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Tax avoidance in a globalised world

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Foreword

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There used to be a time when the OECD, and even the UN, focusing on taxation, primarily cared about the development of international trade through the elimination barriers created by taxes and customs duties. By establishing a model tax treaty designed to serve as a base for future bilateral conventions, these organisations followed the path initiated in the 1920s by the League of Nations. Only in the 1990s did the OECD start thinking seriously about limiting the global impact of tax havens, namely of tax jurisdictions which facilitated tax evasion through an aggressive conception of tax secrecy.

Against this historical background, the idea that aggressive tax planning – or "tax avoidance"– intended with a pejorative connotation – is harmful, of itself appears to be quite recent. The 2007/2008 crisis played the decisive role in this: with the mandate given by the G20 countries to the OECD, this organisation built up an ambitious action plan against base erosion and profit shifting ("BEPS") in a remarkably short period (if one compares it to the long period required to move forward in order to convince States to become fully transparent with their partners). This recent historical trend explains why globalisation not only brings about a harmonisation of treaties; it also fosters a fast convergence of legislations in the field of tax avoidance.

This Guide is an excellent illustration of the ongoing development of anti-avoidance tools on every continent. Africa, Europe, Latin America and Asia are equally concerned. General anti-avoidance rules ("GAARs") have become a common feature of almost all tax systems, even of those which used to be very resistant to this kind of legal technique (such as the UK). GAARs are now to be found in the Anti-Tax Avoidance Directive ("ATAD") in Europe, in China, in Latin America and in many Francophone African countries. Other techniques are also widespread all over the world, such as controlled foreign corporation ("CFC") rules, interest limitation rules and exit taxes. Certainly, this is not entirely new, as many countries had introduced such techniques even before the start of the BEPS Action Plan. Nevertheless, a distinct new trend is emerging which consists of the technical convergence of these mechanisms regardless of their date of introduction or modification. This is particularly obvious in the field of transfer pricing documentation requirements, which are starting to coincide worldwide.

There are naturally limits to this global convergence. Not all continents follow the same course at the same pace. While Africa has moved forward very rapidly in the recent years, not all African countries stand on same footing in this respect. While the German-type "interest barrier" tends to become a model in Europe and in the OECD approach, many countries remain faithful to their traditional thin capitalisation rules relying on debt-equity ratios. Domestic policies regarding withholding tax rates also remain quite different from country to country. Transfer pricing philosophies still vary significantly between proponents of the arm's length principle and supporters of alternative techniques. But for how long?

In the light of this evolution of domestic tax systems and of the adoption of the Multilateral Instrument ("MLI") implementing the BEPS Action Plan under the auspices of the OECD, one may wonder whether there is some space available for tax planning in the future. Will compliance be the sole driver of the tax behaviour of multinational companies in the future?

Probably not. Even though the OECD has devoted considerable energy to convince States to adopt common standards regarding tax avoidance, it has not been able to convince anyone to give up tax competition at a global level. The recent US tax reform is yet another sign of the times: economic wars are to be fought through tax instruments. If our tax world is sick, the diagnosis is easy and the illness is called schizophrenia, with States trying at the same time to distort competition between economic actors and to punish anyone who takes advantage of these distortions. Although the BEPS Action Plan has tried to circumvent this paradox by enhancing the idea that profits should be taxed where they are actually generated, it remains to be seen whether States will *actually* agree on where value is created.

This drives to a final observation: while many legal developments around the world look alike, the vagueness of many tax concepts designed to fight aggressive tax planning is such that harmonisation of anti-avoidance rules in real life is still far ahead of us.

What is Europe Doing about Tax Avoidance?

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Importance of the Anti-Tax Avoidance Directive

The Anti-Tax Avoidance Directive (2016/1164) (the "ATAD" or "Directive") (Council Directive 2016/1164 of July 12, 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market, (OJ L 193/1 (2016), EU Law IBFD) represents a turning point in the history of European Union ("EU") tax legislation. This directive, which is strongly influenced by the OECD Action Plan on BEPS, establishes a minimum framework that EU Member States have to implement in order to address tax avoidance practices that, according to its title, "directly affect the functioning of the internal market".

Member States are, therefore, faced with an obligation to transpose the ATAD into their domestic legislation and, in doing so, make structural policy choices that are likely to affect their tax systems in the long run. (According to article 11 of the ATAD, Member States must transpose the Directive before 31 December 2018, and apply its provisions from 1 January 2019. This principle contains, however, a few exceptions: as far as exit taxation is concerned, the deadline is one year later (with a sub-exception for Estonia, which benefits from a specific treatment regarding exit taxation because of the unique features of its tax system). Also, article 11.6 stipulates that "by way of derogation from Article 4, Member States which have national target rules for preventing BEPS risks at 8 August 2016, which are equally effective to the interest limitation rule set out in this Directive, may apply these targeted rules until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on the official website on a minimum standard with regard to BEPS Action 4, but at the latest until 1 January 2024.")

The historical importance of the ATAD is not only attributable to the fact that it lays down rules of substantive law that go far beyond the reach of existing directives in the field of direct taxation (which, in short, are mainly aimed at eliminating tax surcharges that adversely affect the functioning of the internal market). The ATAD's importance is also due to its very broad scope, which is defined in article 1. The ATAD indeed "applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country." Although Recital 4 of the ATAD clarifies that this scope does not extend to entities that are considered to be transparent for tax purposes, one understands that the ATAD constitutes a first step towards a more general harmonisation of tax bases for groups of companies operating within the EU – a more general trend that is now gaining headway as a result of the publication by the European Commission of two proposals on the common (consolidated) corporate tax base ("C(C)CTB") (these two proposals are part of the package released by the Commission on 25 October 2016: Proposal for a Council Directive on a Common Corporate Tax Base, COM (2016) 685 final and Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM (2016) 683 final).

It is evident, in particular, that even purely domestic situations might fall within the scope of the ATAD. Although some provisions of the Directive (such as rules on controlled foreign corporations, exit taxes and hybrid arrangements) might only affect cross-border situations, others may well apply regardless of any international element: interest limitation rules have a general scope and, therefore, their application is not limited to cross-border financing structures; the anti-abuse mechanism enshrined in article 6 is of a general nature as well. While article 115 of the Treaty on the Functioning of the European Union (2007), which is the legal basis for the adoption of the ATAD, makes a connection between the approximation of laws and rules that "directly affect the establishment or functioning of the internal market," it is noteworthy that the Member States have chosen to agree on a means of harmonisation that might, in specific situations, have a rather remote connection to the internal market.

Interest Limitation Rule

The interest limitation rule is aimed at restricting the base erosion and profit shifting pursued by multinational groups which place higher levels of third party debt in high tax countries or use intra-group loans to generate interest deductions exceeding the group's actual third party interest expenses.

Article 4 of the ATAD combats the above phenomenon by stating that corporate taxpayers are only entitled to deduct exceeding borrowing costs ("exceeding borrowing costs" means the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law) incurred up to 30% of their tax EBITDA. The latter is calculated by adding back to the taxable income the tax-adjusted amounts of interest and depreciation and amortisation expenses.

In line with recommendations of BEPS Action 4, article 4 contains a number of derogations granting some flexibility to Member States for the implementation of the new rule. It appears that such flexibility may create competition among Member States; the various derogations may indeed drive a situation where different tax systems, though all compliant with the Directive, may differ significantly from each other in terms of overall burden suffered by resident taxpayers and, to some extent, may increase transnational tax planning for multinational groups (unless the draft directive on a CCTB, which contains fewer options for Member States, actually limits their flexibility in practice).

In particular, paragraph 3 provides that Member States may allow taxpayers to fully deduct exceeding borrowing costs in case of standalone entities not affiliated to any group, as well as giving them the right to introduce a *de minimis* threshold up to EUR 3m. For entities part of a group the threshold shall be calculated at group level. The facilitations are clearly both aimed at reducing the administrative costs associated with the limitation rule, excluding entities associated with a low risk profile of base erosion and profit shifting and allowing the tax authority to focus on the entities with a higher risk.

Notwithstanding the above, the impact of the Directive will be less important for economies characterised by a high number of small- and medium-sized entities (e.g., Italy, Greece): in those cases, the introduction of a *de minimis* threshold may dramatically reduce the scope of the restriction.

Member States are also given the opportunity to enact a grandfathering clause for loans concluded before 17 June 2016, but not for their subsequent amendments, and to exclude from the exceeding borrowing costs those interests related to long-term public infrastructure projects. In such cases the income associated with the projects must be excluded from earnings before interest, tax, depreciation and amorisation ("EBITDA").

In addition to the above, paragraph 5 lays down the possibility under certain conditions to grant the interest deductibility in full to taxpayers which are part of a consolidated group for financial purposes, to the extent that the entity's equity over its total assets is equal to or higher than the equivalent ratio calculated for the group.

Alternatively, in line with BEPS Action 4, the ATAD also allows a taxpayer to deduct net interest applying the group ratio rule instead of the fixed ratio up to 30% mentioned above. The group ratio rule looks after those companies whose leverage is a consequence of the specific sector in which they operate, rather than the result of a non-genuine tax planning strategy (based on this, the taxpayer may be allowed to deduct the exceeding borrowing costs up to the amount calculated by multiplying its EBITDA by the higher of the fixed rate (up to 30%) or the group rate (group net third party interest/group EBITDA)).

Lastly, Member States have the option to introduce a carry forward mechanism, alone or combined with the carry back of exceeding borrowing costs for three years or the carry forward of unused EBITDA capacity for five years.

Exit Taxation

The exit taxation rule is provided for by article 5 of the ATAD.

The goal of this measure is to establish a common framework which allows Member States to tax the economic value of any capital gain created in their territory, even though that gain has not been realised at the time of the exit.

Article **5 (1)** of the ATAD identifies the following scenarios:

a) transfer of assets from the head office ("HO") to a permanent establishment ("PE") of another Member State/country;

b) transfer of assets from a PE in a Member State to an HO or PE of another Member State/country;
c) transfer of the tax residence to another Member State/country; or
d) transfer of the business of a PE from a Member State to another Member State/country.

In all the above cases, tax shall apply only if assets and/or businesses are actually moving thus resulting in the risk for the country of origin to lose its right to tax. Taxation shall not apply to the extent that assets and/or businesses are linked to a PE maintained in the state of origin.

Article 5 of the ATAD introduces the right to defer the payment of exit tax over five years (see CJEU National Grid Indus (Case C-371/10) concluding that an immediate payment of exit tax results in the breach of the freedom of establishment, as well as cases DMC (Case C-164/12) and VerderLabTec (Case C-657/13)).

The provision applies also to transfers to third countries that are party to the European Economic Area agreement if they have concluded an agreement with the Member State of the taxpayer or with the EU on the mutual assistance for the recovery of tax claims.

The deferral of the payment is subject to some limitations if there is a demonstrable and actual risk of non-recovery: in such case, the taxpayer may be required to provide guarantees to defer the payment.

In addition, the deferred payment will be immediately revoked where:
— the transferred assets or the business carried on by the PE are sold or otherwise disposed of;
— the transferred assets are subsequently transferred to a third country;
— the tax residence of the taxpayer or the business carried on by its PE is subsequently transferred to a third country;
— the taxpayer goes bankrupt or is wound up;
— the taxpayer fails to honour its payment obligations in relation to the instalments and does not spontaneously settle the situation within a reasonable period of time.

Some considerations are relevant to the computation of the taxable base on which the tax must be calculated.

According to article 5, the taxable base is equal to the difference between the value of the assets (i.e., the market value – the amount for which an asset can be exchanged or mutual obligation can be settled between willing unrelated buyers and sellers in a direct transaction) and their value for tax purposes.

In this last regard, complexity may arise for companies which hold intangible assets (patents or trademarks) and for holding companies owning financial assets.

In addition, a potential conflict may derive from article **5 (5)**, which lays down that the exit value taxed by the Member State of origin should be recognised as starting tax value by the host state, unless it does not reflect the market value. It goes without saying that both countries may have an interest in maximising their respective rights to tax. Considering the risk of double taxation which this provision entails, one should welcome the agreement reached by the Council on 23 May 2017 on a draft directive to resolve double taxation disputes within the EU.

Finally, article **5 (7)** provides that exit tax is not due where assets are set to revert in the Member State of the transferor within a period of 12 months as of the financing of securities, assets posted as collateral or where the asset transfer takes place in order to meet prudential capital requirements of purpose of liquidity management.

General Anti-Abuse Rule

Article 6 of the ATAD contains a broad general anti-abuse rule which is designed to challenge abusive tax practices which are not supported by economic substance.

Paragraph 1 provides that Member States shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

The preamble to the ATAD clarifies that the GAAR applies in domestic situations within the EU and *vis-à-vis* third countries in a uniform manner so that its scope and result of application in domestic and cross-border situation does not differ. This intention may however be difficult to realise, as, similarly to the principal purpose test provided for by Action 6 of the BEPS Action Plan, such a general clause has a certain degree of unpredictability, and it is likely that each administration will apply it pursuant to its past domestic experience and to the general attitude of local tax administrations *vis-à-vis* abuse of law and aggressive tax planning in general.

Controlled Foreign Corporation Rules

The CFC rules introduced by articles 7 and 8 address base erosion and profit shifting by reattributing the income of a low-taxed CFC to its parent company, making them taxable in the "home jurisdiction."

The rule represents an important milestone in the European harmonisation process considering that, although many Member States are familiar with CFC rules, more than half of the current Member States do not have CFC rules in place.

The CFC rules will apply only where the following conditions are both satisfied:

a) the taxpayer by itself, or together with its associated enterprises, owns a direct or an indirect participation of more than 50% of the voting rights or owns directly or indirectly more than 50% of capital or is entitled to receive more than 50% of the profits of the entity; and
b) the actual corporate tax paid on its profit by the entity or by the PE is lower than the difference between the corporate tax that would have been charged on the entity or PE under the applicable corporate tax system in the Member State of the taxpayer and the actual corporate tax paid on its profit by the entity or PE.

Member States have been given the choice of two different ways to determine the taxable base. The first option (article **7(2)(a)**) provides that the taxable base is equal to the non-distributed income of the CFC deriving from certain categories of income: interest, royalties, dividends and income from the disposal of shares, income from financial leasing and others. The second option instead looks after the non-distributed income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage.

As far as the first option is concerned, Member States which adopt the above regime may opt not to treat an entity or PE as a CFC if no more than one-third of the income accruing to the entity or PE falls within the categories of non-distributed income under article **7(2)(a)**.

In addition, Member States can also override the CFC rules for financial entities where no more than one-third of their income coming from the categories listed by article **7(2)(a)** refers to transactions with the taxpayer or its associated enterprises.

As far as the second option is concerned, the business is deemed non-genuine where the entity or PE would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.

Where Member States opt for the above approach the income to be included in the tax base of the taxpayer shall be limited to the amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company applying the arm's length principle.

The Directive states some additional exclusions giving Member States the faculty of not considering as CFCs entities with accounting profits of no more than EUR 750,000, and non-trading income of no more than EUR 75,000, or whose accounting profits amount to lower than 10% of the operating costs for the tax period.

As a general rule, under this regime the tax base shall be calculated according to the rules of the corporate tax law of the Member State where the controlling company is resident for tax purposes or situated. A specific regime is also stated for losses suffered by the CFC which shall not be included in the tax base but may be carried forward, according to national law, and deducted in the following tax periods.

Income will be included into the tax base of the controlling company of the fiscal year in which the tax year of the entity ends.

Furthermore, income already included in the tax base shall be deducted from the tax base when calculating the amount of tax due on the non-distributed profits, in order to avoid double taxation.

Hybrid Mismatches

The purpose of the provision on hybrid mismatches (article 9 of the ATAD) is to neutralise the tax effects of hybrid mismatch arrangements that exploit differences in the tax treatment of an entity or instrument under the laws of two or more Member States to achieve a deduction in both states or a deduction of the income in one state without inclusion in the tax base of the other.

The rule contained in article 9 is in line with the recommendations contained in the final report on Action 2 of the OECD BEPS Action Plan. However, it is much more modest in scope, being brief and applicable only to intra-EU situations. It considers hybrid mismatches which result in a double deduction, to be tackled by allowing the deduction only in the Member State where such payment has its source, or mismatches which result in a deduction in the Member State without inclusion in the taxable base in the other state, to be tackled by the first state by denying the deduction of such payment.

Because of the limited scope of the hybrid rule in the ATAD, the European Commission issued another proposal in October 2016 in order to extend the scope of article 9 to third countries and to other forms of hybrid mismatches.

After a first meeting on 21 February 2017, the European Parliament gave its opinion on 27 April 2017 and, finally, on 29 May 2017, the Council of the European Union adopted the Council Directive amending Directive (EU) 2016/1164 and introducing new provisions regarding hybrid mismatches with third countries ("ATAD 2").

Conclusion

The ATAD is likely to have a huge impact on domestic tax systems. While all systems are not affected to the same extent (as some systems clearly served as sources of inspiration for some articles), all of them will have to be reformed in a rather significant way.

What is China Doing on Anti-tax Avoidance?

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The legal environment for transfer pricing and anti-tax avoidance in China has changed significantly over the past few years. Chinese tax authorities are making continuous efforts to create a fairer and more transparent tax environment for international trade and cross-border transactions: multinational corporations with operations in China will need to pay increasing attention to transfer pricing and anti-tax avoidance regulations going forward.

On 7 June 2017, Mr Wang Jun, Commissioner of the State Administration of Taxation ("SAT"), signed the BEPS Action 15 Multilateral Instrument on Tax Treaty Measures to Tackle BEPS ("MLI") on behalf of the People's Republic of China ("PRC"), which marked one of the milestones in China's efforts towards anti-tax avoidance.

New Measures on Tax Avoidance Introduced

Looking back over the past few years, the China SAT has been devoted to improving the domestic legal environment for anti-tax avoidance. *Guoshuifa* [2009] No. 2 Special Tax Adjustment Implementation Measures ("Announcement 2"), issued in 2009, used to be the key guideline for anti-tax avoidance and transfer pricing in China. From 2015, however, in the context of the OECD Action Plan on BEPS, the SAT started to issue a series of new rules and regulations, which has led to significant changes
in the transfer pricing and anti-tax avoidance environment in China:

- on 17 September 2015, release of the Discussion Draft of Special Tax Adjustment Implementation Measures for public discussion, aiming at comprehensively revising the existing Announcement 2;
- on 29 July 2016, release of Announcement [2016] No. 42 Announcement on Reporting of Related Party Transactions and Contemporaneous Documentations ("Announcement 42"), partially replacing relevant chapters of Announcement 2;
- on 11 October 2016, release of Announcement [2016] No. 64 Announcement on Improvement on Administration of Advance Pricing Arrangements ("Announcement 64"), partially replacing relevant chapters of Announcement 2;
- on 17 March 2017, release of Announcement [2017] No. 6 Announcement on Administration of Special Tax Investigation and Adjustment and Mutual Agreement Procedures ("Announcement 6"), partially replacing relevant chapters of Announcement 2.

General Anti-avoidance Rule

The SAT has introduced a general anti-avoidance rule which serves as a broad general rule to crack down on tax avoidance arrangements.

From a historical perspective, the GAAR in China was originally introduced by article 47 of the PRC Corporate Income Tax ("CIT") Law in 2008. In 2009, with the release of Announcement 2, general principles on the implementation of GAAR were further provided. In 2014, the SAT issued Administrative Regulations for the General Anti-Avoidance Rule (Trial) ("SAT Announcement [2014] No. 23"). In conjunction with the PRC CIT Law and Announcement 2, SAT Announcement [2014] No. 23 provides a more comprehensive and transparent legal environment for GAAR implementation in China.

According to the GAAR in China, licence fees or service fees paid to related parties should match the economic benefit that the licence/service brings to the licensee/service recipient. Tax authorities shall redefine the nature of a tax avoidance arrangement based on business substance, and revoke an enterprise's tax benefit obtained from the tax avoidance arrangements. Tax authorities may, from a tax perspective, deny the existence of enterprises without economic substance, particularly those which are established in tax havens and result in the tax avoidance of their associated or unassociated parties.

The GAAR is usually adopted in testing the reasonableness of related party transactions: one example could be the outbound payment of service fees, where the SAT has increasingly focused in recent years.

The following paragraphs provide a detailed introduction to the GAAR in China.

Scope of GAAR

When tax authorities conduct a special tax adjustment based on article 47 of the PRC CIT Law to address a deliberate "tax avoidance arrangement", the GAAR shall apply. Generally, business arrangements with the two characteristics described below are likely to be deemed "tax avoidance arrangements":

- the sole purpose or main purpose of the arrangement is to obtain tax benefits; and
- although the business arrangement appears to qualify for a tax beneficial treatment from a legal perspective, its business nature is not in line with its legal format.

The above-mentioned term "tax benefits" refers to tax consequences such as CIT reduction, exemption or deferral.

However, according to article 2 of Announcement [2014] No. 23, the GAAR does not apply to the following situations:

- arrangements irrelevant to cross-border transactions or payments;
- illegal behaviour, including tax avoidance, fraud for tax refund, other tax fraud, etc.

Further, according to article 6, where a business arrangement falls within the scope of a typical special anti-tax avoidance arrangement, including transfer pricing, cost sharing arrangement, controlled foreign corporations, thin capitalisation, etc., tax authorities shall first apply corresponding special anti-tax avoidance rules (which will be addressed later in this article). Similarly, if tax treaty provisions or a domestic rule on the application of a treaty is applicable (such as rules on beneficial ownership or limitation of benefits), such treaty provisions or domestic rules shall prevail over the GAAR.

General Methods of Adjustment

According to the GAAR, tax authorities may adopt one of the following methods to deny the tax benefits obtained through a tax avoidance arrangement:

- entirely or partially recharacterising an arrangement;
- denying the existence of a certain transaction party, or deeming certain transaction parties as the same one single entity, from the perspective of business nature and substance;
- recharacterising of income, deductible cost, tax beneficial treatment, foreign tax credit, or reallocation of the said items among relevant parties involved in the transaction; or
- other methods which they consider as reasonable.

Standard Procedures of GAAR Application

Case Registration

Local tax authorities are generally responsible for identification of cases subject to a tax special adjustment. However, considering that anti-tax avoidance cases are usually quite complicated, application for case registration shall be reviewed and approved by upper level tax authorities – the provincial tax authorities and the SAT.

Investigation

Local tax authorities are generally responsible for carrying out the detailed process of investigation.

Tax authorities have the right to require taxpayers to provide sufficient information, including background information on the business arrangement, documents explaining the commercial purpose of such arrangement, internal documents related to the arrangement, etc. Upon receiving the Notice of Tax Assessment from the tax authorities, taxpayers are obliged to submit the required documents within 60 days. In special circumstances, a 30-day extension may be granted. If a taxpayer fails to provide the documents required, the tax authorities may deem an amount of tax payable based on the relevant regulations and standard procedures.

The tax authorities have the right to obtain information connected to overseas entities via information exchange systems, or other applicable methods. The tax authorities also have the right to require a party or individual that is involved in tax planning for the entity under investigation to provide relevant information and documents.

Issuing Notice of Special Tax Adjustment

Upon receiving the SAT's approval for the case registration, the tax authority in charge shall proceed with the investigation within the following nine months. Final assessment shall be made based on the review and approval from provincial tax authorities and the SAT.

Upon receiving approval from the SAT, the local tax authorities in charge shall issue an Initial Notice of Special Tax Adjustment to the taxpayer. The taxpayer is allowed to appeal with the upper level tax authorities within seven days of receiving that Notice. The taxpayer's appeal will be reported to, and eventually assessed by, provincial tax authorities and the SAT. If the taxpayer accepts the tax assessment, or if the taxpayer's appeal is rejected, a final version of Notice of Special Tax Adjustment will be issued by the tax authority in charge.

Dispute resolution

If a taxpayer does not agree with the result of the tax adjustment, the taxpayer is allowed to seek legal assistance in accordance with applicable PRC law. Any domestic double taxation resulting from the tax adjustment shall be settled by the SAT. If the tax adjustment leads to cross-border double taxation, the taxpayer may apply to enter a mutual agreement procedure.

Attitude of the SAT towards Anti-tax avoidance and Special Tax Adjustment

The SAT is making continuous efforts on anti-tax avoidance and special tax adjustment. In recent years, the following trends in the SAT's approach can be identified.

Monitoring of Profit Level

Over the past few years, only enterprises under a tax audit have been subject to monitoring by the tax authorities on an ongoing basis, over a five-year follow-up supervision period. With the release of Announcement 6, however, all enterprises in China will be monitored on their profit level over a period of time, through annual reporting of related party transactions. This means that enterprises with an unstable profit level are more likely to be identified and targeted for tax audit. This trend indicates that Chinese tax authorities are making efforts to work out a more comprehensive method for special tax investigation and adjustments. In this context, it is now more important than ever that enterprises in China should efficiently manage their transfer pricing risks through their daily operation.

Types of Enterprises Likely be Targeted for Tax Audits

Announcement 6 makes it clear that enterprises with the following typical characteristics will be more likely to be targeted for tax audit or special tax adjustment:

(i) enterprises with a large amount of related party transactions, or which are engaged in various types of related party transactions;

(ii) enterprises making a loss, low profits or unstable profits, over a period of time;

(iii) enterprises whose profit level is lower than the average level of the relevant industry;

(iv) enterprises whose profit earned does not match the functions and risks undertaken, or whose profit allocated does not match the costs borne;

(v) enterprises that are engaged in transactions with related parties located in countries or regions with low tax rates;

(vi) enterprises that do not meet the compliance requirements including contemporaneous documentation and annual report of related party transactions;

(vii) enterprises whose related party debt-to-equity ratio has exceeded the upper limit;

(viii) foreign enterprises which are controlled by PRC resident enterprises and/or individuals, and established in a country or region where the effective tax rate is lower than 12.5%, and which do not distribute profits or reduce profit distribution without reasonable business needs;

(ix) enterprises that are engaged in other transactions without proper commercial reasons.

It is noteworthy that items (vii)–(ix) are newly included in Announcement 6 compared to the previous regulations; we can see the trend that with more Chinese entities expanding their business overseas, Chinese tax authorities are increasingly paying attention to such so-called "go-global companies."

Hidden Transactions

Announcement 6 brings up the concept of "hidden related party transactions," indicating that any hidden related party transactions which directly or indirectly result in the reduction of the SAT's overall tax income shall be restored for special tax adjustment purposes. For example, if a PRC enterprise provides services or licences to an overseas related party free of charge, such transaction will be "hidden" as there is no cash flow of remuneration for the transaction. However, such "hidden transaction" can be restored, if evidence is found which can prove the existence of such transaction. Such "hidden transactions" are likely to increase with more Chinese enterprises expanding their business overseas.

Intangibles

Announcement 6 stipulates that an entity cannot share returns derived from intangibles if it only legally owns the intangibles without actually making contribution to the value creation of the intangibles. To assess the degree of contribution, various aspects have to be considered, including overall business model and operational status of the group, each group entity's activities in relation to development, enhancement, maintenance, protection, exploitation and promotion of the intangibles, etc.

It is worth noting that Announcement 6 provides for the principles of transfer pricing administration not only for "payment of licence fees," but also for "receipt of licence fees." This may also be seen as evidence that Chinese tax authorities are increasingly focusing on the go-global companies, which are gradually taking on the role of royalty licensors.

Related Party Services

According to Announcement 6, related party services in line with the arm's length principle should be beneficial services and priced based on fair value under normal business circumstances. "Beneficial services" refers to the services which can bring direct or indirect economic interest to the service recipient, and where a non-related party is also willing to purchase or voluntarily carry out the service activities by itself in the same or similar situations. If an enterprise pays service fees to related parties for non-beneficial services, tax authorities can initiate special tax adjustment by disallowing the enterprise from deducting the full costs arising from the service charges from its taxable income for PRC CIT purposes.

Non-beneficial services mainly include the following:

- the services provided by related parties overlap with the activities already conducted by the service recipient itself or purchased by the service recipient from other parties;
- the fees charged are for investment-related activities that benefit the direct or indirect shareholders (e.g., activities of controlling, managing and supervision of the invested companies) of the service recipient;
- the benefits obtained by the service recipient come from extra interest of just being a member of a certain company group, but no concrete services are specifically provided;
- the relevant activities of related parties have already been compensated for in other transactions;
- the related party services are not related to the functions and risks undertaken by the service recipient or are not in line with the business needs of the service recipient;
- other service activities of related parties that do not bring direct or indirect economic interest to the service recipient or the services that a non-related party is not willing to purchase or voluntarily carry out by itself.

Location-specific Factors

It is noteworthy that, differently from developed countries which consider intangibles as one of the most important profit-making factors, Chinese tax authorities are emphasising the contribution of location-specific factors, such as location savings, market premiums, etc., to an entity's profit-making capability. In other words, the Chinese tax authorities may hold the view that additional return should be returned to China, if extra profit has derived from such special location factors closely related to the Chinese market. The Chinese tax authorities' attitude towards location-specific factors is also reflected in another tax document – Announcement 64, which provides for new rules of administration on advanced pricing arrangements ("APAs"). According to Announcement 64, an APA application is more likely to be accepted by the tax authority if an applicant takes into consideration location-specific factors.

Special Anti-avoidance Rule ("SAAR")

Cost Sharing Arrangements

Announcement 2 (articles 69 and 74 being annulled) and Announcement 42 supply provisions on administrative guidance on cost sharing arrangements ("CSA"), according to which participants of a CSA are entitled to the beneficial right of the joint development or assignment of intangible property or participation in services, and therefore should bear the corresponding costs of such activities. The costs borne by the associated parties should be consistent with the costs which would be spent by unrelated parties seeking the beneficial right under comparable conditions. An enterprise's beneficial right associated with a CSA involving intangible assets or services should be based on reasonable and measurable expected returns and based on reasonable business assumptions and operational conversations. CSA participants are not required to pay a royalty for the use of intangible assets developed or received by the CSAs.

During the implementation of a CSA, if the actual costs which the participants share do not match the actual benefits received, compensating adjustments should be made based on the actual situation. The costs allocated to an enterprise under a CSA signed with its associated parties will not be tax deductible where:

- the CSA does not have a solid commercial purpose or economic substance;
- the CSA does not comply with the arm's length principle;
- the allocation of costs and benefits does not comply with the principle that cost should match with income;
- the enterprise has not completed a record process for the CSA, or has not prepared, maintained and submitted contemporaneous documents with respect to the CSAs as required; or
- the enterprise's future operational period will be less than 20 years from the date when the CSA is signed.

Currently, in China, a CSA related to services is generally applicable to group purchase and group marketing planning activities. However, current CSA regulations in China have not provided clarifications on tax implementation and treatment: there is, therefore, still much to be done on a practical level with regard to CSAs in China.

Controlled Foreign Corporations

Announcement 2 includes rules on controlled foreign corporations.

CFCs refer to foreign enterprises which are controlled by resident enterprises and/or individual residents of the PRC ("Chinese resident shareholders," including Chinese resident enterprise shareholders and Chinese resident individual shareholders) and established in a country or region where the effective tax rate is 50% lower than the tax rate of 25% stipulated by the PRC CIT Law and which do not distribute profits or reduce profit distribution without reasonable business needs.

Announcement 2 provides a definition of "control", which refers to situations where substantial control is formed in respect of shareholding, financing, business, purchase and sales, etc. "Control in respect of shareholding" refers to the situation where any single one of the Chinese resident shareholders directly (through a single layer) or indirectly (through multiple layers) holds more than 10% of total voting shares of a foreign enterprise in any day of the taxable year, and all of such Chinese resident shareholders jointly hold more than 50% of total shares of the foreign enterprise.

Moreover, Announcement 2 introduces a calculation method for percentage of shareholding when indirect multiple layer shareholding is involved, as well as a calculation method for deemed dividend income from a CFC that is to be included in the Chinese resident enterprise shareholder's taxable income of the current period.

The deemed dividend income may be exempt from being included in a Chinese resident enterprise shareholder's taxable income of the current period, if any one of the following conditions is met:

- the CFC is located in a non-low-tax-rate country/region, which is designated by the SAT;
- the CFC mainly derives income through active business activities; or
- the annual profits of the CFC are less than CNY 5m (approximately EUR 625,000).

However, there are regulations to avoid double taxation – if the deemed dividend is already taxed overseas, the overseas income tax may be credited in accordance with relevant provisions of the PRC CIT Law or double tax treaties. In addition, if the profits actually distributed by a CFC have already been taxed in accordance with the PRC CIT Law, such profits can be excluded from the Chinese resident shareholder's taxable income of the current period.

Thin Capitalisation

According to the PRC tax regulations, for enterprises in China, any interest expense arising from the related party debt exceeding twice (for non-financial institutions) or five times (for financial institutions) the equity investment in the company cannot be deducted from the taxable income for CIT purposes unless sufficient evidence can be provided to prove that such loan arrangement is made on the arm's length principle. Announcement 2 (article 89 annulled) and Announcement 42 provide for detailed rules on thin capitalisation in China, including calculation methods, compliance requirements, etc.

Non-deductible interest expenses cannot be carried forward to the following tax years, and should be allocated among associated parties according to the proportion of interest actually paid to each associated party against total interest expenses. Such interest allocated to domestic parties which have a higher effective tax rate will be allowed to be deducted for CIT purposes, while interest paid to overseas parties directly or indirectly shall be deemed as dividend distribution, and any gap for tax liability between interest expense and dividend should be made up. Any tax overpayment which resulted from the above treatment will not be refunded.

Conclusion

The legal environment for transfer pricing and anti-tax avoidance in China has changed significantly during the past few years. Chinese tax authorities are continuously making efforts to create a fairer and more transparent tax environment for international trade and cross-border transactions. Foreign companies will need to pay increasing attention to transfer pricing and anti-tax avoidance regulations in China.

What is Africa Doing About Tax Avoidance?

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The anti-avoidance issue is not new in Africa, since African countries are directly concerned by base erosion – their revenue substantially deriving from income tax paid by companies carrying out activities in Africa.

Even before the implementation of the OECD's plan to combat BEPS, African countries had already begun to amend their laws and to implement anti-avoidance measures to address this issue, which has harmful consequences for their economies. With the increase of international economic relations, African countries are more and more conscious of the necessity to come up with relevant national and international laws and measures to address the BEPS issue. In addition, regional bodies like the African Tax Administration Forum, of which 34 African countries are members, play a significant role in building capable African tax administrations that develop, share and implement best practices.

To date, eight Francophone African countries are members of the Inclusive Framework on BEPS, namely Benin, Burkina Faso, Cameroon, Congo, Côte d'Ivoire, Gabon, Democratic Republic of Congo and Senegal; Angola is also a member. They have thus committed to implement the OECD BEPS package in their legislation.

However, Africa groups more than 50 countries. Tax avoidance, and the fight against it, may therefore cover very different realities from one jurisdiction to another. There are several examples of legislation in Francophone sub-Saharan African countries and Lusophone African countries, which fall under our direct competencies.

These countries have implemented four of the main types of anti-avoidance rules against international tax planning, namely:
- transfer pricing rules;
- thin capitalisation rules;
- controlled foreign corporation rules;
- general anti-avoidance rules.

With regard to withholding tax rules and rules limiting the deduction of remuneration for services paid to nonresidents, these are not anti-avoidance rules in a strict sense but they certainly can influence companies' profit shifting opportunities.

Transfer Pricing Rules

Most Francophone African countries have adopted transfer pricing rules to prevent companies from manipulating the price of related party transactions for tax purposes. These rules are generally introduced in the general tax code and based on the arm's length principle.

Some countries have only introduced general transfer pricing rules without further details on acceptable methods or documentation requirements (e.g., Central African Republic, Chad, Togo).

Where a documentation requirement exists, its level differs among countries.

In Guinea, Mali, Niger and Senegal, the transfer pricing documentation is required at the beginning of a tax audit for companies reaching a turnover threshold (e.g., CFA francs 5bn – approximately USD 9m – of turnover in Senegal).

In certain countries where there is no express documentation requirement or where the requirement does not apply because relevant thresholds are not reached (e.g., Benin, Burkina Faso, Congo, Guinea and Senegal), the legislation provides that if, during a tax audit, the tax authorities have an indication that the taxpayer has shifted profits abroad, they may require further information and documents indicating:
— the nature of the relationship between the audited company and the foreign company;
— the methodology of the calculation of prices relating to industrial, commercial and financial operations done with foreign group companies; supporting elements that justify the applied prices; and, if applicable, agreed-upon compensation;
— the activities developed by intragroup companies quoted in the first point above, with respect to operations quoted in the second point above;
— the fiscal treatment reserved for operations quoted in the second point above and realised by companies outside of the country by the audited company, or by companies quoted in the first point above whose major share capital or voting rights are held by the audited company.

In Cameroon, Congo, Côte d'Ivoire and Gabon, documentation requires a disclosure of a transfer price report of related transactions to be filed with the annual tax return or at a specific date. The level of information to be disclosed varies from one country to another.

For example, the Finance Act of Côte d'Ivoire for 2017[1], effective from January 2017 has introduced new transfer pricing documentation requirements that include submission of documentation with the annual financial statements that provide:
— a general description of the legal and operational structures of the group;
— identification of the related parties engaged in intra-group transactions during the fiscal year; and
— a description of the specific transactions carried out with related parties during the fiscal year, including:
  • the nature of the transactions;
  • the amount (value) of the transactions; and
  • the identity and geographical location of the specific related parties involved in the transactions.

If the documentation is not submitted, the deduction of payments related to the transactions carried out with related parties will be disallowed. Incomplete or inaccurate documentation may also result in the disallowance of a deduction.

In Gabon[2], failure to submit the transfer pricing documentation (local file and master file) entails a penalty equal to 5% of the total amount of intragroup transactions, with a minimum of CFA francs 65m (approximately USD 116,500).

Congo, Democratic Republic of Congo, Gabon, Mali and Senegal have recently introduced the possibility to conclude advance pricing agreements.

Transfer pricing is high on Africa's tax agenda. Even though the legislation and administrative doctrine is generally very limited, without sufficient information on acceptable methods and expectations on transfer pricing documentation, or statements of practice, transfer pricing is more and more frequently reviewed during tax audits.

Taxpayers also face many difficulties due to the lack of comparable data and technical skills of tax officials: however, the situation is improving thanks to regional and international training as well as the creation of large taxpayer units ("LTUs") or specific teams within LTUs dedicated to transfer pricing.

As far as Lusophone African countries are concerned, for many years the Angolan, Mozambican and Cape Verdean tax legal framework only contained rudimentary transfer pricing provisions based on the Portuguese Corporate Income Tax Code of the 1960s. These provisions were quite basic, with no definition of related parties or transfer pricing methods to be adopted.

New transfer pricing provisions were approved in Angola in 2013 under which the tax authorities may make the necessary adjustments to the taxable profit of a taxpayer if, due to a special relationship between the taxpayer and another entity, the applicable business conditions deviate from the fair market value. Angola opted to create a list of major taxpayers that need to comply with transfer pricing obligations (transfer pricing file).

Preparing a transfer pricing file is also mandatory in Cape Verde with regulations on the taxpayer's obligations.

The transfer pricing provisions envisaged in the Cape Verdean and Mozambican Corporate Income Tax Codes are modelled on the OECD principles, which entail that all transactions between related parties must comply with the arm's length principle. The Mozambique transfer pricing provisions are still quite incipient and the approved methods to ascertain the fair market price of a given transaction are not even defined in the legislation.

1 Article 36 of the General Tax Code of Côte d'Ivoire
2 Article P-1010 bis of the General Tax Code of Gabon

Thin capitalisation Rules

Thin capitalisation rules and rules limiting interest deductibility for corporate income tax purposes frequently exist in African countries. The design and strictness of these rules may however vary.

Some countries in Francophone Africa only have rules limiting the interest deduction base on a maximum rate. Interest may only be deducted where the applicable rate does not exceed a limit provided by law, generally with reference to the interest rate issued by a central bank.

For example, in Benin, Côte d'Ivoire and Mali, members of the West African Economic and Monetary Union ("WAEMU" – the WAEMU member states are Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo), the maximum rate is the reference rate issued by the Central Bank of West African countries, currently levied at 4.5%, increased by three points (i.e., 7.5%).

As regards Cameroon, Central African Republic and Chad, members of the Economic Community of Central African States ("ECCAS" – the ECCAS member states are Cameroon, Central African Republic, Chad, Congo, Equitorial Guinea and Gabon), the maximum rate is the reference rate issued by the Central Bank of Central African countries levied at 2.45%, increased by two points (i.e., 4.45%).

In other countries, the legislation also provide that the maximum amount of debt on which interest may be deducted for tax purposes is established by the ratio of debt to equity. For example, Burkina Faso, Mauritania and Niger use a debt to equity ratio of 3:1 while Cameroon employs a 1.5:1 debt to equity ratio.

Some countries may provide for other conditions for the deductibility of interest paid in respect of shareholders' loans, such as the reimbursement of the loan within a five-year period in Côte d'Ivoire[3].

In Cameroon, the legislation[4] provides for a combination of several limitations as follows:

Interest on sums of money left or placed at the disposal of the company by partners in addition to their capital shares, irrespective of the form of the company, shall be deductible within the limit of those calculated at the rate of Central Bank advances increased by two percentage points. Besides, such deduction shall be possible with respect to partners who directly or indirectly own at least 25% with respect to partners who directly or indirectly own at least 25% of the share capital or corporate voting rights only if:

— The sums of money made available by all the partners do not exceed two and a half times the amount of equity. Otherwise, interest on the excess amount shall not be deductible;
— Their interest paid to the said partners does not exceed 25% of profit before corporate tax and before deduction of the said interest and amortisations taken into account in determining such profit. Otherwise, the excess amount of interest shall not be deductible.

With regard to the scope of these limitations, it is quite limited, as they do not apply to any loans from a related party but, in most cases, only to direct shareholders loans; except in Cameroon, Democratic Republic of Congo and Niger, where the legislation provides that direct and indirect shareholders fall within the scope of the limitations.

With regard to Lusophone African countries, Mozambique and Cape Verde have similar thin capitalisation rules. Interest on financing between related parties in excess of a 2:1 debt/equity ratio in Mozambique, and CVE 330m (approximately USD 3.5m) or 30% of the EBITDA in Cape Verde, are not deductible for corporate income tax purposes.
In Angola, interest arising from credits and loans granted by shareholders is not deductible for tax purposes and must be included in the taxable income. Angola has therefore adopted a double penalty provision tackling the capitalisation of Angolan companies by foreign shareholders. This provision is nevertheless more focused on foreign exchange concerns than on anti-avoidance for taxation purposes.

Controlled Foreign Corporation Rules

In Francophone Africa, most countries do not have a set of controlled foreign corporation ("CFC") rules for taxing multinationals on their worldwide profits. The situation where a resident of an African country owns a significant interest in a foreign company is not as frequent as in developed countries.

However, African countries have introduced rules according to which payments made to residents in low-tax jurisdictions shall be subject to a specific tax treatment.

For example, in the Central African Republic, Democratic Republic of Congo, Mauritania, Togo and Senegal, the burden of proof is reversed and shifted to the taxpayer: payments made to lower tax jurisdictions may only be deductible for corporate income tax purposes if the taxpayer demonstrates that such payments correspond to actual provisions of services and that they are not abnormal or unreasonable.

[3] Article 18-A-6 of the General Tax Code of Côte d'Ivoire
[4] Article 7-B of the General Tax Code of Cameroon

In Côte d'Ivoire, further to the Finance Act for 2017[5], withholding tax on dividends paid to such jurisdictions is increased to 25%, while the standard rate is 15%. In addition, transactions with such jurisdictions are subject to the transfer pricing rules and only 50% of the sums paid may be deducted for corporate income tax purposes. General expense deduction limitations may also apply whether the relevant party is related or not (please see General Anti-avoidance Rules, below).

Tax havens and non-cooperative jurisdictions are defined as those that are listed by the OECD and do not have any tax information exchange agreement with Côte d'Ivoire. However, no jurisdiction is currently listed as an uncooperative tax haven by the OECD's Committee of Fiscal Affairs. As a matter of fact, after formal commitments to implement the OECD's standards of transparency and exchange of information, jurisdictions were removed from the list.

There are no CFC or other provisions in Angolan legislation to tackle profits or costs arising in connection with low-tax jurisdictions.

Both Mozambique and Cape Verde have adopted CFC-type rules and are signatories of several double tax treaties. Treaty shopping provisions exist in the legislation of both countries.

In Mozambique and Cape Verde, payments made to entities resident in low-tax jurisdictions are not tax deductible in the hands of a Mozambique/Cape Verde company, unless evidence can be provided to the effect that the operation effectively occurred and the amounts paid are not unreasonable.

General Anti-avoidance Rules

Most Francophone African Countries have adopted general anti-avoidance rules based on the civil law doctrine of "Abuse of Rights" *(Abus de droit).* This doctrine allows the tax administration to override any kind of transactions which are fictitious or genuine but with which the sole target is to avoid or reduce the taxation.

For example, in Benin, Cameroon, Chad, Democratic Republic of Congo and Mali, it is provided that any operations in the form of a contract or legal instrument concealing the realisation or transfer or profits or income effected directly or by an intermediary shall not be binding on the tax authority, which authority shall have the right to maintain the true character of the operation and accordingly determine the basis of assessment of company tax or personal income tax. In the event of a court case, the burden of proof shall lie with the tax authority.

Congo, Guinea, Mauritania and Niger do not have GAAR at all in their legislation.

Some African countries (e.g., Benin, Burkina Faso, Chad, Mali, Mauritania, Senegal and Togo) also rely on the "Abnormal Act of Management" concept *(Acte anormal de gestion)* to disregard the deductibility of expenses where the tax authorities estimate that they are not spent in the interest of the enterprise.

Taxpayers may face difficulties in the application of these rules that are too general and that would require strong judicial application to be efficient. Yet, in Africa, there is very limited case law of the courts to protect taxpayers from misuse of these concepts by tax officials.

Other Measures to Tackle Tax Avoidance

Withholding Taxes on Remuneration for Services

In all African countries, one can find withholding taxes on dividends, interest, royalties and other remuneration for services (even payment for goods in some instances), where they are paid to nonresidents. Rates vary from 10% to 25% on gross remuneration paid.

Tax treaties may reduce the applicable rate or even eliminate the withholding tax. However, African countries do not have an extensive treaty network, although the situation is improving. For example, there are 15 tax treaties currently in force in Senegal while there are six in Gabon and only one in Niger: as a comparison, South Africa has concluded more than 70 tax treaties currently in force.

Where a tax treaty applies, African tax authorities tend to apply a very broad interpretation of the term "royalties" so as to apply withholding tax on remuneration for any service involving some sort of transfer of know-how or to consider that the term "technical studies" sometimes mentioned in the treaty's definition of "royalties" necessarily covers all technical assistance services.

Limits on the Deductibility of Remuneration for Services

Some countries have introduced this kind of limit in their legislation.

For example, the 2013 finance law of Gabon[6] introduced a limitation on the deduction of general headquarters costs, costs of studies or technical, financial or accounting assistance costs, etc., of 10% of taxable income when a foreign legal entity provides services to a Gabonese company.

5 Article 183 bis of the General Tax Code of Côte d'Ivoire
6 Article 11-I-1-f of the General Tax Code of Gabon

In Cameroon[7], head office overheads for operations carried out in Cameroon and the remuneration of certain effective services (studies, technical, financial or accounting assistance) provided to Cameroonian firms by foreign or Cameroonian natural persons or corporate bodies shall be regarded as expenses on condition that they are not exaggerated. Any sum exceeding 5% of the taxable profit before deducting the expenses concerned may not be deductible.

In addition, the amounts paid for the use of valid patents, brands, designs and models may be deducted for corporate tax purposes within the overall limit of 2.5% taxable profit before the deduction of expenses claimed. This ceiling shall not apply to the amounts paid to firms not participating directly or indirectly in the management or capital of a Cameroonian firm.

Côte d'Ivoire applies[8] a double limitation on the deductibility of royalties; interest as well as management and service fees paid to foreign parent companies are tax deductible. The deductions should not exceed 5% of the turnover and 20% of the overhead.

It should be noted that Côte d'Ivoire and Cameroon have extended the application of this limitation to payments made to domestic companies in order to undermine the non-discrimination clause.

Conclusion

As we can see, African countries are clearly willing to address tax avoidance issues, but solutions depend on specific situations and the predominant type of tax avoidance in a country. As far as Africa is concerned, all measures of the BEPS Action Plan may not be relevant or have the same priority as in developed countries.

Reforming tax policies, improving enforcement of tax legislation and strengthening tax administration in Africa is crucial and should be a priority. The lack of transparency, the lack of rule of law, weak fiscal jurisdictions leading to arbitrariness and discrimination between taxpayers should also be on Africa's tax agenda. This seems to be the case, as participants to the Africa Tax Administration Forum 3rd International Conference in late September have recognised that if Africa is to effectively address aggressive tax avoidance and evasion, it needs to redesign its tax policies to reflect specific challenges it faces, including the capacity constraints in tax administrations.

7 Article 7-A-1-d of the General Tax Code of Cameroon
8 Article 38 of the General Tax Code of Côte d'Ivoire

Tax Anti-avoidance Rules in Latin America

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Latin American countries have historically approached tax reorganisations in a very formalistic way, prevailing a form over substance criterion for solving tax controversies. They have been reluctant to include general anti-avoidance rules in their legislation for allegedly increasing taxpayer's uncertainty over what qualifies as tax planning *vis-à-vis* tax avoidance, and consequentially mining potential new investments and economic growth.

Notwithstanding, such initial resistance has yielded before the global trend of tackling unacceptable aggressive tax planning by including GAAR and automatic exchange of information between tax administrations among other measures.

This analysis herein contains a summary of the main topics identified in connection with the establishment of tax anti-avoidance rules in Latin American countries, taking into consideration the reality of a representative group of countries such as Argentina, Brazil, Chile, Colombia, Mexico and Peru (the "LATAM countries").

Generally speaking, there is no joint and binding approach among LATAM countries for combating tax avoidance. Rather, each country deals locally and separately with this issue.

However, we can find the following binding exceptions:

a) OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters, subscribed to by more than 90 countries (including the majority of the G20 economies), including all LATAM countries with the exception of Peru. The purpose of this Convention is to tackle cross-border tax avoidance, enabling the cooperation between signatory countries regarding the exchange of relevant information to facilitate the assessment and collection of all kind of taxes (with the exception of custom duties).

b) OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, subscribed to on June 2017 by all LATAM countries with the exception of Brazil and Peru. This Convention seeks to prevent tax planning strategies that exploit loopholes and mismatches in tax rules to artificially shift profits to low-tax or tax-free locations where there is little or no economic activity, resulting in small or nil overall corporate tax being paid.

In both cases, these Multilateral Conventions have the virtue of automatically transposing their results to bilateral tax treaties without the burden of renegotiation.

Further, we can identify a regional non-binding approach found in the Tax Code Model ("TCM"), updated in 2015 by the Inter-American Center of Tax Administrations ("CIAT", for its Spanish acronym), i.e. an international public organisation composed primarily of American countries (all LATAM countries among them) which mainly serves as a permanent forum for considering tax administration problems, such as tax avoidance.

Article 11 of the TCM sets forth the following:

1. *"When performing acts which, individually or together, are artificial or unfit for obtaining the achieved result, tax consequences applicable to the parties involved in such acts will be those corresponding to the acts suitable or appropriate for obtaining the result that has been reached.*
2. *The provisions of the preceding paragraph shall apply only when the artificial or improper acts do not produce relevant economic or legal effects with the exception of the tax saving."*

Together with recommending that each country include such kind of rule in its corresponding Tax Code, the CIAT's commentaries state, among other considerations, that: (i) this rule should be applicable to operations covered by double tax treaties (unless expressly forbidden), and (ii) the corresponding tax authorities must demonstrate the improper, unfit or artificial character of the operations as well as the absence of a goal different than the sole tax benefit.

The introduction of GAAR in each country has been controversial as the use of broad and abstract concepts, e.g., "abnormal", "unusual", or "atypical" legal forms in connection with a "relevant economic or legal effect", may affect the taxpayer's legal certainty, blurring the strict scope of the taxable event. Further, common concerns have been raised regarding the eventual misuse of this tool by the corresponding tax authorities that could end up in arbitrary and abusive recharacterisations of transactions.

In practice, the adoption of GAAR has prevailed over such objections. With the exception of Mexico (which only has targeted anti-avoidance rules) and Brazil (which only has a substance-over-form test set forth in 2001), the other LATAM countries have set forth a local GAAR, i.e. Argentina (1946), Chile (2015), Colombia (2012 and 2016) and Peru (1996 and 2012).

GAAR constitutes one of the main mechanisms to prevent international and local tax avoidance, in addition to the specific anti-avoidance rules contained in each tax legislation.

Though each country has its independent GAAR and targeted anti-avoidance rules, it comes as no surprise that they share many common characteristics as well.

One of the most important ones among LATAM countries comes from the fact that they all follow the civil law system, which is based on fixed codes and statutes, as opposed to the common law system, whereby judicial cases are the most important source of binding rules to apply for solving legal conflicts.

As a consequence, in a civil law system, legislation aims to cover all eventualities and judges are considered to have a limited role for applying the former to specific cases under discussion. Further, past judicial judgments, even if we could identify a specific criterion applied repeatedly and evenly over time, are no more than guidelines which in no case limit the judge's interpretation of law when passing judgment on a case by case basis.

While our system may be considered more stable as rules are stated explicitly in fixed legislation, we certainly lack the flexibility that a common law system provides to rapidly adapt to the ever-changing reality, especially regarding new tax reorganisations.

However, we like to think that GAAR in LATAM countries has granted certain flexibility to counteract tax avoidance practice at a judicial level, as there is enough room for judges to analyse operations using a substance-over-form perspective, among other tools.

Another relevant common aspect is the moderate number of cases where GAAR has been applied, in one way or another. It is probably due to its rather recent establishment, as well as the difficulty of all parties involved to adapt and abandon the formalistic view with which tax controversies have been historically addressed.

Continuing with the similarities found between LATAM countries, we can identify abuse and simulation as the main forms of tax avoidance addressed by GAAR, and that the natural consequence of GAAR application is to disregard the operations as presented, recharacterise their true nature, and impose the avoided tax, with adjustment for inflation, as well as penalty interests. Fines may also be applied.

Further, GAAR would generally not require concurrence of a taxpayer's fraudulent intent to avoid tax. If such intention is present, filing a criminal action against the taxpayer is still an open course of action that may be used as an additional tool to tackle tax avoidance practices.

Finally, initial GAAR application would generally fall within the scope of the tax authorities' powers, although naturally subject to legal recourse, while, in the case of Chile, GAAR application must be immediately known and declared by the courts of justice.

In turn, several aspects of GAAR are different in each LATAM country, such as date of entry into force and the difficulties in its implementation, as we summarise below.

Argentina

It is remarkable that the "economic reality principle", considered as the general anti-avoidance rule, was established all the way back in 1946, in the Federal Tax Procedure Law (No. 11.683), which is the guideline used for interpreting tax regulations and transactions.

Through this rule, the tax authority may disregard the legal forms or structures that are evidently inadequate in view of the economic intention of taxpayers, considering the real economic intention as qualified in the forms or structures that the private law would apply.

The taxpayer has the burden of proof before GAAR application, the duty to prove that the taxable event has been correctly characterised.

Regarding cross-border tax avoidance practices, it is worth noting that, in general, Argentina's double tax treaties do not contain a general anti-avoidance rule. As a consequence, traditionally, the Argentine tax authority has tried to prevent treaty abuse by resorting to local GAAR, even without express authorisation from the treaty. In this sense, the recent case of "Molinos Río de la Plata S.A." (2013), sets a precedent for the application of local GAAR on a double non-taxation case because of misuse of the Argentina-Chile double tax treaty.

Brazil

The government has attempted to tackle tax avoidance by increasing the exchange of information between tax authorities at different governmental levels (federal, state and municipal entities), and by increasing the use of technology. Other measures implemented to fight tax avoidance include the introduction of a substance-over-form test and more recently, increasing the cooperation between domestic and international tax authorities. In addition, a stricter tax regime, applicable to jurisdictions classified as "tax havens", has been imposed.

Since 2001, article 116 of the Brazilian Federal Tax Code (Law No. 5.172/66) has provided a substance-over-form test that allows Brazilian tax authorities to disregard artificial transactions, which, although compliant with all applicable laws if considered alone, have as their sole purpose the concealment of a taxable event.

Brazil also lists certain countries as low-tax jurisdictions ("LTJs"), when its rate of income tax is lower than 17% or when its domestic legislation does not require disclosure of ownership of corporate structures, and as privileged tax regimes ("PTRs"), which comprise specific corporate structures from a group of countries, generally focused on preventing the use of special conduit companies.

Consequences of being incorporated in an LTJ or subject to a PTR include stricter transfer pricing, thin capitalisation and controlled foreign corporation rules. Certain other consequences, such as higher withholding tax rates on payments from Brazil to overseas companies, are only applicable to those based in LTJs.

Chile

GAAR entered into force on September 2015, as one of the pivotal changes introduced by a major game-changing tax reform.

Historically, the interpretation and application of tax legislation has been formalistic, such criterion prevailing over a substance-over-form policy. Further, judicial decisions have been very erratic in considering tax avoidance as legal or illegal conduct.

The new GAAR contains two forms of tax avoidance: (i) the abuse of legal operations, and (ii) simulation.

To address any potential abusive application by the tax authorities, the following measures were set forth to protect taxpayers: a) recognition of the right to a legitimate tax planning practice, conceptualised as the reasonable option of conducts and alternatives found in the legislation to lower the tax burden; b) recognition of the taxpayer's good faith, and thus that the burden of proof regarding the requirements for applying GAAR lies with tax authorities; c) application of GAAR only where there are no specific anti-avoidance rules already in current tax legislation; d) fast-track binding enquiry before the tax authorities regarding potential reorganisations; and e) discussion and ruling of GAAR application to a specific case only before and by a tax court.

Colombia

Law 1607/2012 introduced a general anti-abuse clause in article 869 of the Tax Code that set forth a procedure to deem a transaction or an operation as abusive from the tax law perspective. However, this article set forth such a complex procedure that it hardly had a chance to be applied in practice.

On December 2016, Congress approved Law 1819/2016, a "structural" reform to the tax system. The law included changes to the existing tax law in regards to tax avoidance (modifying said article 869) and anti-deferral rules.

According to the amended article now in force, wider and more practical powers were granted to tax authorities to recharacterise operations and disregard their effects for tax purposes. In other words, the tax authorities are now entitled to modify the legal effects of the transactions or operations carried out by the taxpayer deemed as abusive, and instead they could apply the tax treatment applicable to the "real transaction" or the one which corresponds to the real intention behind the fraudulent or abusive one.

Mexico

Mexico's situation is different from the other LATAM countries.

While there is no GAAR, there is a rather broad tax anti-avoidance rule under article 177 of the Income Tax Law, which empowers the tax authorities, as a result of the exercise of their verification powers, granted by law, to determine that a transaction executed by a taxpayer was simulated, exclusively for tax purposes, in which case the authority may assess a tax liability accordingly.

Nevertheless, this rule is limited to situations that involve transactions between related parties, and it is very difficult for authorities to exercise such power, as the tax authorities are obliged to prove that the conduct was fraudulent.

In recent years, the Mexican tax authorities have sought broader powers to combat tax avoidance practices as well as stricter anti-abuse rules from the Federal Congress.

In 2016, a proposal was submitted to the Federal Congress to amend article 5 of the Federal Tax Code to regulate tax avoidance by means of mechanisms not restricted or prohibited by law. Its purpose was to: a) establish a general anti-avoidance standard; and b) include within the general provisions of Mexican tax law, the power to deal with the abusive behaviours of the taxpayers whose purpose would be to reduce their tax liabilities. However, said proposal was ultimately rejected.

Thus, there are only targeted anti-avoidance rules, where we can highlight strict transfer pricing and thin capitalisation rules, among others.

Peru

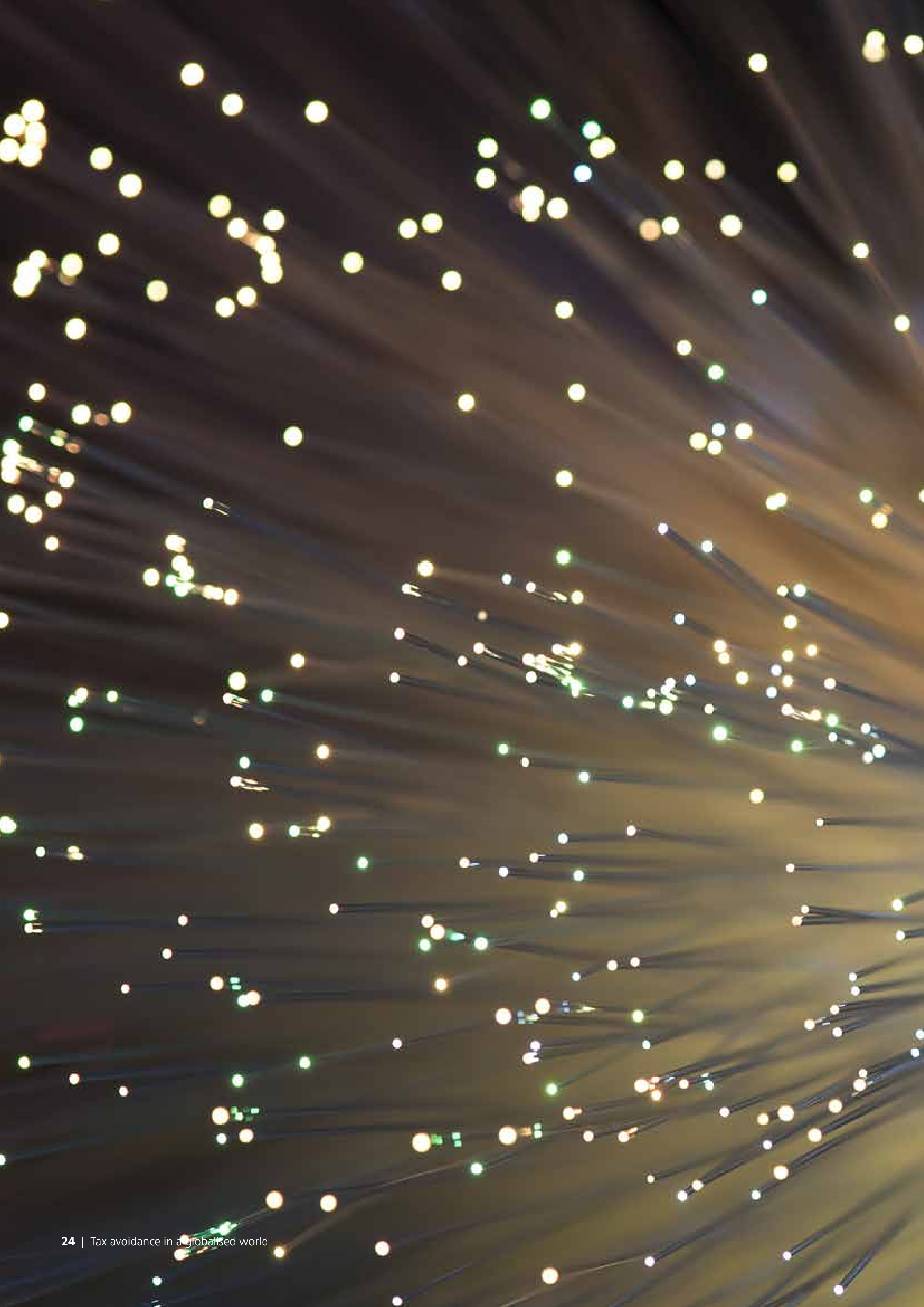
Originally, in 1996, an "economic reality criterion" was set forth in the Tax Code, but was not considered by the tax courts as a new legal interpretation method.

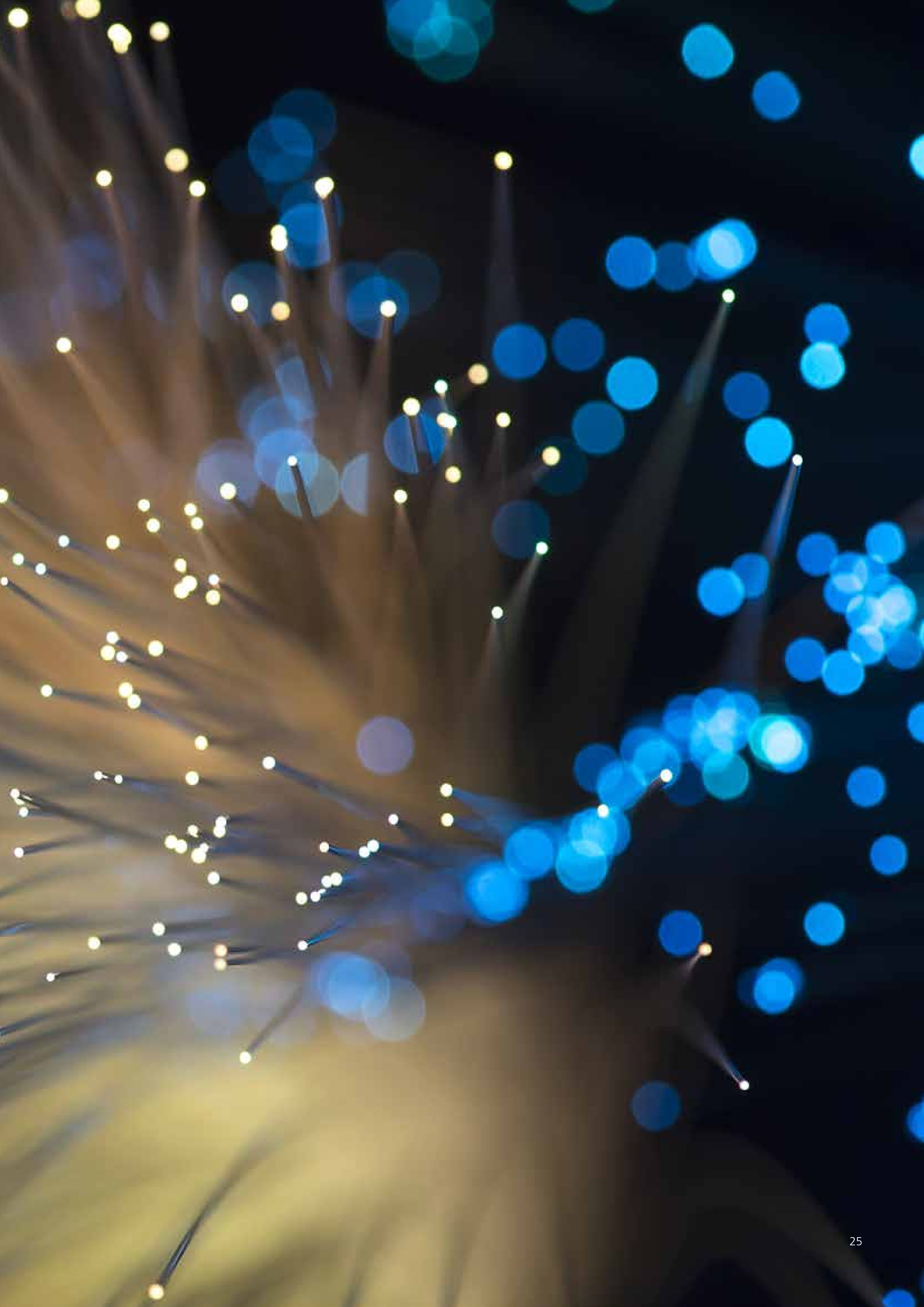
In this context, in July 2012, by Law Decree No. 1121, Act XVI of the Tax Code was introduced, incorporating a new "economic reality criterion" as well as other general anti-avoidance rules to allow the tax authorities to handle tax avoidance and tax fraud schemes.

However, concerns were raised mainly relating to the potential arbitrary misuse by the tax authorities, questioning the: (i) compatibility between Act XVI and the Legality Principle contained in the Tax Code and the Peruvian Constitution; (ii) uncertain range of power of the tax authorities; (iii) application of such GAAR to situations that occurred prior to its coming into force, among others.

In July 2014, the government partially suspended Act XVI until supplementary provisions (which are still pending) allowing its appropriate implementation could be enacted. GAAR regarding abuse and legal fraud was suspended, while the portion regarding the "economic reality criterion" on simulated operations was not.

Finally, we have been informed that the regulations have already been drafted and have been sent for discussion and approval, which is expected during the second semester of year 2018. These regulations will include specific mechanisms for agressive tax planning; they are not envisage for common use or to apply in general cases.





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