



# GLOBAL CONFERENCE, BERLIN

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## Plenary Session I

### Tax Planning and its Limits in the Current Climate

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# INTRODUCTION

- As the scenario has evolved completely over few last years, it is essential for multinationals and all tax advisors to have first-hand knowledge of the current limits of tax planning
- In this session we will provide practical tips and conclusions to bear in mind in our day-to-day activity

# INTRODUCTION

- The current framework of anti-abuse measures in the tax legislation of key jurisdictions. It is of interest to know what is happening in the countries around us to get an idea of what we can expect in our own jurisdiction
- “Hot” topics vis-à-vis tax inspectors and the courts in various jurisdictions, comparing them to see whether or not the underlying principles employed are similar
- “Best business practices” for tax governance - how they will affect tax planning and what conclusions and recommendations should be considered

# GLOBAL TRENDS – ANTI-ABUSE MEASURES

- ❖ Numerous studies at an international level in the last decade
  - ❖ OECD level
    - ❖ Work on harmful tax measures
    - ❖ Model Convention on information exchange between Administrations
    - ❖ Latest OECD progress reports (from April 2009 to date): New lists of jurisdictions divided into countries which have “substantially” implemented, or countries which have committed to implement, the internationally agreed tax information exchange standard)
  - ❖ EU level
    - ❖ EU Code of Conduct
    - ❖ Communication from the Commission, COM (2007) 785 final
    - ❖ European Commission Communication, April 2009 (IP/09/650)

## Anti-abuse provisions contained in the General Taxation Law 25/1995

- Re-characterisation: Article 13
- Abuse of law: Article 15
- Sham transactions: Simulation of Article 16

## Anti-abuse measures in relation to foreign investments in Spain

- Non-applicability of tax treaties
- Non-applicability of exemptions or other domestic provisions (e.g. non-deductibility of expenses for services received from tax havens)
- Applicability of domestic penalty provisions (e.g. regarding tax havens or thin capitalisation rules)

## Spanish investments abroad

- E.g. Non-deductibility of financial goodwill and the impairment loss on the holding in foreign subsidiaries and non-applicability of tax credits or special regimes in connection with transactions or investments in tax havens

## General anti-abuse tools

- ❖ Abnormal act of management (concept)
- ❖ Abuse of law (art. L 64 of the French tax procedure code)
  - ❖ Fictitious acts
  - ❖ Only tax driven acts
- ❖ Transfer of profits abroad (art. 57 of the French tax code (FTC))
- ❖ CFC rules
  - ❖ Companies (art. 209 B of the FTC)
  - ❖ Individuals (art. 123 *bis* of the FTC)

## New tools

- ❖ Abuse of law extended to all taxes
- ❖ Concept of Uncooperative State or Territory: the black list
- ❖ Transfer pricing: new documentation requirements

## What next?

- ❖ Prior declaration of tax efficient structures?



## Economic Substance Doctrine

- ❖ A product of common law – has not been uniformly applied by the courts
  - ❖ Conjunctive Test
  - ❖ Disjunctive Test
  - ❖ Net Economic Effects Test

## Other Related Doctrines

- ❖ Substance Over Form
- ❖ Sham Transaction
- ❖ Step Transaction

## Codified Anti-Abuse Rules

- ❖ Acquisitions made to avoid and evade taxes - IRC Section 269
- ❖ Partnership anti-abuse rules - Reg Section 1.701-2
- ❖ Consolidated tax return anti-avoidance rules - Reg Section 1.1502-13(h)(1)

## Codification of Economic Substance

- ❖ India generally respects form unless it is a sham transaction
- ❖ Specific anti-abuse rules in limited cases e.g. repo, dividend stripping
- ❖ General anti-avoidance rule (GAAR) proposed in draft Direct Tax Code (DTC)
  - ❖ Widely worded granting omnibus powers to administration for classifying a transaction as 'impermissible'
  - ❖ No safe harbours
- ❖ Debate on tax evasion v. tax avoidance in the context of treaty shopping
- ❖ New treaties being negotiated with LOB provisions
- ❖ Transfer Pricing – India becoming an important jurisdiction
- ❖ Recent Judicial Pronouncements
  - ❖ E\*Trade case – Validity of India-Mauritius treat
  - ❖ Vodafone case – Indirect transfer of Indian share
  - ❖ KSPG BV – Beneficial ownership

# TAX INSPECTORS V THE COURTS

- A couple of “hot” topics vis-à-vis tax inspectors and the Courts in order to see whether or not the underlying principles employed by the Authorities at the Courts are similar in the different countries:
  - “Economic substance” vs. “business purpose”
  - Change in business models

## “Economic substance” vs. “business purpose”

- ❖ In general, very restrictive evaluation of the requirement regarding existence of valid economic reasons in restructuring transactions. Application of the “substance over form” principle
- ❖ E.g. Spanish holding companies (deduction of financial expenses):
  - ❖ Some structures attacked on the basis of the abuse of law by inspectors and courts
  - ❖ “Economic substance” may no longer be enough. Business purpose is required

## In general, courts are supporting tax authorities

- ❖ Lack of business purpose is considered enough to uphold the tax authorities views
- ❖ Complex transactions and structures are “per se” suspicious

## “Economic substance” vs. “business purpose”

### Hot French case law

- ❖ Luxembourg holding companies without substance = abuse of law
  - ❖ Lack of substance results from a body of evidences
  - ❖ NB: financial schemes particularly at risk because substance is difficult to create
- ❖ Treaty shopping = abuse of law
  - ❖ Literal application of treaty provisions against the objectives of their authors

### Hot tax reassessments

- ❖ Transfer pricing: management fees, distribution margin, transfer prices of products, interest rate
- ❖ Short term losses on shares

## “Economic substance” vs. “business purpose”

- ❖ Commencing in 1997 with the ACM Partnership case, the economic substance doctrine has become the IRS’s “weapon of choice” to combat taxpayer transactions because it:
  - ❖ is not triggered by defined transactions
  - ❖ is not limited to a particular type of tax benefit
  - ❖ requires a significant profit motive
  - ❖ does not have significant legal precedent defining the types of transactions that fall within it
  - ❖ requires the IRS to determine the intent of Congress on a case by case basis
- ❖ The codification of the economic substance doctrine will raise important issues
  - ❖ Statutory construction
  - ❖ Applicability of safe harbours
  - ❖ Whether in practice IRS examiners will disregard the relevance of the economic substance doctrine to a case by simply applying the two prong conjunctive test
  - ❖ Documentation and burden of proof

## “Economic substance” vs. “business purpose”

- ❖ Source basis of taxation; onerous withholding tax obligations
- ❖ Proposed GAAR under DTC applies to a tax avoidance transaction, if undertaken with the main purpose of obtaining a ‘tax benefit’ and it:
  - ❖ creates rights or obligations, which would not be created if the transaction was implemented at arm’s length; or
  - ❖ results in, directly or indirectly, misuse of the provisions of the DTC; or
  - ❖ lacks commercial substance in whole or in part; or
  - ❖ is implemented by means, which would not be normally adopted for bona-fide purposes
- ❖ A transaction is deemed to be lacking commercial substance if the transaction results in:
  - ❖ a significant tax benefit without having a significant impact on the business risks, or
  - ❖ net cash flows from a situation where the transaction would have been implemented at arm’s length
- ❖ India slow on alternate dispute resolution, MAP under tax treaties

## Change in business models

- Issues currently raised by inspectors:
  - Existence of a permanent establishment (PE) in Spain of a non resident company due to its operating in Spain through a dependent agent, in changes of a Spanish subsidiary-distributor (“fully fledged”) into a limited risk commission agent company or branch
  - Deductibility of charges for management support services borne by the Spanish subsidiary of a multinational group
  - Being questioned: actual existence and need for the services

Reassessments following a change in business model from a buy and sale activity to a commissioner activity

- ❖ Four different business models depending on the level of risk assumed
  1. Buyer and seller (has its own clientele)
  2. Limited risk buyer and seller
  3. Non disclosed commissioner
  4. Agent (no personal clientele)
- ❖ Change from a buy and sale activity to another business model may result in the disposal of an intangible asset
  - ❖ Reassessments of CIT and registration duty
- ❖ Risk of forfeiture of loss carry forwards in case of a change of activity
- ❖ Risk of creation of a permanent establishment in France
- ❖ Conclusion: problem of delimitation of each business model  
→ legal insecurity

## ❖ General

- ❖ India being 'observer', closely follows the developments at OECD
- ❖ India's position on OECD Model Commentaries is divergent from most other countries
- ❖ Sunset of most of the tax holidays and introduction of DTC and GST - key highlights of 2011

## ❖ International taxation

- ❖ Permanent Establishment – always a hot issue for India
- ❖ Judiciary's position on attribution tilted towards arm's length (Single entity approach)
- ❖ Many multinationals opting for Advance Rulings for gaining tax certainty
- ❖ Several rulings on international reorganisations involving contribution of Indian shares
- ❖ Income characterisation for software companies – still a challenge
- ❖ Revenue's stance remains aggressive

- ❖ Proposed Fundamental Changes to US International Tax Law
  - ❖ New Subpart F category added for “excessive returns” attributable to outbound IP transfers
  - ❖ Deferral of interest deductions allocable to unremitted foreign earnings
  - ❖ Determination of the foreign tax credit on a pooling basis
  - ❖ Prevent splitting of foreign income and foreign taxes
  - ❖ Limit income shifting through the transfer of intangible property

US as the foreseeable future in all the relevant jurisdictions

Announcement 2010-9 - Disclosure of Uncertain Tax Positions

- ❖ Calendar year 2010 and fiscal years beginning 2010
- ❖ Who is covered
  - ❖ Businesses with more than \$10 million in assets . . .
  - ❖ . . . With financial statements that include reserve for uncertain tax positions
- ❖ Required disclosures
  - ❖ Concise description of the uncertain position . . .
  - ❖ . . . And statement of “maximum exposure” if the taxpayer does not prevail

Context Behind Announcement 2010-9

- ❖ 2010-9 is intended to address two over-arching concerns:
  - ❖ Inability to identify and pursue the “right” issues
  - ❖ Inability to select the “right” returns for examination



## Transparency and Enforcement Initiatives

- Enhanced information exchanges
- Joint International Tax Shelter Information Centre (“JITSIC”)
- Simultaneous, coordinated examinations involving multiple jurisdictions

*“[W]e are develop[ing] a protocol to conduct joint audits with some of our treaty partners. ... [A] joint audit ... will reduce burden on a corporate taxpayer ... , as well as allow for competent authority resolution earlier in the process, ... [p]erhaps ... as part of the audit team itself. It will also ensure that the corporation gives the same information to both tax authorities, reducing opportunities for arbitrage.” Comm’r Shulman, Jan. 26, 2010 Speech to NYSBA Tax Section.*

- Goal:
  - More timely and less expensive examinations focused on “real” issues
  - More timely and improved guidance from the government to resolve “uncertain tax positions” on a prospective basis



## Transparency and Enforcement Initiatives

### ❖ Potential Pitfalls:

- ❖ Every disclosed issue becomes a potential adjustment
  - ❖ Human nature: “Give it to me and I will take it”
  - ❖ The climate
  - ❖ Process: Restrictions on Exam’s ability to resolve cases involving uncertain “legal” positions
- ❖ Increased scrutiny when a company’s reserves miss the mark at the end of an audit
  - ❖ Media, the Congress, regulators, shareholders
- ❖ Ripple effect, with state, local, and foreign tax authorities (and ultimately other regulatory bodies) joining the party

## “Best business practices” for Tax Governance of multinational groups

- ❖ Fifth OECD Forum held in Paris in 2009 on the international breach of tax legislation of its Member States. Work areas identified included:
  - ❖ Examining the role played by tax advisors and other tax intermediaries
  - ❖ Extending the OECD Guidelines of 2004 on corporate governance to include tax matters (“tax governance”)
  - ❖ Involving management bodies in the tax strategy of companies
  - ❖ Reinforcing the duty of accountants’ companies in the review of companies’ tax risks and reviewing their role when providing tax advice to the companies they audit
  - ❖ Reviewing the compatibility with principles of good governance of the success fee which tax directors and advisors receive for minimising companies’ tax burden

# OUR THOUGHTS ON BEST PRACTICE

“Best business practices” for Tax Governance of multinational groups

The “enhanced” relationship

- The company is obliged to
  - put tax management on the Board’s agenda
  - apply prudent tax policies
  - be totally transparent with the Tax Authorities
- In exchange, the Tax Authorities should accept:
  - a reasonable interpretation of the tax law
  - a fast-track procedure to reply to taxpayer’s questions
  - a reduced tax-audit burden

# OUR THOUGHTS ON BEST PRACTICE

The difficult questions for the Board suggested by the Governance Guide for Board Members and Directors issued by the Australian tax authorities

## •• About tax management

- Are tax payments in line with profits? Too low? How does the company compare with competitors on this?
- Are legislative changes duly analysed?
- Which is the evolution of DTAs?
- Which are the relevant Tax litigation cases?

## •• About relevant transactions

- Is there a true business purpose on top of the tax motivation?
- Is the complexity of the structure justified in pure legal or business terms?
- Is the advice received enough? Should Tax Authorities be consulted?
- The advice refer to the actual executed transaction?  
Are the assumptions accurate?

# OUR RECOMMENDATION

- ❖ Tax Governance – Procedures as a safe haven
  - ❖ There is a possibility that large corporations have to assume a quasi-objective responsibility in the tax area as has already happened in other areas (e.g. environmental, consumer protection or safety in the working place)
  - ❖ Strong internal Tax Governance procedures are the most appropriate way to show the Tax Authorities and the Courts, diligent behaviour

# CONCLUSIONS

- Public opinion is changing: less tolerance towards what is acceptable
- Avoid more than ever operations with tax havens and countries which do not exchange information (12 TIEAs test)
- Choose opportunities in EU countries or countries with well established tax treaties
- In connection with transactions and tax planning in general, it is appropriate to follow two test levels: Economic substance and business purpose
  - Substance is key
  - Economic / legal substance not sufficient on a standalone basis
  - Business substance is required
  - Is tax saving a legitimate business purpose?
  - Different approaches depending on the region / jurisdiction

# KEY CONTACTS

Please contact our Chair speaker or the relevant panel Taxander with any queries about this presentation

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Ricardo is the key Spanish member of the Board of Taxand and leads Garrigues, Taxand in Spain. Ricardo joined Arthur Andersen in 1982 and in 1993 was promoted to partner level within the Tax Advisory Division. Since 1997 he has been the head of the Garrigues Tax Division and member of the Managing Committee of the Firm and of the Professional Practice Committee.

His expertise includes group reorganisations and international deal structuring. He has worked in MBO and LBO transactions, project finance, acquisitions and product design for the banking industry.

He is a frequent speaker in seminars and conferences on these matters in Spain and abroad. He has been a member of the Editorial board of two of the Recoletos Group financial media (Expansión and Actualidad Económica) and publishes frequent articles about tax law and tax policies.



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Olivier is a key French member of Arsene Taxand, Taxand France, and one of the two founding partners of Arsene Taxand. He was also a previous partner at Archibald Andersen. Olivier regularly assists companies in their acquisition and restructuring projects to help optimise tax conditions of their operations (structuring, acquisition due diligence, vendor due diligence, tax analysis of financial flows). His fluency in English and German make him the partner of choice for international transactions, particularly those between Germany and France.



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Mukesh regularly interacts with India's Inland Revenue, CBDT and is a member of OECD's Business Restructuring Advisory Group and ICC, Paris Taxation Commission. He actively participates in Indian affairs of the International Fiscal Association and has been its Secretary General. Mukesh is a regular speaker at significant national and international tax conferences. He regularly contributes to leading tax journals including ITR, Asia-Pacific guide of IBFD. LexisNexis Butterworths recently published his treatise 'Transfer Pricing-An Indian Perspective'. He is actively associated with IFA India's International Fiscal Academy.



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Ernie has counselled clients on domestic and cross-border transactions focusing on tax structuring, due diligence and financial modelling. He has also advised clients in all areas of outbound and inbound international taxation. Ernie has extensive experience with domestic corporate tax issues, partnership taxation and consolidated group matters.

Previously, Ernie was a partner with Arthur Andersen and Deloitte & Touche. At Andersen, Ernie served as Practice Leader for the firm's International Tax Practice in Florida.





## ABOUT TAXAND

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