identified clearly, what is to be taxed. Taxation comes from the rule of law. Therefore, the rule of law needs certainty and needs to be straightforward. Over the years, anti-abuse provisions have tried to create criteria to determine if there is a situation (i.e. facts) that moves from the rule of law so it can be adjusted. The OECD has engaged into radical dramatic change, needed or not, in the way in which tax might be applied in the context of non-arm´s length dealings in the international context. In fact, we might be leaving a time that moves from the application of the rule of law to an application of management risk.

Seminar C: Indirect taxation and financial services

Report by: Susi Baerentzen
Chair: Jennie Rimmer (UK)
Secretary: Shan Sun (UK)
Panel members: Joanne Clarke (UAE),
Karl-Heinz Haydl (Germany), Daniel Lyons (UK),
Bevan Miles (New Zealand), Saibh Young (UK)

1. The increased importance of VAT/GST on a global scale

Since the 1960s there has been a rise in the number of countries adopting a VAT/GST ("value added tax" / "goods and services tax", and more generally a destination-based consumption tax) regime and VAT/GST as a percentage of taxes collected over the years. This is an example of how regimes have adapted to economic circumstances that have evolved from narrow and in important ways "tangible" manifestations of goods, to services, and from domestic to cross-border arrangements in some cases in combinations or "bundles" of complementary and / or supplementary transfer. This development has a high impact on the businesses, and it consequently raises a variety of challenges to be dealt with in order to ensure an efficient system. Many of these challenges revolve around the practical implication of the rules and the policy that lies behind their existence. This entails both management risks and increased costs of administration and compliance, and gives rise to a further need for dispute resolution for the corporations. On the end of the tax administration the increased use of technology for monitoring indirect taxes, poses great challenges at the same time as it provides opportunities. The panel addressed these issues and the analysis is reported in the following sections.

2. Complexity and uncertainty: VAT and international financial service industry groups

The VAT system rests mainly on three basic principles which are simple to say but as the panel discussion reflected, nevertheless entail considerable complexity:

1. A branch and a head office (or a branch and another branch) are treated as single VAT taxpayer (*FCE* (Case C-210/04)).
2. Supplies between two companies within a VAT group should be disregarded.
3. The EU has a common VAT system.

As simple as that may sound, the practical issues arising in relation to these principles are numerous. The most fundamental examples are the CJEU (Court of Justice of the European Union) decisions in *Credit Lyonnais* (C-388/11), *Skandia* (Case C-422/01) and *Morgan Stanley & Co International (Case C-165/17)*, which have challenged these basic principles; these cases all illustrate how complexity has been introduced by the courts, and that it may in some instances appear to conflict with the legislation.

3. Case study I - New Zealand

The Goods and Services Tax (GST) system in New Zealand includes a specific financial services exemption, the scope and application of which still presents uncertainty in various ways including for supplies of mixed and other financial services. The impact of this exemption can be seen in a recent review of the GST, which concluded that the status quo is maintained in the absence of obvious feasible options. One of the reasons for this is the major challenge with respect to the practical implementation of this approach in the case of banks and insurance companies. There is a memorandum of understanding in place between banks and the tax administration, which provides an effective guide to navigate the complexities related to mix of exempt, taxable and zero-rated supplies. No such memorandum exists in the case of insurance companies, which appears to be the source of the concerns.

4. Case study II – the Gulf Cooperation Community (GCC)

The VAT/GST regimes in the Gulf Cooperation Community (GCC) are considerably challenged by the fact that they are usually composed very shortly before they are meant to enter into force, which gives taxpayers an even shorter time to prepare and adapt to the new rules. This problem is aggravated by a profusion of ambiguities (for example, pronouncements from the tax administration are sometimes contradictory), underdeveloped and under-resourced tax administrations, systems issues and by lack of tax professionals. Additionally, the penalty regime, which is very strict, functions effectively.

Kuwait, Oman and Qatar have yet to implement a VAT system; Kuwait has yet to levy an excise tax. Given the number of issues related to this area and apparent lack of readily available solutions to them, it is likely that the GCC states may be obliged to increase the standard rate and to decrease the registration threshold.

5. VAT and the future

The international trend towards transparency results in an ever-increasing amount of data for the tax authorities to interpret and make use of, including data in the area of VAT. Indirect taxation is prone to attacks from fraudsters, so a better access to data to combat these attacks can indeed be beneficial. However, if the tax administrations do not cooperate with each other it will be apparent that technology is not the solution for everything: data can be falsified just like paper can. This shifts the focus to the role of data mining and matching as VAT fraud detection and prevention may provide improvement thanks to the collection of detailed transaction-level data.

The quality of the data received, can further be enhanced by using tools like a real time reporting regime, as for example New Zealand has done. This tool enables the tax authorities to ask more focused questions on specific transactions, which is beneficial for both the administrations and the corporations.

Ultimately, a frictionless flow between taxpayers and tax administrations to reduce audits and manage costs would be the ultimate aim to ensure an efficient VAT system.

Seminar D: Hybrid instruments and entities

Report by: Benjamin Malek
Chair: Diana Wollman (USA)
Secretary: Ioana-Felicia Rosca (Austria)
Panel members: Renata Emery (Brazil),
Christoph Marchgraber (Austria),
John Peterson (OECD), Dario Sencar (Italy)

1. Overview of OECD and EU Anti-Hybrid recommendations

The seminar started with an overview of EU and OECD anti-hybrid recommendations. On the OECD side, these efforts have mostly been implemented through BEPS Action 2, which is not a minimum standard. The EU has enacted three directives to address hybrids: an amendment to the Parent-Subsidiary Directive, ATAD 1 and ATAD 2.

The OECD and ATAD 2 target three types of hybrid mismatches: First, "D/NI", which occurs when the payer, e.g. of interest, benefits from a deduction and the payee benefits from a non-inclusion of the amount from its taxable income. Second, "DD", i.e. double deductions arising from a single payment. Third, imported mismatches, where a payer benefits from a deduction and the payee is burdened with an inclusion which is however offset by a hybrid deduction, which in fine results in D/NI or DD.

The recommendations of the OECD and ATAD 2 include a primary rule which is to be applied by the payer's jurisdiction, and a defensive rule (also called secondary rule) which is applied by the payee's jurisdiction in instances where the payer's jurisdiction fails to apply the primary rule. The seminar focused on D/NI rules. It was stressed that such rules require cooperation and coordination between jurisdictions. Moreover, these rules function best when the concerned jurisdictions have similar corporate income tax systems; states using a non-standard system can raise issues.

2. D/NI case study (Brazil)

The Brazilian Corporate Tax Regime provides for a 34% aggregate rate. Dividend distributions are exempt of withholding taxes, irrespective of the residence state of the beneficiary thereof. However, interests – which are deductible expenses – are subject to a 15% WHT if paid to a non-resident and can be increased to 25% if the recipient is a resident of a low-tax jurisdiction, i.e. subject to a rate below 20%. Interest deductibility is also restricted under general principles such as thin capitalization rules and transfer pricing regulations.

A specificity of the Brazilian system is the "JCP", which equates to interest on net equity. The JCP was created in 1995 to stimulate capital investments in Brazil, by granting a remuneration to shareholders who fund corporations with capital. Only shareholders are entitled to JCP and the payment is not tied to any debt instrument; the funds are paid out of profits or retained earnings. Moreover, the JCP is a deductible expense for the corporation, and is treated as interest for fiscal purposes.

Under Brazilian corporate law, companies must pay a minimum dividend; the JCP is deductible from this minimum dividend. Hence, the JCP is arguably a payment resembling dividends.

All post-1995 tax treaties ratified by Brazil provide that the JCP should be regarded as interest under the meaning of article 11. However, anterior treaties lack such provisions. The tax consequences of JCP payments paid in situations where a pre-1995 treaty is applicable, have thus been uncertain. Indeed, income arising from shares are generally considered to be dividends, as provided for by article 10. Few Brazilian treaties provide for an exemption of dividends, the normal regime being a matching credit to eliminate double taxation.

A Brazilian corporation upon paying JCP to a foreign resident will be able to deduct the JCP from its taxable profits, normally subject to a 34% tax rate. Moreover, as Brazil considers JCP to be interest, the standard 15% withholding tax rate generally applies. This tax treatment, provided the JCP is not taxed in the state of residence, offers net tax savings of 19% (34-15). The Austria-Brazil tax treaty, which was ratified before 1995, would be problematic for JCP payments. Indeed, this treaty grants taxing rights to the state of residence, whilst limiting the taxing rights of the state of source to 15%. Parent companies benefit from an exemption on dividend paid by subsidiaries provided they own at least 25% of said subsidiary. A matching credit of 25% of the gross dividend, or interest, is provided for. Austrian domestic tax law provides that intra-group dividends are generally tax exempt. However, when the payer, i.e. the subsidiary, benefits from a deduction, in the state of source, for the dividend it paid, said dividends will be taxable income for the receiving company. Therefore, there would be no recharacterization of the JCP, but the payment would be taxed to the extent that it leads to a deduction in the state of source.

In Italy, which has a 1978 tax treaty with Brazil, the nature of the Brazilian JCP is not established, i.e. is it interest, and as such covered by interest limitation rules, or is it dividend? Article 23(3) of the treaty provides that Italy, as a residence state, must exempt Brazilian dividends if the Italian entity is a qualified shareholder (25% shareholding). Moreover, Italy must provide for a matching credit (25% rate) for dividends as defined by article 10(4). Italy recognizes treaty primacy and does not proceed to treaty override, and as such the application of ATAD's secondary rule is not certain. Two options are foreseeable for the definition of "dividends" as understood in article 23(3): either the definition provided by article 10(4) or the definition provided by Italian domestic law, by renvoi of article 3(2).

The US has enacted both the primary and secondary D/NI rules suggested by the OECD. According to these rules the Brazilian JCP would be considered as dividend eligible for the US' participation exemption. However, as the Brazilian corporation benefits from a deduction on the JCP payment, the US would deny the participation exemption to the US parent company and would instead recharacterize the JCP as interest. The tax consequences would be that the 15% Brazilian withholding tax levied on the JCP would not be claimable as a tax credit and that the JCP would be fully taxable in the US.

In a 2016 judgment in Spain, the Supreme Court held that the Brazilian JCP is a dividend for domestic tax purposes and that the Spanish participation exemption would thus apply. The Spanish government reacted by amending its participation exemption statute, which now provides that the exemption is not available if the payer, i.e. the Brazilian corporation in this case, is allowed to deduct the payment under its domestic tax law.

The Spain-Brazil Treaty, also ratified pre-1995, provides that if a resident of Spain receives Brazilian source dividend, the dividend is not taxable in Spain. The Spanish tax authorities have however ruled that the JCP is not a dividend for the purposes of the treaty, which has led to controversy with regard to the consistency with the 2016 Supreme Court judgment.

3. Timing mismatches

This part of the seminar covered hypothetical situations where the timing of a deduction would not match with the moment at which the interest was paid. For instance, a debt instrument providing for a 10% annual interest which is payable only when the debt is due, i.e. in year 6. It was assumed that the payer's tax law allowed interest deduction on a yearly basis and that the payee's tax law only requires an inclusion when the payee receives an actual payment, in year 6. The issue here is to determine whether this equates to a "deduction/non-inclusion" (D/NI) situation or to a normal "deduction/inclusion" with a mere timing mismatch.

The panel questioned whether in the aforementioned situation D/NI rules required hybridity to be applicable. Under OECD rules and under the ATAD, both hybridity (interest/dividend) and a timing mismatch must coexist for the application of D/NI rules to apply. Moreover, a safe harbour rule provides that a timing mismatch does not fall under the scope of D/NI rules if the payee's inclusion occurs in an accounting period starting within 12 months of the end of the payer's accounting period. Should the safe harbour not apply, then the payer can be entitled to a deduction by demonstrating to the tax authorities that the payee can be expected to have an inclusion within a "reasonable period of time". The notion of "reasonable period of time" is deemed to correspond to one agreeable to an arm's length situation.

In Austria, D/NI rules require that there is an inclusion. The payer may claim a deduction irrespective of the moment at which this inclusion occurs. However, timing issues arise when the possibility of an event leading to non-inclusion outcome is found. There are no "reasonable period of time" or 12-months rules; the arm's length principle is considered to cover timing issues.

Brazil has no D/NI rules.

Italy has developed D/NI rules which on one hand require the existence of a deduction without inclusion, and on the other hand require either a timing mismatch or a mismatch owed to differences with regards to qualification of the income (hybridity of income) or instrument (hybridity of payment) in the payer's jurisdiction, as compared with the qualification in the payee's jurisdiction.

In the US, timing rules have been proposed. The inclusion would have to occur within a strict deadline, i.e. 36 months after the day the payer obtains the deduction. The D/NI rule would only apply to situations where hybridity is found; however, the special rule (i.e. the 36 months deadline) leads to a deduction of interest even when no hybridity is found. There have been reactions to this proposed rule, arguing that in the event of an inclusion after 36 months, the payer would be able to claim the deduction. Others have argued for inspiration from the OECD/ATAD "reasonable period of time" rule or for a strict 10-year rule.

4. Coordination and implementation challenges

A general concern with the primary and secondary rules is that the implementation of coordinated rules is complex. Indeed, these rules require knowledge of the tax treatment conducted in the other jurisdiction. It is arguably complicated for a taxpayer, or for tax authorities, to determine the tax treatment in other jurisdictions.

Moreover, should the burden of proof fall on the taxpayer, then the payer would face difficulties in proving that the payee reported the income for inclusion, and, conversely, the payee would face similar difficulties in establishing that the payer did not report the payment as a deduction. A distinction is required with regards to the burden of proof, i.e. would the tax law applicable in another jurisdiction have to be proved or would the actual behaviour of the counterparty, i.e. the contents of their tax return, need to be established?

Amongst the numerous OECD recommendations found in the 2015 OECD Hybrid Report (chapter 9), the most relevant, concerning coordination rules set to avoid double taxation, were found to be the review of effective and consistent implementation of OECD recommendations and the exchange of information between jurisdictions on the treatment of hybrid instruments and entities.

The panel concluded with a consensus that there is a pressing need for awareness of what the tax consequences on the other side of a transaction are, which implies some form of information sharing between parties, because deduction rules now require such information. The possibility of joint-risk assessment by tax authorities was also mentioned.

Seminar E: Taxation of space

Report by: Mirna S. Screpante
Chair: James Anderson (UK)
Secretary: Alex Rigby (UK)
Panel members: Timothy Nelson (USA),
Jonathan Schwarz (South Africa/UK), Rohan Shah (India),
Christine Simoes (Brazil), Yun Zhao (PRC)

1. Introduction

Allocating and aligning taxing rights with performance of activities are fundamental to what we call "international taxation" – the reconciliation of countries interesting tax claims based on connections of taxpayers and their income earning activities to more than one taxing jurisdiction. Now, increasingly this basic aspect of inter-nation tax relations is seen more and more clearly as presenting issues that go beyond the limits of the earth, posing important and undeniable questions about the delimitation of the air space and the outer space – in other words identifiable "territory" or "space" where regulatory, including tax, jurisdiction may extend or even be affirmatively asserted. In this regard, the seminar covered regional perspectives and diverse areas from different countries, such as: (i) conceptual frameworks for space taxation and sovereignty from a US perspective; (ii) resource exploration from the Chinese perspective; (iii) taxation boundaries considering that the geostationary orbit is a scarce resource from a South American perspective considering the Bogota Declaration and Geostationary Control; (iv) taxation of satellites, communication and transmission in space from an Indian perspective; and (v) the attribution of income considering "out of this world" permanent establishments and challenges of determining residence, i.e., more generally a taxable "presence", for individuals and corporations as well as source for business income from African and European perspectives.

The goal of this seminar is to address the characteristics of tax jurisdiction and the challenges entailed in sharing it, by considering how sovereignty under the current legal framework interacts with the taxation of space, i.e. air space and outer space, as regards the delimitation of the jurisdictions to tax considering historical international space agreements and the developments of technology that allow us today to question new jurisdictions beyond countries and the earth. In a manner of speaking this seminar tests old and venerable themes of international taxation, which are mostly concerned with reconciling the contemporaneous over-lapping exercise of sovereign tax jurisdiction by more than one country, but provoked to think harder about the "truths" of this aspect of international taxation by having to decide how jurisdiction to tax can and in any event should be asserted and in that connection what it means to be "present" where income may at least in part originate. Curiously, this is similar to the line of inquiry now underway in a terrestrial setting, involving the implication of conducting business "digitally".

2. Conceptual frameworks for space taxation and sovereignty - US perspective

Taxation of space presents some concerns in relation to sovereignty. The main issues are: the definition of air space and the definition of outer space. There are no clear boundaries to delimit space taxation unlike taxation on earth where we know where the territory of a country begins and ends which forms a starting point for conceiving the parameters of legal regulation. As regards space the question where space begins does not yield a straightforward response; the response is even less clear to the question where space ends. Yet, fundamental to any international tax inquiry is the existence and definition of borders. There are three pillars which could serve to delineate between air space and outer space:

i. the International Telecommunication Union (ITU) regulates allocated spectrum on international level, including terrestrial level allocation;
ii. the Partial Nuclear Test Ban Treaty 1963 prohibits the weaponization of space;
iii. insight from the principle of "freedom of the high seas" about the assertion of extraterritorial tax jurisdiction.

Also, the principle of the "freedom of the skies" under the 1944 Chicago Convention reaffirms that "every State has complete and exclusive sovereignty over the airspace above its territory". Even so, the delimitation of airspace is not clear-cut. For that purpose, four different theories have been developed about border delineation between air space and outer space. These theories vary with distances ranging from 80 km (mesopause) to 35,781 km (geostationary orbit (GSO)/Bogota Declaration). The main constraint against a common agreement in this regard lies in the protection of the *national security* of states – states which have and necessarily pursue their own interests on terms familiar to them, a not uncommon situation in international taxation generally.

It is worth mentioning that there are several treaties which deal with space law and to some degree offer a relevant framework, such as the Outer Space Treaty from 1967; the Rescue Agreement from 1968; the Liability Convention from 1971; the Registration Convention from 1976; and the Moon Agreement from 1979. However, the Outer Space Treaty (OST) is the one that reflects the most consensus on crucial issues such as:

i. space is to "be free for exploration and use by all states" (OST, art. I.);
ii. space, moon and celestial bodies are not subject to national appropriation (OST, art. II.);
iii. space is to be used for peaceful means: no nuclear weapons/WMD to be deployed in space (OST, art. IV.);
iv. liability for damage on earth caused by space objects (Liability Convention); and
v. that International Telecommunications Union (ITU) has the power to allocate satellite slots and that spectrum has gone largely unchallenged (but not even mentioned in OST).

Yet, there are areas of uncertainty such as: (i) liability for in-orbit debris; (ii) exploitation of space resources (connected to the issue of ownership); and (iii) problems to delimit where space begins. Consequently, there is a paradox that taxation is a sovereign right of states but outer space does not belong to any state based on the "non-appropriation principle" (no country may claim that its sovereignty extends to space which may even be the equivalent of a state in ways pertinent to issues of concern to tax systems as a region in which "connections" and "presence" may be established and the "source" of income-generating events). Therefore, there is a need to establish a point of convergence to find a solution in the context of the international treaty framework directing the relationships of nations active in outer space.

3. Resource exploration - Chinese perspective

China has been a key player in the international "space race" for a great number of years. Five space treaties were concluded during the 1960s-1970s. However, space commercialization and exploitation of space resources were not well considered. The governing principle of those treaties is the "non-appropriation principle" which means that no country could claim sovereignty over space. However, the US enacted the Commercial Space Launch Competitiveness Act (H.R. 2262) in November 2015, which states that "private entities shall be entitled to any asteroid resource or space resource obtained, including to possess, own, transport, use and sell the resource".

As regards the legal nature of "space resources", which first appeared in the Moon Agreement, it is clearly stated that they are "common heritage of mankind". Therefore, it is not possible to claim any sovereignty over space resources, although all countries involved must share the benefits derived from their exploitation. This leads to questions about how rights shall be attributed over space resources having in mind that there is no "government" of space and the non-appropriation principle applies. However, aside the strict question of political sovereignty and relevant for tax questions, there are no prohibitive rules on using space or profiting from that use, invoking more familiar questions about what it means to carry on activities "in" a place and what standards of connection to possible taxing jurisdictions would be established by that use even if space is not, itself, a tax jurisdiction.

Within this unclear context, there is a great need to reach consensus on how to regulate the exploitation of the space resources. Ideally, international cooperation should devise an international mechanism for space exploitation and allocation of rights and profits. Unilateralism, which we see in other more familiar jurisdictional settings involving "non-tangible", i.e. digital business presence, is not an option as indicated by the International Institute of Space Law if a successful outcome is expected. However, it has been made clear that setting up an international mechanism to exploit space resources is the most challenging task and needs deep and further debate.

China holds the opinion that there should be some kind of an international mechanism like a regulatory authority that follows a free-market approach (such as in transferring relevant technologies) with minimal intervention in the space exploratory activities but with promotion of orderly exploration. Ideally, a transparent environment should be encouraged with registration and publication of the relevant activities, charging fees and management (e.g. in the form of an international levy) and decision-making on relevant policy.

4. Bogota declaration and geostationary control - South American perspective

As regards delineating air space and outer space, the sovereignty over geostationary orbit (GSO) is crucial for developing countries. Basically, the GSO is of utmost importance since most telecommunications, broadcasting and weather satellites need to be placed at an orbit at a specific (fixed) point in order to establish a suitable, indeed necessary, connection to terrestrial places and persons benefiting from the communications facilities of the satellites. Again, mainstays of international tax jurisdiction, namely "connection" and "presence", are in play. Taxation rights over the GSO or in spite of, or possibly because, of the terrestrial connections to a satellite in GSO, may represent an important source of revenue (especially for developing countries). The GSO is both a scarce resource and a means of non-tangible connection; notably, the size and number of devices which can be placed in GSO is limited (collisions and "space debris") despite the importance of being in GSO to earn income in what might otherwise be regarded as typical ways.

As regards the delimitation of space, the Bogota Declaration states that according to the equatorial states, the GSO is not part of outer space but it is a territory subject to corresponding national sovereignty, so the non-appropriation principle does not apply to GSO. Therefore, devices placed permanently in GSO would require authorization by the respective states; a state then could claim taxing rights. In this regard, the GSO exists only because "earth" exists, and it is part of a country´s own territory. Consequently, if a state considers that the GSO is part of its territory that state could claim taxing rights over the exploitation of resources in that part of the GSO.

In contrast, the OECD did not adopt the Bogota Declaration approach. Thus, a satellite in GSO seemingly could not constitute a permanent establishment according to article 5 of the OECD Model Tax Convention – at least, that would be the typical view. The UN has not formed a position yet in this regard, but it is analysing the definition and delimitation of outer space, the character and utilization of GSO, and how to ensure the rational and equitable use of the GSO.

The moon agreement has similar concepts to the Outer Space Treaty. However, the moon agreement went a bit further since it foreshadows more restrictive regulation of the moon: (i) exploration and use of the moon for the benefit and in the interest of all; (ii) non-appropriation of the surface or subsurface; (iii) international regime to govern the exploitation of natural resources. As regards this latter issue, taxation of the moon would require an international regime and an international institution to divide resources and allocate taxing rights. This triggers many questions as to which principle countries should follow, i.e. source or residence taxation or PE on the moon. As we mentioned earlier, no international agreement exists so far, thus, local and unilateral rules apply, although unilateralism is not a good option. Preferably, consensus is needed but so far this seems to be doubtful.

5. Taxation of satellites, communication and transmissions in space - Indian perspective

Taxation of satellites has become a challenging issue in tax law since it is not clear how to classify the income derived from their use. In the case of India, domestic income tax law considers that a non-resident accrues royalties in India where the royalty is payable "in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India". Also, the term royalty includes consideration for the use of any "secret formula or process". As regards taxation from the use of satellites the key points are the place where related processes to the satellites are performed and whether those processes are secret or not to determine if the corresponding payments should accrue as royalties or services.

For example, in the case *Asia Satellite - Delhi High Court Ruling – (2011) 332 ITR 240 (Delhi)* it has been determined that satellites did not use Indian orbital slots nor were they positioned over Indian airspace. The signals from the transponder were uploaded and downloaded outside India. The fact that the assessee was the operator and had the control of the satellites and had not "leased" the satellite to its customers means that the assessee only provided services to its customers. This means that royalties cannot accrue from those processes when no such purported use has taken place in India as the assessee and its customers are situated outside India.

In 2012 there was an amendment to the Indian Income Tax Act, which overrules the consideration in *Asia Satellite Telecommunications Ltd* and *ISRO Satellite Centre* since the amendment considers that the term royalty includes consideration for any right, property or information, whether or not: the possession or control of such right, property or information is with the payer; such right, property or information is used directly by the payer; or the location of such right, property or information is in India. Moreover, a "process includes and shall be deemed to have always included transmission by satellite, whether or not such process is secret."

With respect to those changes, in 2016 there was a case *DIT vs New Skies Satellite BV (Delhi High Court – ITA No. 473/2012 and 474/2012)* in which the key points under discussion were two. On the one hand, at issue was whether amendments to the definition of royalty in domestic law can be read into the definition of royalty under India's tax treaties. On the other hand, a question was whether the definition of royalty under the given treaty refers to "process" or "secret process". It was concluded that an amendment in the domestic law cannot be read into a treaty so the interpretation of "royalty" in *Asia Satellite* before the amendment will continue to apply under DTAAs. This means that a royalty accrues only when there is a secret process involved. Since the majority of India's DTAA treaties are based on the OECD model, a process must be a secret process for example as contemplated in article 12(4) of India-Netherlands DTAA. The OECD position is that payments by customers under 'transponder leasing' agreements are for use of capacity and are not royalties. They cannot constitute payment for secret process, as there is no technology transfer. In the case of the UN Model Tax Convention, characterization of payment depends on the specific contract. If the owner of a satellite leases to an operator, then lease payment is royalty. Normally, customers generally do not acquire possession or control, so the income constitutes transmission services under articles 7 or 12A.

In short, the key issue about royalties is that a process must be a "secret process" as per DTAA (in line with the global position). In this regard, the OECD Commentary states that income from data transmission services is not a royalty. As regards, the amended domestic law a process may or may not be "secret" unlike before that the process required the use of any "secret formula or process". According to the *New Skies Satellite* case, the unilateral amendment of domestic law cannot modify the intent of the provision that is along the same lines as the amended provision under a treaty since treaties involve negotiation between sovereign nations. Interestingly, this is a current issue in more typical settings, as the discussion about the implications of "digital" business has caused taxing jurisdictions to consider their interests and indeed the notion of "tax". Moreover, it must be considered that domestic law prevails only when the treaty terms are not defined (article 3(2) of the OECD Model).

6. The attribution of income from African and European perspectives

Much of the concern of taxation in space involves the use and presence of satellites in relation to the so-called digital economy, possibly magnifying already difficult issues in this regard.

Today there are new forms of technology which, generally, displace the need for physical presence to perform certain types of activities which in the past in fact needed that physical presence. In this regard, the use of satellites plays a key role.

To this extent, there are judicial decisions featuring satellites in relation to their predominant roles, for example, satellite imaging was used as evidence in tax litigation in order to demonstrate the character of property for article 13 of the OECD Model in the case *CoT v Resource Capital Fund (2019 FCAFC 51)*. There is another case *Vodacom Nigeria v FIRS(CA/l/556/2018*) in which bandwidth capacity was supplied by a satellite operated by a Dutch company for use in Nigeria. The bandwidth was transmitted by the Dutch company to its satellite in geo-stationary orbit which in turn transmitted the capacity to the earth station of a Nigerian company in Nigeria. The court decided that the supply was one of services rendered in Nigeria.

There are more fundamental questions in connection with taxation and space. Taxation is imposed by states; it is an essential element of statehood. Therefore, the law regarding the acquisition of territory or property is useful in space analysis. For that, the panel referred to roman law which considered that acquisition of territory has two categories: (i) *res communis omnium* which means that a territory is capable of being owned by anybody. This is related with the space exploration and the principle of high seas, the "non-appropriation principle" which means that no country could claim its sovereignty; and (ii) *res nullius* which means that a territory is not presently owned by someone but is capable of being owned by somebody. This is intrinsically related to exploitation of resources of the moon because in principle now, the moon is outer space and countries cannot claim sovereignty, but someone could potentially own it.

Residence and source are also basic principles closely related to taxation of space and the connection of events that ought to be considered to take place "there". As a general rule, residence is based in physical presence, e.g. time spent in a country. So, according to this notion seemingly people who spend physical time in space could become space residents and also residents of a terrestrial political jurisdiction if they are consequently within the airspace of a state. However, if the person is in the outer space, it is equally possible that in terms familiar to income taxation as we now understand and have typically framed it, the person could be resident in no state at all. When it comes to companies, the incorporation and the place of management, or direction and control principles typically define the residence of a company. In relation to the latter principle, companies could actually be resident in space if the persons who manage the company are located physically in space or are "there" virtually by means of artificial intelligence because of necessary implications of the reach of their management, direction and control activities via the space facility. However, if the persons or the management are in the outer space these companies could be stateless according to existing principles construed in an orthodox fashion, so as to facilitate "stateless income" in ways reflective of the international disenchantment with "profit shifting" based on the legal formalities and narrow tax jurisdiction parameters. It is perfectly feasible to have companies resident in space even if it sounds like science fiction.

In relation with the source principle, people who work in an airspace station could be a source, or at least the origin – which may or may not be the same thing, of income but the question that arises is where the employment is exercised and any dependence on the number of days spent in the air space. If the activity is performed in outer space, it may be possible that this kind of income could be stateless. There is an interesting case *LeTourneau v CIR (2012 T.C. Memo. 2012-45)* in which the most significant message from the Tax Court is that income earned in international airspace is not earned within a foreign country. Therefore, this leads us to the question whether income from services in international airspace are "foreign" and if it is so, they could be also stateless or be considered to be earned in a country or be sufficiently proximate to a country to amount to the same thing. An important issue in this regard is, for example, article 15(3) of the OECD Model Tax Convention in relation with income from employment as crew of ship or aircraft operating in international traffic. That income is taxable only by the residence state so here among others the question is what international traffic means. If for example the traffic starts in one country and finishes in that or another, is that international traffic according to established standards. Similar questions would arise with respect to space. The delimitation of where space begins and ends has no straightforward answer so it is also difficult to define whether there is an international space, and if there is, most probably activities performed within those boundaries would be stateless too.

7. Conclusion

There are many open questions as regards taxation of space. Remarkably, the lack of certainty in the treatment of the exploitation of space resources is connected to issues of ownership and sovereignty; the problems associated with delimiting where space begins and ends, and how space is or may be connected to typical political and hence taxing jurisdictions invoke these main concerns. There is no clear delimitation of air space and outer space, which is a crucial point to determine potential taxing rights. The development of technologies that enable income generation in space evolve at tremendous speed, whereas the law framework has a different rhythm – giving rise to new connotations of the "mystery" of space, considering that outer space does not belong to any state based on the "non-appropriation principle" (no country could claim its sovereignty). There is need to study these issues, issues that are in fact much more familiar to international tax practitioners than they might have imagined, and to find a point of convergence to mitigate profit shifting to and in space.

Seminar F: IFA/OECD

Report by: Susi Baerentzen, Mirna S. Screpante
and Benjamin Malek
Chair: Stef van Weeghel (Netherlands)
Secretary: Erisa Nuku (Netherlands)
Panel members: Huey Min Chia-Tern (Singapore),
Richard Collier (OECD), Lafayette (Chip) Harter (USA),
Achim Pross (OECD), Amy Roberti (USA),
Pascal Saint-Amans (OECD), Wolfgang Schön (Germany),
Natalia Quiñones Cruz (Colombia)

1. Summary of the seminar

The IFA/OECD Seminar is one of the permanent seminars at IFA Congresses, dealing with the most relevant developments in the international tax field. This year, the overarching themes for the seminar were transparency and tax certainty as part of the OECD's current initiatives and the tax challenges arising from digitalisation.

2. OECD initiatives on transparency and tax certainty

In terms of transparency, one of the most significant achievements of the OECD is the Global Forum on Transparency and Exchange of Information for Tax Purposes that celebrates its 10-year anniversary this year. The success is measurable in both a growing number of member states now counting 157 member jurisdictions, and in the fact that 90 governments are now automatically exchanging financial accounts of non-residents.

Tax certainty or the lack thereof is equally a dominant theme in the OECD's current initiatives, as the lack of certainty for taxpayers is constantly exacerbated by the rapid digitalisation of the economy and increased internationalisation driving changes in the international tax rules. The OECD approaches these challenges through the wider G20/OECD tax agenda by endorsing dispute preventing measures and by ensuring the work of tax administrations across borders. The highlights of these initiatives include BEPS Action 14 to improve the effectiveness and timeliness of dispute resolution mechanisms and the International Compliance Assurance Programme (ICAP), which is a voluntary multilateral risk process to facilitate open and co-operative engagements between multinational corporations (MNEs) and tax administrations using Country-by-Country (CbC) reports and other information. Currently 15 tax administrations are participating in a pilot programme.

Finally, the implementation of the BEPS project is an ongoing area of focus for the OECD and participating states. Some of the significant successes of this project are the transparency framework for compulsory spontaneous exchange of information on certain tax rulings as part of the minimum standard in Action 5, and the entry into force of the Multilateral Instrument (MLI) under BEPS Action 15, facilitating a widespread efficient implementation of developed tax treaty measures.

On the more challenging side of the OECD works, the work for a solution to tax and digitalisation was addressed. Some ground has in fact been covered, as the Action 1 Report did provide a recommendation for indirect taxes. The recommendation was to implement the destination principle contained in the 2017 OECD International VAT/GST Guidelines, together with the mechanisms for effective collection of VAT/GST on cross-border supplies of services and intangibles presented in those Guidelines.

For direct taxes, the success was less palpable as the Action 1 Report observed that while digitalisation could exacerbate BEPS issues, it also raises a series of broader tax challenges, which it identified as "nexus, data and characterisation". These challenges were found to go beyond BEPS and were described as mainly relating to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions. A number of potential options to address these concerns was discussed, but none was ultimately recommended. Instead, the Action 1 Report called for continued work in this area, notably by monitoring developments in respect of digitalisation, with a further report to be delivered by 2020. These works will be analysed further in paragraph 3 below.

3. Tax challenges arising from digitalisation

Continuing the debate on the tax challenges arising from the increased digitalisation, the key point to solve the issues is a multilateral approach based on consensus. Since the work towards a common solution on how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries began in 2015, several obstacles have come in the way of achieving the objective. These challenges have resulted in unilateral and isolated initiatives, which have further undermined a solution, but at the same time have highlighted the scale of how difficult it really is to scope and develop a system capable of handling these challenges.

An important step towards a broad solution has been taken by the OECD/G20 Inclusive Framework on BEPS with the Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, issued in May 2019.

This programme focuses on two pillars:

1. Pillar one (profit allocation and nexus) seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules;
2. Pillar two (global anti-base erosion proposal) focuses on the remaining BEPS issues and seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. I.e. it is meant to protect the interests of capital export jurisdictions following the new allocation of taxing rights under Pillar One and to ensure a minimum level of taxation on cross-border income.

The programme includes an economic analysis and impact assessment that will be carried out over the next months, envisioning an internationally unified approach. This step forward is essential as it shows the willingness of the Inclusive Framework members to agree on a global and sustainable solution by the agreed timeline of 2020, and it is anticipated to be fulfilled by the publication of a policy paper (the OECD Secretariat published a consultation document and proposal for a "Unified Approach" under Pillar One on 9 October 2019).

The main challenges appear to be centred around Pillar One, as it essentially designs a new distribution of taxing rights regardless of the physical presence in the taxing jurisdictions, going beyond the arm's length principle (ALP) and using a relatively simple formula for profit apportionment. It is not the aim to replace the ALP and the traditional transfer pricing rules. Rather, the new approach is envisaged to partially override the AML with regard to the residual profits by creating a new system to co-exist with the current ALP-system with several specific limitations (e.g. revenue, ornature of business activities) and carve outs. This entails a generic issue in terms of scoping out the building blocks for the new system, which ultimately depends on what the states will agree too, the decisive policy factors and the reality factors intervening in the process. These issues will be addressed in sections 3.1.-3.4. below.

3.1. *Pillar One - Scope*

To reach the desired outcome of allocating more revenues to the market jurisdiction, scoping appears to be key. For this purpose, it is necessary to establish limitations such a size-based limitation or profit thresholds, together with explicit carve outs. In addressing these questions, some good seems to have come out of the challenging path leading up to the current proposals in the sense that businesses are now more constructively engaged in contribution to the OECD work than ever before, as they have a dire need for certainty. Another of their main concerns is the excessive focus on the market jurisdiction, which they find to be deceptive and that the focus should rather be on the value creation. In reality, the current proposal is dealing with a new set of principles, where the concepts of value creation and digitalisation are actually losing their previous relevance.

3.2. *Pillar One – New nexus*

The underlying idea of Pillar One is a novel concept of a taxing nexus unconstrained by physical presence. Such a nexus presents a wide range of challenges for business operating in several countries including the possibility that nexus is created somewhere not intended or simply too soon, which can be undesirable for the corporations. On the other end of the scale, the nexus approach poses specific issues for developing countries, especially if it is not created soon enough, as many of the activities that these countries could tax years ago are now disappearing. The first step towards a solution to these obstacles seems to be ensuring simplicity and administrability in the implementation and the form of framing the new rules. It is unclear how the new nexus rule will be delivered, but some options were considered regarding the link between a taxable presence and the taxing jurisdiction. The options are: (i) any sale of service going to a specific country could create a nexus; (ii) a traditional situation of a PE with a physical presence; and (iii) a virtual PE, services PE, concept of user participation and marketing intangibles. However, the third option seems to be the preferred one, i.e. significant economic presence based on sale revenue.

3.3. *Pillar One – Profit allocation*

By changing the nexus in Pillar One, it evidently also entails a change for the profit allocation rules. The programme of Pillar One intends to reallocate a portion of group profits to the market/user jurisdictions, using proxies and preserving the stability of the tax system and tax certainty. This issue raises a number of questions such as how to create the infrastructure to do this reallocation. Is it to be done based on the group accounts? And if yes, which accounting rules should apply and what adjustments should be made? From the view of business and developing countries with the need to deal with these rules in practice, a formulary apportionment approach is key in order to be able to administer them realistically.

On the other hand, it is also important not to oversimplify. Sufficient profit should be allocated to where the functions are actually performed, and that again leads to the question about residual profits. Traditionally, routine profit is allocated to the existing functions, and the remaining profit will then be the residual profit. This is done at one level, but the approach changes when all the profit remains at the same place, the transfer pricing distribution is done and then the rest goes to the overall group profit. This includes two levels, and there will be a need to integrate the second level into the first one somehow. At the end of the day, it will be a question of which country should give up part of its taxing right. This needs to be dealt with alongside a number of questions as to how to handle losses and their potential carry forward and deductibility, and how to reduce the above-normal profits or profits below the margin for that matter.

3.4. *Pillar One – Elimination of double taxation, tax certainty and tax disputes*

Pillar One entails a complex issue as regards the elimination of double taxation. The issue is reconciling the group profit allocated to the market jurisdictions with the entity-based approach of the common system. This is dealt with by identification of 1) the paying entity and 2) the relieving jurisdiction, and by then ensuring that the double tax is removed. A second set of problems is represented by the interaction between the new rules and the existing transfer pricing rules. A top-down approach to this issue is leaving the existing ALP system and then identifying the new profits rather than inventing a whole new system in order to necessarily preserving and ensuring a certain level of tax certainty.

4. Pillar Two (global anti-base erosion proposal -GloBE)

Contrary to Pillar One, Pillar Two appears to be very uncontroversial in its nature. It is a proposal strongly influenced by the global intangible low-taxed income (GILTI) rules implemented by the US to grant jurisdictions the power to “tax back” group profits subject to a zero/low rate of taxation, ensuring the imposition of a minimum level of taxation at the international level. The objective is reached through four rules: inclusion rule, switch-over rule, under-taxed payments rule and subject-to-tax rule. Despite its uncontroversial nature, there are still some issues to work out in the sense that the interaction between Pillar Two and the CFC rules should be decided. If that is achieved, it is possible that Pillar Two could overcome several difficulties arising in applying the CFC rules (blurred distinction between passive and active income, proof of economic substance etc.). Ultimately, the rules could prevent tax competition, which may be an appealing goal, but could have a detrimental effect for e.g.

developing countries. An example of this is Columbia's tax holiday for new or significantly remodels hotels, which has been put in place to facilitate the country's tourist business, and which has been very successful for the country. Incentives like these will be hindered by the Pillar Two incentives, leading the developing countries to lose by the initiative.

5. Conclusion

For all the novel global tax challenges addressed at this seminar, the key point was that in addressing them a multilateral approach based on consensus must be developed. The lessons learned from the process of providing solutions to the challenges is that unilateral and isolated initiatives will undermine a proper solution and that it is generally not advisable to venture down that road. The solution to the challenges in obtaining consensus appears to be to approach the issues by determining the areas in need of repair and then leaving the rest be, rather than revolutionizing the systems and building them from scratch.

6. Post-scriptum

On 9 October 2019, the OECD Secretariat published its proposal for a Unified Approach designed to address the tax policy challenges raised by Pillar One. This document will form the basis of a public consultation which will be held in Paris on 21 and 22 November 2019.

Seminar G: Tax transparency/enhanced cooperation/CbCR experience

Report by: Susi Baerentzen
Chair: Timothy McDonald (USA)
Secretary: Alessandro Turina (IBFD)
Panel members: Reinhard Biebel (EU), Marlies de Ruiter (Netherlands), Alan McLean (UK), Achim Pross (OECD), Natalia Quiñones Cruz (Colombia), Takahiro Yasui (Japan)

1. Transparency, certainty and corporation

Tax transparency is very high on the agenda at both the OECD and the EU, and the apparent ever-growing need for transparency is accompanied by a corresponding need for tax certainty for the taxpayers who have to navigate their new and continuously more transparent reality. There are several ways to ensure transparency while facilitating increased tax certainty, and already at this point, some experiences from the specific measures can provide an indication of what works and, perhaps even more important, what does not work. These issues will be addressed in the following sections.

2. Tax transparency

The concept of tax transparency is an essential element for the public confidence in the tax system, but ensuring this transparency is not without difficulties. It does not form an end in itself, but it is necessary for the improvement of processes and the creation of trust between authorities and taxpayers. For that reason, the OECD's Common Reporting Standards (CRS) disclosure rules and the EU's more recent DAC 6 Directive have been great successes for transparency in the sense, that they have resulted in more available data to create certainty. However, while the amount of data available continues to grow, more data does not necessarily mean a better insight and, hence, more transparency.

In fact, if regarded from the two complementary perspectives of governments and taxpayers, transparency is likely to prompt very different associations.

The government perception particularly focuses on the unprecedented amount of information that is now in the hands of administrations, and the challenges they face in handling it. The effective and efficient use constitutes a challenge and implies an intensive demand for human and technological resources, as well as a learning curve in the processing of the available information. This makes further demands an efficient tax administration, which may pose a plight especially for developing countries in interpreting complex data and business supply chains.

The perspective of the taxpayers very much revolves around the information asymmetry between taxpayers and tax administrations, which is difficult to reconcile. The data is not information in itself, it only becomes so once it can and has been interpreted. This will likely require a certain level of interaction between governments and taxpayers to make proper sense of the data and ultimately to make proper use of it.

3. The experience with Country-by-Country Reporting (CbCR)

CbCR is a tool with a great range of applications, which begs the question as to whether it is indeed only a high-level risk assessment tool for tax authorities, in conformity with the original intent that led to its adoption or, instead, if it also has become a tool directly used in tax assessments to increase tax revenue through adjustments in the hands of the tax administrations.

In analysing this issue, it is noteworthy that the experience in the global implementation of BEPS Action 13 has provided positive feedback, as it appears that the participating jurisdictions are in fact extremely mindful of respecting the original intent of CbCR and are committed to the proper use of the latter solely as a risk-assessment tool.

From the view of the taxpayers however, the success may appear less obvious as they are faced with the difficulties associated with the sourcing of data within MNEs, and the burdensome system upgrades required to capture. These challenges are exacerbated by the fact that the data and many items of information included in the CbCR template were not collected or aggregated before the introduction of this reporting obligation and retrieving them now, post CbCR, can be very challenging.

This also factors in the difficulties for the tax authorities with interpreting the data and finally it poses the risk that raw and potentially mishandled data can be released to the public and misinterpreted.

4. Enhanced cooperation and tax certainty

Increased transparency supported by a cooperative compliance relationship may enable early tax certainty and valuable predictability for both businesses and governments. In fact, the global trends in achieving international tax certainty breathe life into transparency via dispute prevention mechanisms such as advance pricing agreements, cooperative compliance programmes and risk assessment programmes. The crux of the success seems to lie in the ability for the taxpayers and the tax administrations not only to co-exist in the new world of transparency but actually cooperate.

A great example of bringing together tax administrations with MNEs is the new ICAP (International Compliance Assurance Programme) launched by the OECD Forum on Tax Administration in 2018. The new programme has brought together tax administrations from several Member States together with a number of MNEs headquartered in these jurisdictions.

What also draws a positive outlook is the comprehensive detailed statistics on mutual agreement procedures (MAPs), which was released on the occasion of the first "Tax Certainty Day", organised by the OECD in Paris on 16 September 2019 (the statistics are available online: http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm). The positive statistics include an increased number of reporting jurisdictions (currently 89), the continuous increase of the MAP case load, the average closing time (which has been increasing for transfer pricing cases but decreasing for other cases) as well as on the positive outcomes of most cases, which are closed with full resolution.

Tax compliance and tax certainty go hand in hand, and tax certainty entails the predictability of outcomes for both sides. To get there, measures aimed at achieving greater certainty may foster the consolidation of best practices such as pre-determined transfer pricing approaches applicable to low-value adding services, which may ultimately be beneficial to reaching the goal.

5. The future of transparency and tax certainty

By adding the issue of taxing the digital economy to the mix of tax transparency and tax certainty, it is possible that greater transparency and a re-establishment of international agreement on jurisdictional taxing rights with elimination of unauthorized unilateral measures causing double taxation, could be expected. This possibility raises a number of issues to be dealt with in the near future, such as:

– the balance between additional revenue and administrative simplicity;
– the balance of administrative simplicity and greater international tax certainty;
– the balance of a re-allocation of the international tax base and dispute prevention; and
– the balance of "facts and circumstances" versus formulaic approaches.

An outcome comprising of simplification, increased tax certainty and a non-disruptive re-allocation of taxing rights should be considered the most desirable outcome across all of the above.

On top of this, there is a clear need to jointly promote the de-politization of international tax (and in particular, transfer pricing) disputes accompanied by greater administrability of rules in this area. In this view, a possible desirable outcome would entail a scenario where subjective professional judgment implicit in the current "practiced art" of transfer pricing, would (largely) be replaced by a formulaic approach and certainty would be enhanced because:

– destination markets would receive a formulaic minimum without audit controversy; and
– the risk of double taxation for taxpayers might (largely) be eliminated.

Transparency may not have been achieved in full yet, and further developments, also in light of technological advances, can be expected. When considering this, it is important to note that transparency towards tax administrations and public transparency are substantively different as the latter is meant to provide public scrutiny and as such will need further review and adaptation compared to the more established transparency towards tax administrations.

Seminar H: Unilateral treaty override

Report by: Benjamin Malek
Chair: Mukesh Butani (India)
Secretary: Parul Jain (India)
Panel members: Sophie Chatel (OECD),
Robert Danon (Switzerland),
Adolfo Martín Jiménez (Spain),
David Rosenbloom (USA)

1. Historical perspective

The first international tax treaties were ratified between 1870 and 1920. At that time, as new technologies appeared, cross-border trade flourished. In the 1920s, the League of Nations formulated "general principles for an international convention to remove the evil consequences of double taxation". This led to the adoption of the London Model and the Mexico Model. After the First World War, states increased their tax rates, significantly raising the burden of double taxation on cross-border companies. The OECC, which was to become the OECD, adopted a Model Tax Convention in 1963. The 1980s saw a wide expansion of the treaty network. As of 2019, there are almost 4,000 tax treaties worldwide.

In 1986, a US Tax Reform was considered by many OECD member states as the enactment of legislation which was overriding the US' obligations with regards to tax treaties. A major concern of states was that it would pave the way for countries dissatisfied with their treaty obligations to enact legislation thereon.

In 1989, the OECD member states, including the US, drafted the OECD Treaty Override Report and recommendations. According to the report, treaty override consists of unilateral domestic measures, enacted in legislation, that are then invoked by a state as a justification for not fulfilling treaty obligations, on the grounds that doing so would conflict with domestic law. This was considered problematic because the overriding of treaties undermines their objectives and benefits, i.e. stability, allocation of taxation rights, elimination of double taxation, and tax certainty.

2. Concept of treaty override

Three forms of treaty override can be distinguished. First, explicit, or legislative, treaty override, which is the form referred to in the 1989 OECD Report. Second, implicit treaty override, which can occur in any country, even in states which recognize the primacy of treaty obligations. A timely example is the qualification of digital service taxes (DSTs) as indirect taxes, the latter being outside the scope of tax treaties. The third form is judicial override, of which the importance was diminished in the 1989 Report. However, judicial override remains relevant because if a judicial decision is at odds with international standards, tax authorities could endorse a different position.

The 1989 Report assumes that treaty override is noticed with ease. However, whether there is treaty override very much depends on the method of interpretation, of the treaty or domestic law. For instance, if treaties are interpreted literally, GAARs and SAARs are generally at odds. On the other hand, if object and purpose are considered, these rules do not conflict. Another example is DSTs, whose object and purpose would attribute to the field of direct taxes. However, if a literal approach is followed, DSTs would be qualified as indirect taxes. It follows that the object and purpose of the domestic legislation is crucial to define treaty override. States that recognize the possibility of treaty override, such as the US or Germany, have established clear rules to that effect.

In the 1989 Report on treaty override, a section is dedicated to legal analysis, quoting extensively the Vienna Convention on the Law of Treaties (VCLT), which is of customary nature. The rank of treaties vis-à-vis domestic law is determined in each domestic legal system. In France and the Netherlands, the Constitution gives precedence to treaties. In the US, treaties have the same rank as domestic law. In Canada, the UK and India, implementing legislation gives treaties precedence to domestic law; the treaty itself does not have force of law.

The risk of treaty underride was mentioned, for instance when new taxes, not covered by a tax treaty, are enacted. Some jurisdictions, such as Finland, require that treaties which may conflict with domestic law be approved by an act of parliament.

From the perspective of constitutional law, treaty override is an issue of international public law but more importantly a domestic law issue because the rank of international law is determined by domestic law. The evolution of constitutional law shows that after the Second World War, many systems recognized that there are several principles and rules which prevail over domestic law. Nonetheless, in some states the final word belongs to parliament. Despite multilateral initiatives, the tax world remains tied to unilateralism.

3. Differences among state legal systems

India follows the dualist system: all treaties must be translated into acts of parliament. In this country, taxes may only be levied on income and require an act of parliament. The executive assumes power under delegated legislation to ratify treaties. Only parliament has the right of implementation of a treaty. Once the treaty enters into force, there remains a specific statute in the Indian tax code, which provides that the treaty is not applicable before a specific issue is made by the Ministry of Finance.

India abides to the VCLT despite not being a signatory state. Although primacy is given to treaties, taxpayers can choose to opt for more beneficial provisions. Therefore, special provisions in the Indian Income Tax Act apply to the extent that they are more beneficial than treaty provisions. India has introduced, with respect to its GAAR, an override of treaties, irrespective of taxpayer consent. Other forms of override include the recently implemented equalization levy, which applies in India to advertisement transactions.

The Madras High Court made observations regarding the right of parliament to enact legislation that overrides treaty obligations. Subsequently, courts have upheld the right and sovereign power to cancel treaty benefits, even subsequent to entering the treaty. However, the principle of good faith excludes an act that leads to defeat of the object and purpose of the treaty. Arguably, when states enact domestic law to breach treaty obligations, the good faith principle is breached.

The US has numerous cases and a lot of history on treaty override. What singles out the US, is that the question is not abstract in that jurisdiction. The possibility of treaty override is not questioned in the US: the supremacy clause of the US Constitution (article VI section 2) gives equal status to statutes and treaties; both can override each other.

The US has often overridden tax treaties. Paradoxically, the US is currently one of the most vocal complainants regarding treaty override. Congress seemingly forgot that tax treaties exist when adopting the Tax Cuts and Jobs Act (2017; TCJA). The TCJA contains provisions inconsistent with treaties. Most important is the alternative minimum tax which only gives a partial credit possibility. The base erosion and anti-abuse tax (BEAT) does not allow deductions paid to foreign related persons (for computation), which contradicts the treaty obligation of non-discrimination and the tax credit provided for by treaties.

Regarding the possibility of treaty override, Congress may do so but must make its intention clear. Courts, although not consistent, have exhibited reluctance to treaty override upon congressional silence. It is uncertain if modern tax courts would go that far. The qualification of "treaty" and the existence of a conflict are not settled in the US. It was stressed that the later in time principle applies to resolve conflicts, i.e. the application of the principle requires the existence of a conflict. In the US Treasury's view, nothing in the legislative history of the TCJA is useful; the chief of the joint committee on taxation has testified that the TCJA is not in conflict with treaties. The US Treasury is taking the position that the TCJA is later in time to all existing treaties and will thus not accept entirely new treaties to enter into force.

A judgment of the German Constitutional Court (15 December 2015) was also mentioned. In this decision, the court concluded that the democratic principle, i.e. the sovereignty of parliament, should prevail over the rule of law. There was however a dissenting opinion which considered, inter alia, that in a 'globalized world' the view of the court is outdated; (i) that there is a need to strike a 'careful balance' between the principle of the rule of law and openness to international law and (ii) the aforementioned principle of democracy, the aim being to achieve both. Moreover, it was argued that breaches of international obligations should only be possible in exceptional circumstances and be required to balance: the aim of later statutes and their importance to achieve the common 'good', their effects on the legal position of individuals who benefit from treaties, the need to act quickly, and the absence of alternatives, i.e. treaty termination.

The OECD council produced two main recommendations in 1989. First, if a state is dissatisfied with its treaty obligations, it has the duty to engage into bilateral or multilateral discussions. Second, if subsequent legislation is enacted, it must be ensured that it does not clearly override treaty obligations.

It was noted that the whole topic of treaty override is tied to the relevant country's constitutional law. What this evolution overlooks, is the fact that giving too much importance to *pacta sunt servanda* does not indicate what the content of the *pactum* is.

4. Domestic anti-avoidance rules

Some domestic anti-avoidance rules do not conflict with tax treaties:
- Sham or simulation doctrines: their purpose is to look at the true facts of an arrangement. Conceptually, treaties apply to *real* facts. A doctrine which substitutes fake facts to real facts is therefore not an issue.
- Substance over form doctrines: some countries, such as Luxembourg, have been very reluctant to apply SAARs. Nevertheless, some of these countries have substance over form doctrines and consider that they may be applied to tax treaties insofar as they are used to put into effect undefined treaty terms (article 3(2) OECD MC). Under this approach, there would thus not be any conflict if, based on the substance over form doctrine, the state of source considers that the recipient is not in the other contracting state (e.g. where an interposed entity is a sham).

Contrastingly, the following cases raise issues:
- It may be more complicated to determine whether the content of a GAAR conflicts with the object and purpose of the treaty. This first question should however become less problematic as states implement the OECD Principle Purposes Test (PPT) on the basis of the OECD Commentaries and guidance.
- SAARs or rules whose underlying purpose is to reverse the allocation of taxing rights between contracting states. The issue could for instance be relevant in the case of an indirect transfer of assets and a domestic rule designed to override the allocation of taxing rights pursuant to the capital gain provision (article 13(5) OECD MC). From a policy perspective, this particular topic has been addressed by the 2018 IMF/OECD/UN/WBG Report, *The Taxation of Offshore Indirect Transfers — A Toolkit*.

The general question of whether domestic anti-avoidance rules conflict with tax treaties, gradually evolved over time.

As a result of amendments made to the OECD Commentaries in 1992, it became clear that a majority of states supported the application of domestic substance over form approaches to tax treaties. Moreover, and in the same line, the work conducted, for example in the area of international hiring of labour, mentioned that the notion of employer in article 15 OECD MC was to be construed autonomously and on the basis of a substance over form approach. A minority of countries however rejected this position, noting in particular that it would conflict with the principle of *pacta sunt servanda*.

In 2003, the OECD Commentaries confirmed the position of the 1992 Commentaries (i.e. the application of domestic anti-avoidance rules to tax treaties) as well as the possibility for states to deny tax treaty benefits in cases in which the object and purpose of the treaty would be frustrated. According to the 2003 OECD Commentary, the two approaches however had to comply with a so-called 'guiding principle', which is actually a main purpose test (the ancestor of the PPT). States that had expressed a minority view in 1992, consistently maintained this view in 2003 in the form of observations to the Commentaries. However, none of these states, namely Luxembourg and Switzerland, categorically rejected the application of tax treaties in blatant abusive cases. Rather, tax treaty benefits may be denied, either on the basis of an implied prohibition of abuse (Switzerland) or when the relevant domestic anti-avoidance rule is common to both contracting states (Luxembourg). Conversely, even where the application of domestic anti-avoidance rules to tax treaties is widely accepted, it is also accepted that the application of these rules is not unlimited and should not frustrate the object and purpose of the treaty.

For these reasons, it was observed that the question of whether domestic anti-avoidance rules or substance over form approaches conflicts with tax treaties is, in the end, a question that must be settled in light of the interpretation of the relevant tax treaty, based on its wording, object and purpose. In other words, while the principle of *pacta sunt servanda* strictly applies in international law, the determination of the actual content of the *pactum* is a matter of interpretation.

Concerning the US, an observation was made with regard to the necessary distinctions between views of one branch of the executive and Congress: the Treasury does not represent Congress. The state versus treaty issue frequently includes situations where Congress is too impatient to abide to positions that Treasury might have taken in the OECD context.

BEPS and the MLI (*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*) address tax avoidance. In the past, several states which were dissatisfied with the system, drafted legislation to override their treaty obligations. Thus, one of the great successes of the MLI, which currently covers 89 jurisdictions, was to deter treaty override and unilateral action.

The PPT has a dual role: (i) it acts as a genuine treaty GAAR for countries that do not have one, and (ii) it acts as a blocker, as domestic anti-avoidance rules must not be in contradiction of the PPT.

Finally, the panel discussed the consequences of the PPT's application (i.e. the availability of treaty benefits that would have applied in the absence of abusive arrangements). Article 7(4) MLI deals with this question and allows states to grant these alternative benefits on a discretionary basis. It was however observed that the operation of many domestic GAARs lead to the granting of these alternative treaty benefits in the event of fact pattern recharacterization. This is generally done to comply with the principle of proportionality (especially under EU Law). From this perspective, article 7(4) MLI should not be seen as restricting these existing practices.

5. Unilateral measures & digitalisation of the economy

There is a proliferation of unilateral measures, most of which are being developed in tense negotiation with the business sector.

In the EU, taxes on a supplier are considered to be income taxes, but if the tax falls on the supply, they are regarded as indirect taxes. According to the EU Council, if a tax is technically a turnover tax but legal obligation lacks to pass on the tax to the consumer, the tax remains a direct tax under EU law. The Hungarian sales tax, on which Advocate Kokott rendered an opinion (*Vodafone*), is a special direct tax intended to skim off the financial capacity of telecom companies and can thus be considered to constitute treaty override.

6. Conclusion

From the OECD's perspective, through multilateralism, the interests of business and government are aligned. A fair solution, which includes tax certainty in the system, is called for. DSTs conflict with tax treaties, a multilateral solution is hence necessary. There was some concern that the international community is acting too fast in too many areas.

It was suggested that the factors mentioned in the dissenting opinion of the German decisions (see above) were relevant for jurisdictions that allow treaty override. For implicit treaty override, solutions are already available: namely the EU Directive on tax dispute resolution. However, the only problem is that too many obstacles to the initiation of MAPs and arbitration remain.

It was mentioned that the OECD should take into account consistency and legal certainty, as some BEPS outcomes facilitate treaty override. In the OECD Report of 1989, the OECD council asked the Committee of Fiscal Affairs to follow the development of this issue and publicly mention breaches of treaty obligation. In modern parlance this equates to peer review and 'name and shame'. Arguably, there should be more publicity on treaty override.

Seminar I: Recent developments in international taxation

Report by: Mirna S. Screpante, Susi Baerentzen and Benjamin Malek
Chair: Chloe Burnett (Australia)
Secretary: David Lewis (Australia)
Panel members: Jos Beerepoot (Netherlands), Ruth Mason (USA), Dominic Robertson (UK)
Guest speakers: John Avery Jones (UK), Michael Keen (USA), Stig Sollund (Norway)

1. Introduction

The recent developments in international taxation addressed by this panel have five main pillars:

- the idea that there is a trend to a retreat to domestic law;
- the theory that there is an arm´s length principle 2.0.;
- developing standards in transparency and disclosure rules;
- the IMF perspective on corporate taxation in the global economy; and
- changes in corporate tax residence rules.

2. A return to domestic tax law?

The BEPS Actions Plan is commonly seen as one of the greatest multilateral achievements in recent years. However, it seems that currently there has been a shift back to domestic law: Unilateral measures are playing a key role in the reactions of countries to uncertainty about where income arises and the reasonable scope of their income tax regimes, e.g. in the form of a digital services tax (DST). One of the potential challenges to the DST with respect to EU law is that it could violate the non-discrimination principle with regard to the threshold amount. For example, as regards the relationship between the EU and the US, the EU is allowed to discriminate against Americans but according to EU law not against EU subsidiaries of US headquarters companies. As regards non-discrimination in the context of double tax treaties from an US perspective, scholars argue that the US BEAT (Base Erosion and Anti-Abuse Tax, which functions as a kind of minimum tax) presents compatibility issues with article 24 of the OECD Model Convention because the BEAT denies a deduction of an amount paid to a related foreign party and that amount seems to be deductible domestically in the jurisdiction of the foreign party. In fact, under such a scenario the BEAT could override the treaty.

In addition, several cases also illustrated the focus on domestic law. First, the *Satyam Computer Services Case* (Australia) challenged the customary international law principle that double tax treaties (DTTs) can only relieve taxation and not create tax liability. As a general comment, a DTT itself does not impose any tax because imposition is an exclusive matter of domestic law. Second, *the Fowler Case (UK)* dealt with income classification under a DTT. The case considered that the nature of income is decisive irrespective of the tax outcome since determining the taxing jurisdiction is a matter of tax sovereignty unfettered by other jurisdictions. Third, the *Burton Case (Australia)* discussed whether the concept of income should be understood according to the DTT or to domestic law for the consideration of the taxes that should be computed. The outcome was that the definition under domestic law prevails, even if it constitutes a disadvantage for the taxpayer.

3. Arm's Length 2.0

The arm's length principle (ALP), thought to be analogous as a notion based on a comparability of tested circumstances to others, is moving to a different level. The principle changed from a traditional transactional test to a more mechanical and formulary test along with the increased use of profit splits and safe harbours. The main reason for that shift is to gain simplification and practicability, which are the greatest concerns for taxpayers. In fact, the strongest proposals submitted to the OECD for simplification come from taxpayers. For example, the Johnson & Johnson proposal departs from the arm's length standard since it uses a formulaic method that starts with setting a base rate and uses three levers: assessing group profitability and profit allocation in local markets; analysing business marketing expenditure on a country-by-country basis; and setting profitability targets for local market activities to limit the impact from other parts of the supply chain. Some believe that the proposal is more a transfer pricing safe harbour for multinationals such as the simplification method for low value-added services. Similarly, in the area of interest deductibility, BEPS Action 4 is an example of how the ALP shifts from a comparable standard to a mechanical fixed Comparable Uncontrolled Price (CUP) method.

A Subcommittee of Tax Experts at the UN also questions whether the arm´s length principle will be a hybrid approach between comparability and formulary apportionment in the future. Presumably, formulary methods (including profit splits) will only be used for large and complex issues like intangibles, and fractional or other mechanical methods will be used for other types of less complex transactions. As a matter of fact, the future might bring a "fraction ALP" approach.

It is clear that these days the arm´s length principle is challenged to survive. Therefore, it is worth asking whether in ten years a more mechanical than comparable transactional approach will be the new reality. Recent case law shows that transfer pricing disputes are now centred on other issues besides comparability such as: (i) incomplete documentation (*Microsoft Denmark Case*), (ii) recharacterization (*Cameco Canada Case)*, (iii) commercial rationality (*Glencore Australia Case)*, *(iv)* the ALP does not require comparables (*Altera US Case*), and (v) definition of intangibles (*Amazon v. Commissioner Case)*.

4. Transparency and disclosure rules

Transparency is one of the key points in the international tax arena. In this regard, Dutch banks have developed a set of good practices. Nowadays, financial institutions need to determine the tax integrity risks of not only domestic but also international clients in relation to risk on tax evasion and tax avoidance. Essentially, the client portfolio is scanned based on tax integrity risks so risk indicators can be identified and a tax integrity heatmap can subsequently be designed. This means that it is necessary to perform a tax integrity risk assessment of individual clients (based on factors such as transparency and tax morale). These measures not only require a detailed monitoring of transactions but also a trained and educated staff. The main drawback is that these types of measures may eventually lead to expulsion of clients.

In recent years, NGOs and exponents of "civil society" are more involved in tax issues and have called for greater transparency in tax matters. There is a notable increase in litigation involving NGOs, for example: Tax Justice *Network Africa v Kenya (2019) or R v HMRC ex p UK Uncut (2012)*. Also, there were several disclosure regimes in recent years: Australia (tax payments by large businesses) in 2015; EU28 (government payments by financial, extractive and logging companies) in 2015; EITI and UK (mandatory publication of tax strategy by large businesses) in 2016. And in addition to that, NGO´s also played their part in the cases related to the Panama Papers and the Paradise Papers. In this regard, there are two cases concerning the use of documents and information by tax administrations. One case is the *Glencore Case* from Australia. The key question for the court was to determine whether a regulator could use privileged material that had been made public by a third party. The High Court ruled unanimously in favour of the defendant that the legal professional privilege operates as a means of defensibly resisting the compulsory production of information but does not provide a positive right entitling the holder of the privilege to a remedy, such as an injunction restraining the use of legally privileged material. Another case is *Legal Privilege* in the US which is still pending. The US has strong attorney-client privilege rules. Primarily, privilege applies to: (i) communication between privileged persons for purposes of obtaining legal assistance, and (ii) information learned only in an attorney-client communication. However, there is crime-fraud exception that removes the privilege when there is probable cause to believe that: (i) a fraud or crime has been attempted or committed, and (ii) the (otherwise privileged) communications or materials were in furtherance of the crime of fraud. Secondly, the privilege is waivable when the client talks to federal officials by selectively revealing information.

In many countries it is questionable whether tax administrations could compel disclosure of information from overseas parties. There has been a recent leading case in the UK in which the key question was whether HMRC could serve a taxpayer information notice on a former UK resident living in Dubai. The High Court (2017) decided that it is not possible due to the territoriality principle (sovereignty). However, the Court of Appeal (2019) held that it was possible because there is no express territorial limit in the legislation.

Another significant area in connection with transparency is the role of intermediaries and their reporting obligations. There are primary and secondary intermediaries depending on the access to information. A question that follows is whether a financial institution could be considered as an intermediary. There are several activities that could trigger the qualification of a financial institution as intermediary, for example, the reportableness of an arrangement, i.e. does an arrangement contain a hallmark; the providing of payment services; the providing of aid, and the assistance or advice relating to the implementation, i.e. where the key is to determine the substance of the role. All these situations are very much linked to what the financial institution "does know or could be reasonably expected to know" to delimit its type of participation. In this regard, intermediaries are required to file information that is within their knowledge, possession or control.

5. The IMF perspective on corporate taxation in the global economy

An additional key player in the international tax arena is the IMF, which focuses on tax administration and tax policy issues. More specifically, the IMF works on tax reform, business taxation and corporate taxation. In its view, the key issues that need careful analysis, are:

1. the effects of profit shifting on revenue loss since it is uncertain how much it really represents for countries;
2. the possibility and ways that tax competition could become more intense and more aggressive among countries;
3. how tax competition is of great concern for low income countries since corporate income tax is a great source of revenue in comparison to high income countries; and
4. the meaning of value creation in the context of the digital economy because so far it seems to be a purely emblematic concept.

In addition to all that, and in relation to transfer pricing, the IMF is working on the impact of residual profits allocation. It is crucial to determine how large residual profits actually are and where they are allocated. In general, residual profits are largely concentrated in US-headquarters. Also, many large MNEs appear to have negative residual profits which triggers the question as to where to allocate those negative residual profits. Another point of consideration is the impact of residual profits allocation on investments incentives. It is questionable whether investments incentives will be reduced provided profit shifting will decrease. These are some of the key questions that the international tax debate has to face.

6. Changes on corporate tax residence rules

Finally, yet importantly, corporate tax residence also faced some significant changes that will have a great impact on taxpayers. On the one hand, the elimination of the tax breaker rule on corporate residence (elimination of the Place of Effective Management (POEM) criteria in (article 3(4)) could leave taxpayers in limbo when determining the residence country because if there is a conflict, it needs to be resolved via a MAP process which is time-consuming. On the other hand, the central management and control test (CM&C) for residence of foreign incorporated companies raises the costs of doing business for corporate groups that operate offshore. For example, the *Development Securities (UK) case* deals with corporate tax residence of a number of Jersey companies that for the HMRC were tax resident in the UK because the management control was in UK. The First-Tier Tribunal also found that Jersey directors who had relied on directions from a UK parent company in relation to implementing a loss-making transaction, had effectively ceded control of the companies to their UK parent. However, the Upper Tribunal reversed the decision from the First-Tier Tribunal and decided that the Jersey companies remained resident in Jersey and not in the UK for tax purposes. The Upper Tribunal based its decision on the fact that the Jersey directors had not abdicated their responsibilities and they had not ceded control to the UK parent company.

7. Conclusion

The international tax system is living through most interesting but turbulent times. Even though international taxation is becoming more and more global every day, we are experiencing a return to unilateral measures under countries' domestic laws at the same time. This is due to the lack of consensus in many aspects about issues that have long been taken for granted and are fundamental to international taxation, such as what is "income", what is the "source" of income, and what types of "connections" to a taxing jurisdiction are sufficient or at least necessary to warrant sustained taxation even according to established protocols for allocating taxing rights. Taxation of the so-called digital economy is a notable case in point where possibly it is not so much new or unconventional issues that stymie solutions but, curiously, facing and facing down a lack of understanding and even misunderstanding of key tenets of tax jurisdiction which have not been seriously tested for some time. Also, but in the same vein, transfer pricing is going through a paradigm shift in which the comparability nature of the arm´s length principle is moving in the direction of a more formulaic approach. Transparency is also facing dramatic changes since now not only governments and tax authorities are involved in the process but also taxpayers, employees and intermediaries. There are interesting times ahead to see how all new changes evolve either for better or for worse.

Seminar J: IFA/EU

Report by: Benjamin Malek, Susi Baerentzen
and Mirna S. Screpante
Chair: Luc De Broe (Belgium)
Secretary: Jasper Korving (Netherlands)
Panel members: Daniel Gutmann (France),
Christian Kaeser (Germany), Edwin Visser (Netherlands),
Bert Zuijdendorp (EU)

1. Introduction

The seminar IFA/EU focused on three pillars:

– tax policy developments at the EU level;
– the concept of abuse in EU law with a focus on the CJEU Danish Beneficial Ownership cases (C-115/16 and C-116/16); and
– new mandatory disclosure rules (DAC 6).

2. EU tax policy developments

During the last five years, several major achievements in the area of direct tax were accomplished under the current European Commission: the anti-tax avoidance directives, automatic exchange of information in tax rulings, double taxation dispute resolution mechanism, etc. All these achievements addressed major points in terms of: (i) transparency initiatives, (ii) fair taxation, and (iii) tax certainty.

With respect to transparency, there has been a revolution with the enormous developments achieved for a new framework in the EU for Administrative Cooperation from 2011 until 2018. As regards the DAC 3, it allows automatic exchange of information on advanced binding cross-border rulings and advanced pricing arrangements since January 2017. In addition to that, statistics showed a noticeable increase of exchanges in this matter in 2017. The DAC 4 permits exchange of information since June 2017 and it transposes the minimum standard set by BEPS Action 13 for country-by-country reporting (CbCR) into EU law. However, a distinction should be made between DAC 4 and the OECD minimum standard, in the sense that the "local reporting" and a public CbCR is not included (a separate legislative proposal is currently under negotiation). The general evaluation of the whole package of instruments introduced in the last couple of years, is very positive since they all have been functioning well and the goals were mostly achieved.

There are also many other non-tax initiatives, namely the proposal on whistle-blowers which despite not being a tax directive has a great impact on tax matters since it has a very broad scope. Its application only requires that a whistle-blower can reasonably expect that there was a breach of law or abusive behaviour. Any tax advantage that defeats the object or purpose of the applicable law can be reported. Furthermore, this report benefits from protection. This may be difficult for each single employee to assess reasonably and even more difficult for non-tax experts who also fall under the scope of reporting. There might be a temptation to report since, once an employee blows the whistle, an immunity against a termination of his/her employment contract applies. Indeed, it will be very difficult for an employer to prove that the termination is not related to the whistleblowing. Currently, the level of protection varies significantly within the EU, a common level of protection is thus highly needed. Member States will have until 2021 to implement the directive. Moreover, whistle-blowers played an important role in influencing the tax agenda, notably in revealing scandals such as the Lux Leaks and the Panama Papers.

Concerning fair taxation worldwide, 95 jurisdictions across the world were assessed by the OECD. The outcomes have been successful since a vast majority committed to adopt good governance standards within a new framework for dialogue. Numerous harmful regimes, including regimes in third states, have been abolished in less than two years and new standards for no/low tax jurisdictions are under consideration.

With respect to the EU Code of Conduct for Business Taxation, the general outcome is very positive as 400 regimes in the EU were scrutinized and it plays a central role in the EU listing process. It also encompasses issues in connection to preferential tax regimes, tax competition, alignment with international reforms, and increased and improved transparency. In relation to CCTB and CCCTB, it has been explained that the current proposal (relaunched in 2016) is based on a pragmatic two step approach (common corporate tax base and consolidation). Progress has been made with respect to the common base but there is no progress on consolidation so CCCTB will still play a key role in future discussions in the context of international tax reform.

As regards digital taxation, the EU reaction was partly based on the disappointment that certain EU Member States expressed on the outcome of BEPS Action 1. However, there is no consensus yet among Member States about the proposed two pillars (pillar one seeks to develop new profit allocation rules and pillar two focuses on achieving a minimum income taxation). The EU decided to wait for the results from the action taken by the OECD. Nonetheless, EU actions in this area could be expected if there are no results at the OECD level.

When it comes to certainty and transfer pricing, the general perception is that the fact that EU Member States have adopted the arm's length principle, contributes to avoid different interpretations. Also, consistency can be found through guidance at the EU level via soft law and the continued input from JTPF, e.g. the use of comparables.

In connection with dispute resolution, EU Member States now have a legal duty to take conclusive decisions, otherwise taxpayers can initiate a Mutual Agreement Procedure (MAP) whereby the Member States must try to resolve the dispute within two years. If no decision is made, the taxpayer can request the setting up of an Advisory Commission to deliver an opinion. If the decision is not implemented, the taxpayer may seek to enforce its implementation before national courts.

Tax compliance and good governance are areas where there is great room for improvement. On one hand, tax authorities will be dealing with increasing data and complex tax planning structures; and on the other hand, taxpayers have a challenging task ahead dealing with a growing number of rules and multiple tax systems. For these reasons, it is important to find new forms of cooperation in order to promote compliance and to fight fraud and evasion.

Finally, the key influencers for the EU on the future agenda will be:
- for the European Commission: improving fair and efficient taxation;
- for the European parliament: right of initiative, the qualified majority voting and the creation of a TAXE4 committee;
- for the Member States, a closer alignment due to the global reforms induced by the OECD and the G20; and
- for the international partners: the challenge between unilateral measures or multilateral solutions.

3. Abuse of EU law after the CJEU judgments in the Danish Beneficial Ownership cases

The Danish Beneficial Ownership cases (C-115/16 and C-116/16) from the CJEU disallowed the exemption of withholding taxes based on the Parent-Subsidiary Directive (hereafter the "PSD") and the Interest and Royalty Directive (hereafter the "IRD") in abusive situations. These EU directives allow for the tax-free distribution of dividends, royalties or interest between two EU Member States when certain conditions are met. The Danish tax authorities argued in the cases that the directives did not apply, and the tax exemption was denied because the relevant payments eventually ended up in third, non-EU countries, rendering the interposed EU holding companies mere conduits. The cases were referred by the Danish national courts to the CJEU with a request for a preliminary ruling to establish the interpretation of the EU law in order for the national courts to make the correct decision in the end.

The preliminary rulings from the CJEU addressed the following key points: (i) whether there is a general principle of EU law that abuse of rights is prohibited; (ii) the CJEU's interpretation of 'beneficial ownership' within the framework of the IRD; and (iii) the abuse of the PSD and the IRD by conduit companies. Denmark had not introduced any anti-abuse rule that could be applicable to these cases so the only option available was to use the beneficial ownership limitation.

As regards the existence of a general principle of EU law that abuse is prohibited, the CJEU reaffirmed the existence of a general principle that EU law cannot be relied on for abusive or fraudulent ends. In fact, Member States must refuse to grant the benefit of the provisions when they are relied upon with a view of benefiting from an advantage in EU law. In the absence of domestic or agreement-based anti-abuse provisions, it does not affect the national authorities' obligation to refuse directive benefits. This begs the question as to why optional GAARs are provided for in the PSD and IRD if there is indeed a general anti-abuse principle in EU law. Especially since the introduction of an autonomous definition of abuse in the PSD (January 2015), there is a discrepancy between the text of the PSD and the IRD. However, this case law might, to a certain extent, be obsolete as the Member States adopted a mandatory GAAR in the PSD in 2016 and since 2019 Member States must adopt ATAD I which provides for a mandatory GAAR into domestic corporate tax law. Nonetheless, the principle might still be applicable because in some countries withholding taxes are not considered to be part of the corporate tax system and there might be differences in the scope between the ATAD and withholding taxes considered by the directive. Nevertheless, EU principles shall not apply in purely domestic situations because the Court held in the past that if a situation is outside the scope of EU law there is no reason for EU law-based principles to be applicable.

The potential application of the general anti-abuse principle to treaty freedoms was mentioned and concerns were expressed as to the potential loss of case law on the treaty freedom access (three-pronged test: existence of a restriction, justification thereof, and proportionality) in situations considered to be "abusive".

In connection to the interpretation of the concept of beneficial ownership, only the IRD referred to the beneficial ownership concept. Thus, it is not understandable why the Court referred to the concept in the cases decided in the framework of the PSD. It is worth noting that the Court considered the OECD Commentary relevant for interpretation, as the IRD draws from article 11 OECD MC. The Court probably took an economic approach to the concept of beneficial ownership which is understood as the power to freely determine the use of the income received. As an example, a subsidiary of an MNE was given, such a company being legally able to dispose of income and assets as it sees fit. This differentiation between economic and legal ownership triggers several concerns as regards interpretation to the extent that it is not clear-cut what the consequences will be. A potential tie between "significant people functions" and beneficial ownership could be a solution to this.

With respect to abuse of the PSD and IRD directives by conduit companies, the cases confirm earlier case law (*Emsland Stärke Case; Cadbury Schweppes Case*), which states that the abuse assessment comprises two elements: the objective element (acting against the objective of rule of EU law), and the subjective element (essential intention to claim improper advantage offered by EU law). Both elements must be proven by the tax authorities on the basis of a series of coherent objective circumstances proper to the case. For example: remittance of all or almost all of the income received to other entities, very soon after receipt, conduit making a reduced profit given the obligation to pass on the income, absence of economic activity apart from passing along the income received, existence of a contractual or legal obligation to pass on the income received, or existence of a structure set up to circumvent adverse tax consequences following from a change of law in the state of source.

The indications mentioned by the Court to assess whether a conduit company might be abusive, were criticized and challenged. Regarding the temporal indicator, it may be asked if merely holding the income for a year would suffice to fall outside the scope of abuse? Against the "insignificant profits" criterion, the impossibility to assess what a correct margin is, was raised. On the question of absence of economic activity, it can be argued that having large staff numbers in financing companies would be foreseeable. Lastly, the fact that the structure had been set up to circumvent adverse tax consequences can also be considered deceptive in that it is common for a restructuring to take place in anticipation of legislative changes.

Also, and more importantly, the difference between the concept of abuse and beneficial ownership must be taken into account. Whereas beneficial ownership is an objective condition required for obtaining the benefits of a directive, abuse denies the person meeting the formal conditions for a benefit when the underlying construction frustrates the object and purpose of EU law (namely, a directive). Ideally, the concept of abuse of law and the notion of beneficial ownership should be completely separate, or it could even be argued that only abuse should exist. However, the beneficial ownership requirement will remain. Therefore, it would be recommendable to add a beneficial ownership clause to the PSD (where it is not mentioned), or replacing the optional GAARs by mandatory GAARs in both the PSD and IRD, instead of aligning the EU concept of beneficial owner with the concept used in the 2014 version of the OECD Commentary (a more restricted notion).

4. Mandatory disclosure rules (DAC 6)

In the context of international tax policy, the new mandatory disclosure requirements which were introduced as an amendment to the Directive on Administrative Cooperation in the Field of Taxation ("DAC 6") should be considered. Transparency is instrumental in combatting tax evasion and tax avoidance. It is expected that transparency will change the behaviour of MNEs and tax advisors.

Essentially, DAC 6 introduces an obligation for intermediaries to disclose information on cross-border arrangements that meet certain criteria. The reporting obligation falls on national tax authorities. Rules for the subsequent exchange of this information between tax administrations are also considered. The information passed by intermediaries must be filed when it is within their knowledge, possession or control, with the competent authorities within 30 days. The parties involved in the reporting responsibility are: (i) intermediaries (any person involved in designing, marketing, organizing, making available, managing implementation of reportable cross-border transaction, if (a) resident, (b) PE, (c) incorporated, (d) member of professional organization in EU); (ii) extended intermediaries (any person that knows or could be reasonably expected to know that they have undertaken to provide aid, assistance, or advice with respect to designing, marketing, organizing, making available for implementation of a reportable cross-border arrangement); and (iii) other intermediary and then to the taxpayer if an intermediary – is outside the scope of the Directive (third country); is exempt – legal professional privilege; or is absent (the taxpayer developed the arrangement in-house).

Using an example from the Finnish tax administration perspective, tax certainty and tax transparency are hot topics in the post BEPS world which in fact is a cultural challenge in which tax administrations have a key role to play. For example, Finland is very proactive in pursuing that change. There is a corporate compliance program in place and an open dialogue with taxpayers and stakeholders exists. The massive new information flow (AEIO, rulings, CbCR, DAC 6) poses a significant challenge for tax authorities so technological solutions to process the massive information and handle audits are under development. Nonetheless, for the Finnish tax authorities an open dialogue is more important than massive data. Also, solid guidance on reporting obligations will be provided to taxpayers. The DAC 6 poses a potential risk of over-reporting which could be reduced by this guidance. The use of the information from DAC 6 will be used for a better understanding of organizations and to improve corporate compliance.

Biographies of reporters

Susi Baerentzen is a visiting researcher at IBFD and a PhD student at PwC Denmark and Aalborg University under the Industrial Research program of Innovation Fund Denmark. Her research is interdisciplinary in Tax Law & Economics and focuses on the effectiveness of general anti-avoidance rules and the effects of the Danish beneficial ownership cases. She graduated from the Law School of the University of Aarhus, Denmark and Université de Strasbourg (previously Université Robert Schuman). Susi has published several articles on tax issues related to the Danish beneficial ownership cases, state aid and alternative financing. Furthermore, she has published on general legal issues related to international humanitarian law and human rights law when she was previously engaged as a legal advisor at the Danish Red Cross and the Royal Danish Army. Prior to commencing her research, she was a legal advisor for the Danish Ministry of Taxation and an external lecturer in Tax Law and EU Law at the University of Copenhagen, Denmark. In part of her current research activities she is officially appointed to the Danish Corps of External University Examiners in EU Law and Tax law.

Benjamin Malek has been a research associate and PhD candidate (Law) at the Tax Policy Center of the University of Lausanne, Switzerland, since March 2018. He is currently preparing a doctoral thesis on tax treaty abuse. Benjamin is also enrolled at the University of Oxford, where he reads tax law at the Law Faculty's Masters in Taxation (MSc). He was awarded a Field Court Tax Chamber Scholarship to study at Oxford. He graduated from the Law Faculty of the University of Lausanne (Bachelor of Law, June 2016 and Master of Law, January 2018). In July 2019, Benjamin obtained the University of Geneva's Certificate of Advanced Studies in Legal Professions, a prerequisite for bar admission. Benjamin's Master's thesis, which critically analysed the Beneficial Ownership requirement found in tax treaties, was formally published by the University of Lausanne's Law School and awarded a Faculty Prize by the University. Benjamin was also awarded the 2018 OREF Award (1st Prize) by the Western Switzerland Certified Tax Experts' Association (OREF), for the extensive article he wrote on the impact of BEPS Action 6 and the Principal Purposes Test (PPT) on Switzerland. Beyond his doctoral thesis, Benjamin's research interests include various fields of Swiss and international law, such as tax avoidance, EU law, treaty interpretation, and the interaction of treaties with domestic law.

Mirna Solange Screpante is an academic and tax professional, currently working as a research and lecturer fellow at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU). She is associated with the WU Transfer Pricing Center where she obtained the Vienna Certificate in Transfer Pricing and is pursuing her PhD research. Her thesis explores the implications of Actions 8-10 BEPS in intangibles structures and the reinterpretation of the arm´s length principle in light of value creation. She is also actively engaged in international publications and projects.
Mirna holds a degree in accounting from the Universidad de Buenos Aires (Argentina), a specialization in tax law (EDT) from Universidad Austral (Argentina) and an LLM in corporate taxation from Universität zu Köln (Germany). She served as a teaching assistant at Universidad de Buenos Aires and as a lecturer at Universidad Austral. Mirna has been a visiting scholar at

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International Fiscal Association