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I. Introduction

While global financial commerce has rapidly evolved in light of new technology, the momentum of legislative response with respect to tax standards has proven comparatively sluggish. As an example, due to the digital economy, a corporation in one country may have customers located in an entirely different country in which the corporation has no taxable presence.¹ Deficiencies in existing international tax legislation have encouraged base erosion and profit shifting (BEPS). The lack of timely international tax legislation provides for ample planning possibilities. There is a widespread perception that, although the tax planning structures are legal, multinational corporations (MNCs) are not paying their fair share of taxes.

A holistic response to the deficiencies in international tax legislation calls for international collaboration to achieve accord between source country and resident country tax regulations, to produce anti-abuse provisions, and to update transfer-pricing provisions.² Acknowledging the need for resolution, the OECD published an ambitious action plan in July 2013 entitled the “Action Plan on Base Erosion and Profit Shifting” (BEPS Action Plan). The BEPS Action Plan identified fifteen actions needed to comprehensively combat BEPS.

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1. *Action Plan on Base Erosion and Profiting Shifting*, OECD, 7, 10 (2013), <https://www.oecd.org/ctp/BEPSActionPlan.pdf>.

2. *Id.* at 14.

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The OECD has recently published its final reports on the BEPS Project. In the meantime, the European Union (EU) is also working on countering BEPS.³ Countries are beginning to alter their domestic tax systems, as well as their treaty provisions, in order to facilitate cooperation with the initiatives in the BEPS Action Plan. But, it is difficult to predict whether and to what extent countries will endorse and achieve harmonization of international tax standards. This Article explores the real-world response to counter BEPS in China, Italy, India, Mexico, the Netherlands, and the United States. It also addresses the EU state aid developments.

II. China⁴

A. NEW INDIRECT TRANSFER RULES

In February, the State Administration of Taxation (SAT) issued the “Bulletin of the State Administration of Taxation on Several Issues of Enterprise Income Tax on Income Arising from Indirect Transfers of Property by Non-Resident Enterprises” (Bulletin Seven).⁵ Bulletin Seven took effect on February 3, 2015 (effective date), and retrospectively applies to indirect transfers that (1) had taken place before the effective date, and (2) had not been assessed by Chinese tax authorities in regards to whether capital gains tax (generally ten percent) must be paid.

Bulletin Seven repeals the relevant indirect transfer provisions in the SAT Circular 698 (2009) and SAT Bulletin Twenty-Four (2011), and contains more detailed rules for tax treatment of indirect transfers of equity interests in Chinese resident companies (by transferring shares of the offshore intermediate parent company) and other assets situated in China. Bulletin Seven significantly impacts future and past indirect transfer transactions involving China.

Bulletin Seven broadened the scope of indirect transfer rules to encompass non-resident enterprises’ indirect transfers of (1) the assets of an establishment or place situated in China; (2) real property situated in China; and (3) equity interests in Chinese resident enterprises. Bulletin Seven also realigned and detailed the criteria and factors based on how the Chinese tax authorities determine cases in which the indirect transfer lacks reasonable commercial purpose and therefore should be subject to Chinese capital gains tax.

3. The European Commission presented its own action plan already on December 6, 2012. *An Action Plan to strengthen the fight against tax fraud and tax evasion*, COM (2012) 722 final (June 12, 2012), available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf; its most recent action plan was released on June 17, 2015. *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM (2015) 302 final (June 17, 2015), available at http://eurlex.europa.eu/resource.html?uri=cellar:5e1fd1b0-15b7-11e5-a342-01aa75ed71a1.0003.01/DOC_1&format=PDF.

4. David Dingfa Liu would like to thank Fangfang Xiang, associate of Jun He Law Offices, for her kind assistance in the preparation of this Article.

5. Issued pursuant to the Enterprise Income Tax Law of the People’s Republic of China, which was promulgated by the National People’s Congress on March 16, 2007 and took effect on January 1, 2008; and the Tax Collection and Administration Law of the People’s Republic of China, which was promulgated by the National People’s Congress on September 4, 1992 and took effect on January 1, 1993. *State Administration of Taxation’s Bulletin on Several Issues of Enterprise Income Tax on Income Arising from Indirect Transfers of Property by Non-resident Enterprises*, SAT BULLETIN (Feb. 3, 2015).

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In addition, Bulletin Seven created safe harbors of certain qualified indirect transfers, changed the reporting obligations, clarified that the transferor is the taxpayer, and imposed withholding obligations and heavy penalties on the transferee for failure to withhold with mitigation for voluntary disclosure of the transaction.

B. PRE-EMPTIVE STRIKE AGAINST BEPS

On March 18, 2015, the SAT issued Bulletin Sixteen, which disallowed income tax deductions vis-à-vis certain service fees and royalties paid by Chinese resident companies to their overseas affiliates.⁶ Bulletin Sixteen reflects Action Two (“Neutralizing the Effects of Hybrid Mismatch Arrangements”) and Action Four (“Limiting Base Erosion Involving Interest Deductions and Other Financial Payments”) under the OECD BEPS Project by targeting service fees and royalty payments made by Chinese resident enterprises to their overseas affiliated companies that do not undertake significant functions and risks associated with Chinese operations and/or lack economic substance. According to *China Tax Monthly*, it “appears to be retroactive at least to January 1, 2008, the date on which the current Enterprise Income Tax Law took effect, and possibly as far back as ten years, which is the statute of limitations for special tax adjustment cases.”⁷

1. Non-Deductible Payments

“Bulletin [Sixteen] introduces four categories of payments by Chinese companies to their overseas affiliates that are non-deductible from the taxable income of the Chinese company.”⁸ According to *China Tax Monthly*, these categories of payments are as follows:

- Outbound payments to overseas affiliates that do not perform any functions, do not assume any risks, and/or do not engage in any substantive operational activities;
- Outbound payments to overseas affiliates for services that do not directly or indirectly provide any economic benefit to the Chinese company;
- Outbound royalty payments to overseas affiliates that have legal ownership of intangible property (IP) but have not made any contributions to the creation of value in such IP, and the payments do not conform to the arm’s-length principle; and
- Outbound royalty payments to overseas listed vehicles in exchange for incidental benefits arising from the listing activities.⁹

On the one hand, the above categories were “broadly drafted and give a great deal of discretionary authority to tax officials on how to interpret and apply them.” On the other hand, “the vagueness of these categories creates room for taxpayers to make legal arguments in favor of deductibility.”¹⁰

In conclusion, “[t]hese new rules also highlight the importance of strong transfer pricing analysis to support the assertion that service fee and royalty payments meet the

6. *Id.*

7. *China Tax Monthly – 2015 Midyear Review*, BAKER & MCKENZIE, 1, 12 (Jan.-June 2015), http://www.bakermckenzie.com/files/Uploads/Documents/Publications/AP/al_china_taxmidyear_jun15.pdf.

8. *Id.* at 12.

9. *Id.*

10. *Id.*

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“arm’s length” standard, even when such payments are not deemed to be non-deductible under Bulletin [Sixteen].”¹¹

2. *IP Value Creation Requirement for Royalties*

Article Five of Bulletin Sixteen provides additional valuable information that pertains to resident enterprises. It states:

[T]hat when a resident enterprise makes royalty payments to a non-resident related party that only has legal ownership of the intangible property, but has not made any contributions to value creation in such IP and such payments do not conform to the ‘arm’s length’ principle, such payments shall not be deductible when calculating the amount of taxable income of the resident enterprise.¹²

Bulletin Sixteen provides further that the “value creation” analysis “should take into account the functions performed, assets used, and risks assumed by relevant parties in the development, enhancement, maintenance, protection, application, and promotion of the intangible assets, such as technology or brands.” The Official Explanatory Note also states “royalties should be proportional to the ‘value created’ by the recipient of the royalties.”¹³

This Committee thus agrees that “[t]o some extent, Article [Five] of Bulletin [Sixteen] appears to be in line with proposals under the BEPS Project.” Action [Eight] (Aligning Transfer Pricing Outcomes with Value Creation):

states that legal ownership alone does not entail a right to retain all income attributable to IP; instead, the party performing functions, contributing/using assets, and undertaking risks related to developing, enhancing, maintaining, and protecting IP, that is, the economic owner, should retain a portion or in some cases all of the returns attributable to the IP.¹⁴

Finally, and given the above,

the value creation requirements in Article [Five] of Bulletin [Sixteen] may pose problems for IP holding companies that only fund and assume all of the risks associated with the development of IP but outsource all of the other functions, such as R&D work or brand building, to other entities that are incorporated and operating in China.¹⁵

This is especially true because Bulletin Sixteen is “unclear as to whether the legal owner has to physically perform these functions to be treated as contributing to the ‘value

11. *Id.*

12. *Id.* at 13.

13. *Id.* at 14.

14. *China Tax Monthly – 2015 Midyear Review*, BAKER & MCKENZIE, 1, 14 (Jan.-June 2015), http://www.bakermckenzie.com/files/Uploads/Documents/Publications/AP/al_china_taxmidyear_jun15.pdf.

15. *Id.*

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creation' in the intangible asset."¹⁶ The OECD position is that "it is not essential that the legal owner physically perform all of the functions, but control is a minimum."¹⁷

As has been said,

[t]he new measures in Bulletin [Sixteen] will likely have a significant impact on holding structures, supply chain planning, and global tax planning and cash repatriation strategies of MNCs that have subsidiaries in China. At the same time, certain aspects of Bulletin [Sixteen] may be open to taxpayers' legal challenges, depending on how the SAT and local taxation offices interpret and implement these new measures.¹⁸

III. India

A. BEPS AND EMERGING ECONOMIES

The World Bank recently reported that India is set to emerge as the world's fastest-growing economy by 2015, moving ahead of China.¹⁹ The unbridled growth of emerging economies, such as India, makes it all the more important to include them in the decision-making process for an effective implementation of the BEPS Action Plan.

Emerging countries rely heavily on corporate tax as the major contributor to their national treasuries.²⁰ The report of Action Aid, a global anti-poverty organization, states that corporate income tax constitutes eighteen percent of tax receipts in low- and lower-middle-income countries, compared to 12.6 percent in high-income countries and around ten percent in the U.K. and seven percent in the United States.²¹

B. GENERAL VIEW OF BEPS BY INDIAN AUTHORITIES

Indian courts have held that OECD commentaries are not binding and at best have only persuasive value.²² Furthermore, Indian judicial forums have taken a checkered view on the validity of BEPS proposals. Recently, the Mumbai bench of the Honorable Income Tax Appellate Tribunal (ITAT) placed reliance on Action Eight ("Aligning Transfer Pricing Outcomes with Value Creation") and held that specific adjustments for location saving are not required.²³ On the other hand, the Delhi bench of ITAT held that judicial process will infringe neutrality, if it is swayed by the policy considerations of BEPS and that its role is limited to interpreting law as it exists and not how it ought to be in light of certain underlying notions.²⁴

16. *Id.*

17. *Id.*

18. *Id.* at 12.

19. *Getting Prices Right—The Recent Disinflation and Its Implications*, SOUTH ASIA ECONOMIC FOCUS (2015), <https://openknowledge.worldbank.org/handle/10986/22708>.

20. *See id.*

21. *A level playing field? The need for non-G20 participation in the BEPS process*, ACTION AID (last visited Apr. 3, 2016), https://www.actionaid.org.uk/sites/default/files/publications/beps_level_playing_field_.pdf.

22. *Comm'r of Income Tax v. P.V.A.L. Kulandagan Chertair*, (2004) 267 ITR 654 (India)(The Honorable Supreme Court has held that the nature of OECD commentaries as non-binding on courts).

23. *Watson Pharma P. Ltd, Mumbai v. Dep't of Income Tax* (2015) 38 ITR(T) 97.

24. *ADIT (International Taxation) v. Baker Hughes Singapore Pte. Ltd.*, (2015) 41 ITR(T) 212.

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Disparities in the treatment afforded to developing economies vis-à-vis developed economies might lead to inter-country tax imbalances. But BEPS may have sidestepped some of the important issues concerning developing countries as it failed to address how the tax base from MNCs is divided between capital-exporting and capital-importing countries.²⁵

C. INDIAN IMPACT ASSESSMENT

From an Indian standpoint, action plans relating to treaty abuse (Action Six), transfer pricing rules on intangibles (Action Eight), and country-by-country reporting (Action Thirteen), as well as digital economy (Action One), assume greater significance because the majority of tax disputes in India revolve around such areas.

In particular, Action Six (“Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”) proposes a three-pronged approach. First, Action Six suggests the inclusion of a provision that the treaty is not intended to create opportunities for tax evasion and avoidance. Second, Action Six proposes to include specific anti-abuse provisions in the treaty in the lines of the Limitation on Benefits (LOB) clause. And third, Action Six proposes to include general anti-abuse rules such as a Principal Purpose Test (PPT).

The inclusion of the PPT clause, in addition to the LOB clause, in the tax treaties would certainly impinge the setting up of corporate offices in the tax-friendly jurisdictions solely for the purpose of tax avoidance. Furthermore, incorporating a preamble into treaties stating “treaties are not intended to create opportunities for tax evasion and avoidance” would drive the judicial forums to interpret provisions of the treaties in a more purposive manner, rather than a strict interpretation of treaty provisions.²⁶

The proposals made by Action One, addressing the direct tax challenges faced in the digital economy, seem to be largely in favor of developing economies. The proposals state that e-commerce transactions may be taxed at the place where the goods are sold, which may lead to a surge in tax collections by developing nations from the e-commerce industry.

Likewise, integrating Action Thirteen (“Transfer Pricing Documentation and Country-by-Country Reporting”) into the Indian transfer-pricing regime would provide a better horizon to revenue officers to access international data pertaining to MNCs. This, in turn, would facilitate the determination of the “arm’s length” price of international transactions between the associated enterprises in a more effective and efficient manner.

India will continue to amend its domestic tax laws to give effect to the BEPS proposals insofar as they are in alignment with India’s tax policy. The question remains to be answered: What is the extent of cooperation between the emerging economies, including India, and the developed economies in collaboratively seeking to achieve the intended objective of the BEPS initiative? BEPS is undeniably a laudable initiative to streamline

25. *The BEPS Process: failing to deliver for developing countries*, ACTION AID (Sept. 2014), https://www.actionaid.org.uk/sites/default/files/publications/aauk_report_-_bepsuk_16th_sept_2014.pdf.

26. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD/G20 Base Erosion & Profit Sharing Project 98 (2015), available at <http://www.oecd.org/ctp/treaties/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm>.

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the existing international tax rules to accommodate the pressing needs of the global village.

IV. Italy

OECD Action Five (“Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance”) describes the outer limits of a proper IP tax regime:²⁷ it may grant benefits to R&D but it cannot have harmful effects on other countries. Also, a proper IP regime provides a benefit only if a substantial activity is carried on (the so-called nexus approach).

The OECD, while recognizing that IP-intensive industries are a key driver of economic and employment growth, makes no recommendations on the introduction of IP regimes so that countries remain free to decide whether to implement Action Five. In this context, Italy—through the 2015 Stability Law, as amended and implemented²⁸ — introduced an optional regime that provides preferential tax treatment for income arising from qualifying intellectual property (patent box regime). The option for the regime applies for a period of five years, cannot be revoked, and may be renewed at the end of the period.

Under this regime, fifty percent of income earned by selected persons through either exploitation (i.e., licensing to third parties and related parties) or direct use of qualifying IP is exempt from corporate income tax and business regional tax.²⁹ In addition, capital gains arising from the sale of qualifying IP are exempt upon the condition that at least the seller in R&D activities reinvests ninety percent of the consideration.³⁰ Transitional rules apply for the first tax years of the new regime: for 2015, the exemption is reduced to thirty percent and for 2016 to forty percent.³¹ No reduction applies for capital gains.

The persons who can exercise the option for the patent box regime are those earning business income, carrying on qualifying R&D activities, and having the right to economically exploit the qualifying IP. In particular, the definition of qualifying persons includes not only resident individuals, partnerships, and companies, but also non-resident persons having a permanent establishment in Italy to which the qualifying IP is attributed. But a non-resident person may benefit from the regime only if its country of residence has a tax treaty in force with Italy and guarantees an effective exchange of information. Persons subject to insolvency procedures—including bankruptcy—are excluded from the regime.

The qualifying R&D activities generally include the development, maintenance, and improvement of qualifying IP. More specifically, the relevant activities expressly regulated by law are preventive, fundamental, and applied research, excluding design,

27. *Addressing Base Erosion & Profiting Shifting*, *supra* note 1, at 18.

28. Legge 23 dicembre 2014, n. 190, art. I, para. 37-45 (It.). The law provisions have been implemented by the Interministerial Decree 30 July 2015 and the Regulations of the Revenue Agency dated 10 November 2015 and 1 December 2015. The first guidance from the Revenue Agency is contained in the Circular Letter 1 December 2015, no. 36 /E.

29. *Id.* (Corporate income tax rate is 27.5 percent in year 2016 and will be 24 percent as from 2017; business regional tax rate is 3.9 percent.)

30. *Id.*

31. *Id.*

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invention, and realization of software protected by copyright, tests, market surveys, and other activities aimed at obtaining protection, communication and promotion activities.

Qualifying IP includes (1) software protected by copyright; (2) industrial patents granted or subject to the granting process; (3) trademarks, whether registered or subject to the registration process; (4) designs and models, if legally protectable; and (5) business and technical-industrial information, commercial or scientific information, and know-how, if legally protectable and treated as confidential. In particular, the IP above shall be defined in reference to national law, EU law, and other international rules, especially those contained in international treaties and international agreements on industrial and intellectual property.

The qualifying income (i.e., the income to be reduced to fifty percent for corporate income tax and business tax purposes) derived from exploitation or direct use of the qualifying IP is calculated as follows: first, the revenues generated are reduced by the direct costs and part of the related indirect costs, and second, the outcome of the previous difference is multiplied by the ratio of qualifying expenditures to overall expenditures.³²

The patent box regime is intended to comply with Action Five guidelines on IP box regimes. Because the OECD specifically requires substantial activity for any preferential regime (in order to avoid profit shifting toward countries different from the ones in which the income is geographically produced) and presents the nexus approach as the tool to put the substance requirement into practice, Italy introduced a principle that (1) excludes access to the preferential regime to persons not carrying on R&D activities, and (2) grants the related benefits proportionally to the amount of costs incurred for R&D activities.

As for the ratio, qualifying expenditures include costs incurred for R&D activity carried on directly by the qualifying person or by third-party companies, universities, and research institutions through research contracts. If related entities incur expenses for R&D activities outsourced to third parties and charge those expenses to the qualifying person or, if there is a cost-sharing arrangement, such costs may also be included in the definition of qualifying expenditure. The qualifying person is allowed to increase up to thirty percent the amount of the qualifying expenditure with costs incurred for transactions with non-third parties and costs incurred for the purchase of the IP, if any.³³ Overall expenditures include qualifying expenditures, costs incurred for transactions with non-third parties, and costs incurred for the purchase of the IP.

A tax ruling issued by the Italian tax authorities is compulsory if income arises from the direct use of the qualifying IP. A tax ruling request is also allowed in order to determine the income or the capital gain derived from transactions with non-third parties.

The newly introduced Italian patent box regime compares favorably with the BEPS guidelines, as the above ratio implements the nexus approach. But the inclusion of trademarks within the eligible IP deviates from such guidelines. Indeed, Action Five states that marketing-related IP assets such as trademarks can never qualify for tax benefits under an IP regime. As a result, current political discussions about keeping or deleting trademarks in the Italian framework are ongoing. Action Five suggests a transitional solution for inconsistent regimes; specifically, the option for trademarks should be eligible only until June 30, 2016, and, after the five-year term of the option (ending June 30,

³². *Id.*

³³. *See id.*

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2021), could not be renewed. Press sources reveal that this solution could be implemented in Italy.

V. Mexico

A. CURRENT BEPS IMPLEMENTATION

Several recommendations from the OECD in connection with BEPS have been implemented in Mexican legislation. Specifically,

- A limitation on the deductibility of hybrid instruments;³⁴
- A limitation on the payments made to transparent entities for tax purposes; and
- An inclusion of an anti-avoidance provision by which, as per the requirement of the Mexican tax authority, the taxpayer should prove a juridical double taxation in order to be able to apply tax treaty benefits.³⁵

Through the 2015 Treasury Regulations,³⁶ the scope of such measures has been defined as follows: First, payments made to Mexican tax residents that are considered transparent entities in accordance with foreign legislation will be deductible to the extent and by a ratio under which such payments are taxable abroad either in that year or in the following year. Second, payments made to foreign transparent entities will be deductible to the extent and by a ratio under which such payments are taxable for the members of such transparent entity either in that year or in the following year. And third, the anti-avoidance provision will not apply in the following cases: (a) if the taxpayer resides in a territorial jurisdiction; (b) if the taxpayer is not subject to tax in its residence's jurisdiction for applying an exemption method of a tax treaty; (c) if it is a shares transfer conducted in a corporate restructure; or (d) if the taxpayer is receiving dividends.

B. FUTURE DEVELOPMENTS

Among the relevant modifications to the 2016 Tax Reform Decree, the following are highlighted:

1. *Voluntary Disclosure and Repatriation Amnesty*

"The amnesty entitles Mexican resident individuals, legal entities, and Mexican permanent establishments of foreign principals, with income from direct or indirect investments held abroad prior to December 31, 2014, to pay the taxes owed on that income."³⁷ In order to do so, the self-correcting taxpayer must comply with the following requirements, among others:

34. Ley del Impuesto Sobre la Renta [LIR][Income Tax Law], art. 28, frac XXXI. 11 de Noviembre de 2013 (Mex.).

35. LIR, art. 4.

36. CPSS, *Payment, clearing and settlement systems in Mexico*, § 3.3.1 at 267-69 (2011), available at <http://www.banxico.org.mx/sistemas-de-pago/material-educativo/intermedio/%7B7503D60E-680E-8096-4396-CC6F69AF7DDB%7D.pdf>.

37. *Tax Bulletin Tax Reform 2016*, SANCHEZ DEVANNY (2016) 1, 2, <http://www.sanchezdevanny.com/boletines/144-en.pdf>.

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- The income from the investments must not originate from payments that generated a tax deduction in Mexico.
- Repatriation of income and principal to a Mexican bank or brokerage firm must be completed by June 30, 2016.
- The voluntary disclosure tax payment must be paid within fifteen days from the date of repatriation of the income and principal, granting a foreign tax credit, if applicable.³⁸

2. *Tax Incentive for the Reinvestment of Profits by Legal Entities for Their Shareholders*

Mexican tax reform has introduced “a tax incentive for resident[s] regarding the ten percent tax on dividends with respect to 2014, 2015, and 2016 profits generated by the legal entities in which they hold investments if these entities reinvest them and defer their payout to 2017 and thereafter.”³⁹ “The incentive consists of granting a [partial] tax credit that can be applied to the ten percent tax on dividends generated from profits generated in 2014, 2015, or 2016.”⁴⁰

3. *Introduction of the Common Reporting Standard*

The Mexican “Federal Tax Code has been amended to incorporate the OECD’s” common reporting standard “through the enactment of Article 32-B Bis.”⁴¹ “These information exchange obligations are applicable to financial entities that are Mexican tax residents or have a branch in Mexico.”⁴²

4. *Country-by-Country Reporting*

“A new obligation of filing information returns regarding operations with related parties was” included in Article 76-A of the Income Tax Law.⁴³ “The purpose of [such] filings is to provide tax authorit[ies] with enough information regarding operations and structures that could derive from moving profits from one company to another, thereby totally or partially avoiding taxation in Mexico.”⁴⁴

V. The Netherlands

A. BEPS COMMITMENT

The Dutch government considers most BEPS topics, such as hybrid mismatches, to be a multilateral issue that must be resolved at an international level through changes to “hard law.”⁴⁵ The Netherlands believes the BEPS measures should be implemented in a

38. *Id.* at 2.

39. *Id.* at 4.

40. *Id.*

41. *Id.* at 7.

42. *Id.* at 7.

43. *Tax Bulletin Tax Reform 2016*, SANCHEZ DEVANNY (2016) 1, 9, <http://www.sanchezdevanny.com/boletines/144-en.pdf>.

44. *Id.*

45. Letter of Dutch Ministry of Fin. with its reaction to the final OECD BEPS Action (Oct. 5, 2015).

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coordinated manner within the EU or at a global level, and it is committed to cooperating with this practice. Furthermore, the Netherlands has stated that it wishes to be a front-runner for certain BEPS topics, most notably for anti-abuse measures to be included in bilateral tax treaties concluded with a selection of developing countries, and for transparency, including country-by-country reporting, transfer pricing documentation, and automatic exchange of information on rulings between tax authorities.⁴⁶ The Dutch government is proactively working on these topics.

The Netherlands has also taken concrete action, following the coordinated implementation of BEPS measures within the EU. The most noticeable, recent and concrete BEPS measures taken within the EU are the amendments to the EU Parent Subsidiary Directive (PSD). These amendments introduce a mandatory general anti-abuse rule (PSD GAAR) and a hybrid mismatch rule (Anti-Hybrid Rule). Both measures need to be implemented by the EU Member States by January 1, 2016, at the latest. The Dutch implementation legislation was approved by the Second Chamber of Dutch Parliament on November 18, 2015. The legislation will have to be adopted by the First Chamber of Dutch Parliament in order to be effective.

B. EU PARENT SUBSIDIARY DIRECTIVE (PSD)

The PSD provides under certain conditions for withholding tax exemptions and corporation tax exemptions (or credits) for profit distributions from subsidiaries to parent companies in different EU Member States. The purpose of the PSD is to eliminate the risk of double taxation. The PSD GAAR and the Anti-Hybrid Rule aim to deny the PSD benefits in abusive situations.

C. PSD GAAR AND DUTCH IMPLEMENTATION

The PSD GAAR was adopted on January 27, 2015.⁴⁷ It requires that the EU Member States refrain from granting the PSD benefits (i.e., dividend withholding tax exemptions and possibly also corporation tax exemptions of dividends at EU parent level), if one of the main purposes of an arrangement is to obtain a tax advantage that would be in conflict with the object or purpose of the PSD and such arrangement lacks economic reality, i.e., is not genuine. The PSD provides that an arrangement or series of arrangements is regarded as not genuine to the extent they are not put in place for valid commercial reasons reflecting economic reality. The idea behind the PSD GAAR is that all Member States should combat abuse of the PSD benefits in a consistent manner. Currently, however, there is uncertainty as to the exact interpretation of the PSD GAAR. Surprisingly, the EU has given little guidance for interpretation of the terms used in the PSD GAAR.

The Netherlands levies, in principle, a dividend withholding tax of fifteen percent, but under certain conditions exemptions at the source are available, *inter alia*, for dividends paid to EU parent companies. But the PSD GAAR is implemented not in the withholding tax act (apart from amending specific anti-abuse rules for cooperatives), whereas in the Dutch non-resident corporation tax rules (NRCT Rules). This means that for outbound

^{46.} *Id.*

^{47.} Council Directive 2015 O.J. (L 21/1).

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distributions, the currently existing exemptions at the source for dividend withholding tax would still be available, but taxation in abusive situations would take place via the NRCT Rules.

Until January 1, 2016, the provision in the NRCT Rules is that foreign corporate shareholders holding an interest of five percent or more in a Dutch tax resident company (Substantial Shareholding) would be liable to Dutch corporation tax (in principle, at a rate of twenty-five percent) for the income derived from the Substantial Shareholding, unless the Substantial Shareholding is attributable to an active business enterprise, is not held with one of the principal purposes to avoid the levy of personal income tax, and/or dividend withholding tax of another person. The main purpose is in principle tested by verifying whether Dutch tax benefits are obtained by having the foreign corporate shareholder in the structure.

As of January 1, 2016, the NRCT Rules will be reworded to bring them in line with the PSD GAAR by providing that there should not be an arrangement or series of arrangements. The existing principal purpose test remains. An artificial arrangement is considered not to be present if there are business reasons reflecting economic reality. The allocation of a substantial shareholding to a foreign corporate shareholder conducting an enterprise or fulfilling a strategic management function as top holding company of an active group is considered to constitute business reasons, i.e., not an artificial arrangement. Hence, the application of the NRCT Rules would not change in that respect. Intermediary holding companies that perform a linking function within a corporate group, engaged in an active business, are also not subject to the NRCT Rules for their substantial shareholding; however, provided that they meet minimum substance requirements as of January 1, 2016, at the latest.

The implementation legislation has a broader reach than prescribed by the PSD GAAR, since it covers both EU and non-EU situations and applies not only to dividends but also to other sources of income such as capital gains, currency results, and certain interest income derived by a foreign corporate shareholder with a substantial shareholding. The Dutch government takes the position that bilateral tax treaties concluded by the Netherlands are, in principle, not affected by the implementation of the PSD GAAR. Thus, treaties may still offer protection in the form of an exemption or reduction of corporate tax due in situations where the PSD GAAR applies.

Unlike some other EU Member States, the Netherlands does not implement the PSD GAAR for application of the participation exemption for Dutch corporation tax purposes for inbound dividends derived by Dutch taxpayers from participations. In that respect, the Netherlands refers to the statement of the European Commission (Commission) that the PSD GAAR is not meant to intervene in domestic participation exemption regimes.⁴⁸

⁴⁸ *Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*, at 11, COM (2013) 814 final (Dec. 5, 2014).

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D. ANTI-HYBRID RULE AND DUTCH IMPLEMENTATION

The Anti-Hybrid Rule was adopted by the EU Council on July 8, 2014.⁴⁹ It requires EU Member States to no longer provide tax exemptions for the profits received by a parent company from a subsidiary in another EU Member State to the extent such profits are tax deductible for the subsidiary. This aims to prevent double non-taxation of distributions by using hybrid-financing arrangements (hybrid financing). The Anti-Hybrid Rule does not target hybrid entities. In such case, the mismatch is caused by the hybrid entity rather than by hybrid financing. The EU is working on guidance for dealing with hybrid entities.⁵⁰ The Netherlands plans to target hybrid entity mismatches in a coordinated manner and at a multilateral level.⁵¹

The Netherlands implements the Anti-Hybrid Rule by amending the Dutch participation exemption regime as of January 1, 2016 (Amendments). The participation exemption provides for a full exemption from Dutch corporation tax for income (including dividends and capital gains) derived from qualifying participations. As of January 1, 2016, the participation exemption is no longer applicable to remunerations or payments derived from participation to the extent those remunerations or payments can be deducted legally or de facto, directly or indirectly, from a profits tax basis. Hybrid financing could include hybrid loan receivables and preference shares held by Dutch tax-resident parent companies. The Amendments provide for a broader implementation than required by the PSD, among others, because they apply to EU and non-EU situations and capture all qualifying participations rather than only direct parent-subsidiary relationships within the meaning of the PSD. There are no grandfathering rules. Capital gains should not be affected by the participation exemption's new limitation. But the Amendments contain certain provisions aimed at preventing taxpayers from converting taxable income regarding Hybrid Financing into tax-exempt capital gains.

VI. EU State Aid Cases

Another EU development to be seen in light of BEPS concerns is the investigation by the Commission of EU cases involving illegal state aid in the tax area. The Commission appears to be of the view that tax distortion within the EU should also be combated by the EU state aid instrument. EU state aid is based on the European rule that any selective advantage granted by an EU Member State to a particular company is prohibited if it distorts or threatens to distort EU competition.

The Commission is investigating various tax rulings of multinationals. This investigation has already resulted in four opening decisions of the Commission in formal state aid investigations, dated June 11, 2014, and October 7, 2014. These decisions were published on September 30, 2014, regarding the advance pricing agreements (APA) for Apple⁵² in Ireland and Fiat⁵³ in Luxembourg; on November 14, 2014, regarding the APA

49. Council Directive 2014 O.J. (L 219/40)

50. On December 11, 2014, the EU Code of Conduct Group issued a discussion paper to the EU Council that includes draft guidance on hybrid entity mismatches within the EU.

51. Letter of Dutch Ministry of Finance, dated October 5, 2015, with its reaction to the final OECD BEPS Action reports.

52. *Commission on Ireland's alleged aid to Apple*, COM (2014) 3606 final (Nov. 6, 2014).

53. *Commission on Luxembourg Alleged aid to FFT*, COM (2014) 3627 final (Nov. 6, 2014).

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for Starbucks⁵⁴ in the Netherlands; and on January 16, 2015, regarding the advance tax ruling (ATR) for Amazon⁵⁵ in Luxembourg.

Subsequently, on October 21, 2015, the Commission announced its final decisions in the formal investigations into the APAs for Starbucks and Fiat.⁵⁶ Starbucks' APA covers pricing of intra-group royalties for coffee-roasting know-how and of coffee beans purchased intra-group. FIAT's APA covers the pricing of intra-group financing activities. The Commission considers the APAs concluded with Starbucks and Fiat to constitute unlawful state aid. The decisions' text will be published after removal of confidential information. Formal state aid investigations into Apple's APA and Amazon's ATR are still ongoing. More formal state aid investigations regarding tax rulings can be expected to follow.

The announcement of the two final decisions shows that the Commission is determined to challenge potential state aid elements embedded in APAs focusing on transfer pricing methods and the application thereof agreed to by tax authorities. Although the final decisions have not been published yet, the announcement thereof by the Commission combined with its opening decisions provides some insights. The Commission underlines that transfer pricing analyses have to reflect economic reality. Even if a transfer pricing analysis is consistent with OECD guidelines, it could still constitute state aid, which would be the case if its outcome does not conform to market conditions. In essence, this means that the Commission is applying its own rather broad benchmark of how the "arm's length" principle must be applied by EU Member States, independently of whether and how a Member State has incorporated the arm's-length principle into its own tax system. The Commission's approach is novel and does not seem to entail a selectivity test that compares APAs with national law and practice for other taxpayers in the same Member State; instead, it focuses on a market conformity test. Tax authorities must test whether outcomes in APAs differ from outcomes if the transaction had been concluded between independent parties, i.e., in line with market conditions.

Based on its conclusion that Starbucks and Fiat have benefited from unlawful state aid granted by the Netherlands and Luxembourg, the Commission ordered both countries to recover the granted state aid. The Commission estimates that the tax amounts to be recovered are EUR 20 to 30 million for each company for the period under investigation. The Member State involved, other Member States, and beneficiaries and other parties who are directly and individually concerned can challenge the final decisions before the EU's Court of Justice. Both Netherlands and Luxembourg have issued statements that they are of the opinion that no state aid was granted.⁵⁷ On November 27, 2015, the Netherlands announced that it will appeal the Starbucks decision. It is expected that the Luxembourg government will appeal the Fiat decision. It is uncertain whether the Court

54. *Commission on Netherlands Alleged aid to Starbucks*, COM (2014) 3626 final (Nov. 6, 2014).

55. *Luxembourg Alleged aid to Amazon by way of a tax ruling*, COM (2014) 7156 final (July 10, 2014).

56. European Commission Press Release IP/15/5880, Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules (Oct. 21, 2015).

57. *Compare* MINISTRY OF FINANCE, *Dutch response to EC decision on Starbucks* (Oct. 21, 2015), <https://www.rijksoverheid.nl/ministeries/ministerie-van-financien/nieuws/2015/10/21/nederlandse-reactie-op-ec-besluit-over-starbucks>; *with* GOVERNMENT OF LUXEMBOURG, *Luxembourg's position on the decision of the European Commission in the case Fiat Finance and Trade* (Oct. 21, 2015), <http://www.gouvernement.lu/5359308/21-fiat-finance.pdf?print=true×tamp=1459917591&token=4c19b7dd95878cfd446312d690f08519>.

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of Justice will accept the Commission's new distinct European transfer pricing notion for state aid purposes.

VII. United States

A. ACTION FOURTEEN AND THE MUTUAL AGREEMENT PROCEDURE (MAP)

Recognizing the importance of consistency and predictability for business,⁵⁸ OECD Action Fourteen ("Making Dispute Resolution Mechanisms More Effective") prioritizes the efficacy of mutual agreement procedures (MAP) in resolving treaty-related disputes.⁵⁹

At the end of 2013, ninety percent of the outstanding MAP cases stemmed from twenty countries.⁶⁰ In the spirit of the BEPS Project, these countries have committed to improving cross-border cooperation on tax matters by establishing time limits for mandatory and binding MAP arbitrations in the case of bilateral tax treaties.⁶¹ Though the possibility of double taxation once established a barrier to cross-border investment and trade, these improvements increase communication and demolish the preexisting barriers.

1. *Minimum Standard: Impact on Procedure*

To achieve the objective of establishing and monitoring specific measures that promote an effective MAP system, countries have agreed upon a minimum standard focusing on three objectives.⁶² First, countries should ensure that treaty obligations related to MAP are implemented efficiently and in good faith.⁶³ Second, countries should institute administrative procedures that facilitate resolution of treaty disputes.⁶⁴ Third, countries should ensure qualified taxpayers have access to MAP.⁶⁵

a. Access

Per Element 1.2 of the minimum standard, countries should provide MAP access to taxpayers who disagree with the taxing authority. Disagreement may be over whether the conditions for a treaty anti-abuse rule are satisfied or whether a domestic anti-abuse rule conflicts with a treaty. If a country intends to limit or deny MAP access, express agreement between the country and its treaty partners must exist. Moreover, the country must notify its treaty partner's competent authority about any such cases.⁶⁶

58. OECD, *supra* note 1, at 23-24.

59. *Id.* at 39 ("Make dispute resolution mechanisms more effect" (Develop solutions to address obstacles that prevent countries from [re]solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.")).

60. *Action Plan on Base Erosion and Profiting Shifting*, OECD, 7, 10 (2013), <https://www.oecd.org/ctp/BEPActionPlan.pdf>.

61. *See Leaders' Declaration G7 Summit, 7 - 8 June 2015, G7 GERMANY (2015)*, https://www.bundesregierung.de/Content/DE/_Anlagen/G8_G20/2015-06-08-g7-abschluss-eng.pdf;sessionid=090F2E084E4190B45F804B756B3AE3F8.s7t2?__blob=publicationFile&v=6.

62. *See* OECD, *supra* note 60, at 11.

63. *Id.* at 12.

64. *Id.*

65. *Id.*

66. *Id.* at 15.

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b. Initial Evaluation

According to paragraph 1 of Article 25 of the OECD Model Tax Convention, taxpayers must follow certain procedural steps in order to exercise a right to MAP access. Within three years from the first notification of action giving rise to the tax, the taxpayer may present a case to the competent authority,⁶⁷ at which point the competent authority must find whether the objection appears justified. Note that Element 3.1 requires notification of both competent authorities for the contracting states.⁶⁸ Each authority may weigh in on whether the objection is justified and whether the competent authority should afford the taxpayer MAP.

Once the competent authority determines the objection is justified, it may institute a unilateral resolution. But when the objection appears justified and the competent authority cannot unilaterally provide a satisfactory solution, the MAP case will rise to the bilateral stage of MAP.⁶⁹

c. Timely Resolution

In Element 1.3 of the minimum standard, countries are expected to resolve MAP cases within an average of twenty-four months.⁷⁰ This objective is facilitated by Element 2.3 of the minimum standard, which indicates that countries should empower the staff of the MAP processes with the authority to resolve MAP cases.⁷¹ By vesting MAP personnel with requisite authority, resolution is no longer subject to the approval of the tax administration or influence of the country's desired policies that run contrary to the existing tax treaty.⁷²

d. Provision of Resources

Perhaps one of the most valuable elements to expediting the processing of MAP cases is Element 2.5 of the minimum standard, which indicates that countries should provide adequate resources, such as funding, personnel, and training, to MAP.⁷³ The provision of resources along with diligent compliance with the minimum standards will achieve greater efficiency and efficacy of MAP.

2. *Best Practices*

Beyond the elements of the minimum standard, the work on Action Fourteen also produced best practices. Best practices include items to which not all OECD and G20 countries would commit, and items not easily assessed or monitored due to their subjective or qualitative nature.⁷⁴ Like elements of the minimum standard, best practices also affect the efficient processing of MAP cases, propounding procedures that render MAP more accessible to taxpayers.

67. See OECD, *supra* note 60, at 14.

68. *Id.* at 22.

69. *Id.* at 15.

70. *Id.* at 15.

71. See OECD, *supra* note 60, at 18.

72. *Id.*

73. *Id.* at 19.

74. *Id.* at 12.

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For example, Best Practice 5 would afford multi-year resolution to a taxpayer when the facts and circumstances are the same. But the issues would still have a three-year window between the first notification of action resulting in taxation and the presentation for resolution.⁷⁵ In addition, Best Practice 6 would afford taxpayers with pending MAP cases a suspension of collections. The suspension would at minimum reflect the momentary relief afforded to a person pursuing domestic remedies via administrative or judicial proceedings.

B. AN EARNEST EFFORT OFFERING PROCEDURAL IMPROVEMENTS

Upon merely considering the minimum standard and best practices of Action Fourteen, which aims to improve international dispute resolution mechanisms, one finds that the BEPS Action Plan hinges upon country adherence to agreed principles and continued international collaboration. Making MAP more accessible to taxpayers through clear application procedures and ensuring efficiency and efficacy through procedural standards, countries afford business access to international dispute resolution. Such mechanisms ensure greater consistency and predictability for businesses. These dispute resolution methods and the increased communication between countries offer timely response to international business developments, decrease the possibility of double taxation, and respond to abuses arising from outdated treaty provisions. The success of the BEPS Action Plan will depend upon the communication and commitment of the countries involved.

⁷⁵ *Id.* at 30-31.

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