Panel on Future of treaty formed holding companies and preferred tax regimes and unwinding existing structures adversely impacted by BEPS or the EU Parent-Subsidiary Directive

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Introduction

Holding companies in their new environments: Local GAAR, EU GAARS and Treaty GAARS and LOBs

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New environment for Holding companies:

1. Holding company : the world as it used to be
2. Holding company under attack
    - Domestic context
    - EU context
    - DTT context
3. Conclusion

Holding Company and Tax Planning

- **What is a holding company?**
  - owns shareholdings
  - may assists the group with services (management, financial, etc)
- **Why a holding company (tax planning)?**
  - Tax neutrality between the investment (target) / sub and the ultimate owner
    - Tax neutral extraction of cash
      - no or limited cross border tax (inbound and outbound WHT);
      - no or limited taxation of dividends (Participation exemption or deductions);
      - hybridity (“extra” deduction in target with no corresponding pick up for instance);
      - tax free realization of investment (PE).
- **Where to locate a holding company ?**
  - Country offering PE and DTT protection/EU PSD protection/other tax attributes

Holding Company under attack

– **Change of rules on PE (dividends) and on deduction of interest (hybridity)**
  - Dividends may no longer be exempt if distributing company not subject to tax
  - Dividends no longer exempt if gave rise to a deduction
  - Limitation in deductibility of interest (thin-cap; hybridity; M&A context; general)

– **Anti-abuse fronts.**
  - Domestic
  - EU
  - DTT

Holding Company under attack

Domestic context

- Use of Holding companies **downstream (PE)**
  - Take benefit of PE regime on inbound flow
  - GAAR
    - PE purpose : economic substance of the Holding and its location.

- Use of Holding companies **Upstream (WHT)**
  - Reduced WHT
  - CGT free
  - EU law : PSD (before 2016)
    - Anti-abuse left to EU states
      - Main purpose test
    - Combination with domestic GAAR

Holding Company under attack

Domestic context

- GAAR EU inspired : "*concept of establishment within the meaning of the Treaty provisions on freedom of establishment involve(d)* ***the actual pursuit of an economic activity*** *through a* ***fixed establishment*** *in that State for an indefinite period"* Cadbury Schweppes and Cadbury Schweppes Overseas (ECJ C-196/04).

Holding Company under attack

EU context

- For a Holding company to be able to claim the benefit of the PSD and other EU provisions, it must be able to demonstrate that it actually exercises one of the 4 EU fundamental freedoms : freedom of establishment
  - establishment requires to exercise a genuine economic activity through a fixed establishment
  - "*the exercise of an economic activity in the host member state which is the raison d'être of freedom of establishment*"
    - What is the threshold for holding companies?
      - Turnover, expenses, local management, premise, competent employees, actual control of subsidiaries?
    - any satisfactory answer for pure holding company? (for tax purposes).

Holding Company under attack

EU context

– Limitation of Freedom of Establishment.
  - preferential tax treatment will not be applied when the arrangement has **no other purpose than tax avoidance** and is **then deemed to be artificial** (ECJ, December 14, 2006, Denkavit Int. BV and SARL Denkavit France (C-170/05).

Holding Company under attack

EU context / PSD

- An action plan was issued by the Commission on 6 December 2012 for a more effective EU response to tax evasion and avoidance (COM (2012)722).

- In Novembre 2013, the European Council proposed to amend the PSD to stop it from being misused for the purpose of tax avoidance.

- On January 27, 2015, the Council formally adopted a binding GAAR to be included in the PSD – Council Directive 2015/121

- Member States had until December 31, 2015 to implement the GAAR in domestic law.

Holding Company under attack

EU context / PSD

Member States shall not grant the benefits of this Directive to 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 this Directive,

are not genuine having regard to all relevent facts and circumstances. An arrangement may comprise more than one step or part.

For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for

–valid economic reasons which reflect reality.

Holding Company under attack

EU context / PSD

Old	New
This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.	This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.

Holding Company under attack

EU context / PSD

- The PSD GAAR aims at preventing misuse of PSD and to « *ensure greater consistency in its application in different States* »
  - No guidance on how MS should interpret it.
  - Valid economic reason seems to bring us back to the substance and economic activity test.
  - How it will affect domestic rules?
    - French turmoil:
      - GAAR effective as of January 1, 2016 for outbound dividends to EU and EEE MS and for PE on EU and EEE source dividends.
      - Interpretation: (Senate Finance commission comments)
        - Difficulty and uncertainty to expect in its application;
        - Illustration given by Gvt : use of EU holding by non EU investors for WHT purpose
          - Artificial arrangement : use of pure holding;
          - Valid economic reason : comparison between tax and non tax advantages
          - Substance of the holding (economic activity).

Holding Company under attack

EU context / PSD

- **Conclusion** :
  - Valid economic reason test (or artificiality) brings to the exercise of an economic activity which is not compatible with passive or pure holding companies.
  - Only « active » holding companies may survive
    - Effective control and influence (subs);
    - Gross revenue (services rendering);
    - Workforce, premises, expenses.

Holding Company under attack

DTT Context

– **Before BEPS**

- Combination between domestic GAAR and specific anti-abuse provisions (certain income or structure and DTT anti-abuse provisions).

- Typical anti-abuse provision (related to holding companies)
  – Main purpose test
  – Subject to tax (residence State)
  – Anti-back-to- back test
  – LOB
  – Beneficial ownership (« BO »)

Holding Company under attack

DTT Context

- **Before BEPS**
  - Narrower approach of BO for dividends since the holding company holds/owns the shares and has generally economic rights on dividends ?
    - Necessity of (domestic) GAAR to conclude that the recipient is not the economic recipient of dividend?
    - see French case *Bank of Scotland* : domestic GAAR reclassified a temporary sale of PS to Bank by Corporate as a loan to determine that Bank was not the BO of the dividend + refund of tax paid to Bank. Corporate was -through a reclassification of the transaction into a loan by Bank to Corporate- with dividends + refund of tax being « owned » by Corporate and assigned by Corporate to Bank for reimbursment of the Loan (CE 29-12-2006).

Holding Company under attack

DTT Context – Life after BEPS ?

- **BEPS – Action 6 : Preventing the granting of treaty benefits in inappropriate circumstances**
  - DTT limitation
    - Treaty shopping : non resident seeks benefit of a resident
      - Clear statement in Title and Preamble
      - **LOBs** (simplified and detailed)
        - **Holding company (owned by non resident shareholders) likely to qualify only through *the derivative test*** :
          - be directly or indirectly owned at 75 or 95% by equivalent beneficiaries
          - which benefits from an equivalent or more favorable treatment and « deemed to hold the same % in the distributing company as the company claiming the treaty benefit

Holding Company under attack

DTT Context – Life after BEPS ?

– ***Principal Purpose*** **Test** ("**PPT**") rule = entitlement to benefit provision inluded in the LOB.

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

- Uncertainty / no consistency between Contracting States.

Holding Company under attack

DTT Context – Life after BEPS ?

- More specific limitations (on dividends)
  - Transactions intended to avoid dividend characterization (prevalence of domestic definitions);
  - Dividend transfer transactions
    - Holding requirement
    - Intermediary entities
    - Use of collective investment vehicle
  - Others ?

Holding Company under attack

Conclusion

Domestic, EU, DTT

Holding company and tax planning?

Prerequisite for a holding company:

–Business purpose of the holding

–Economic substance of its location

–Prevalence of non tax attributes

Pure Holding no longer viable

Active holding requires substance and economic activity

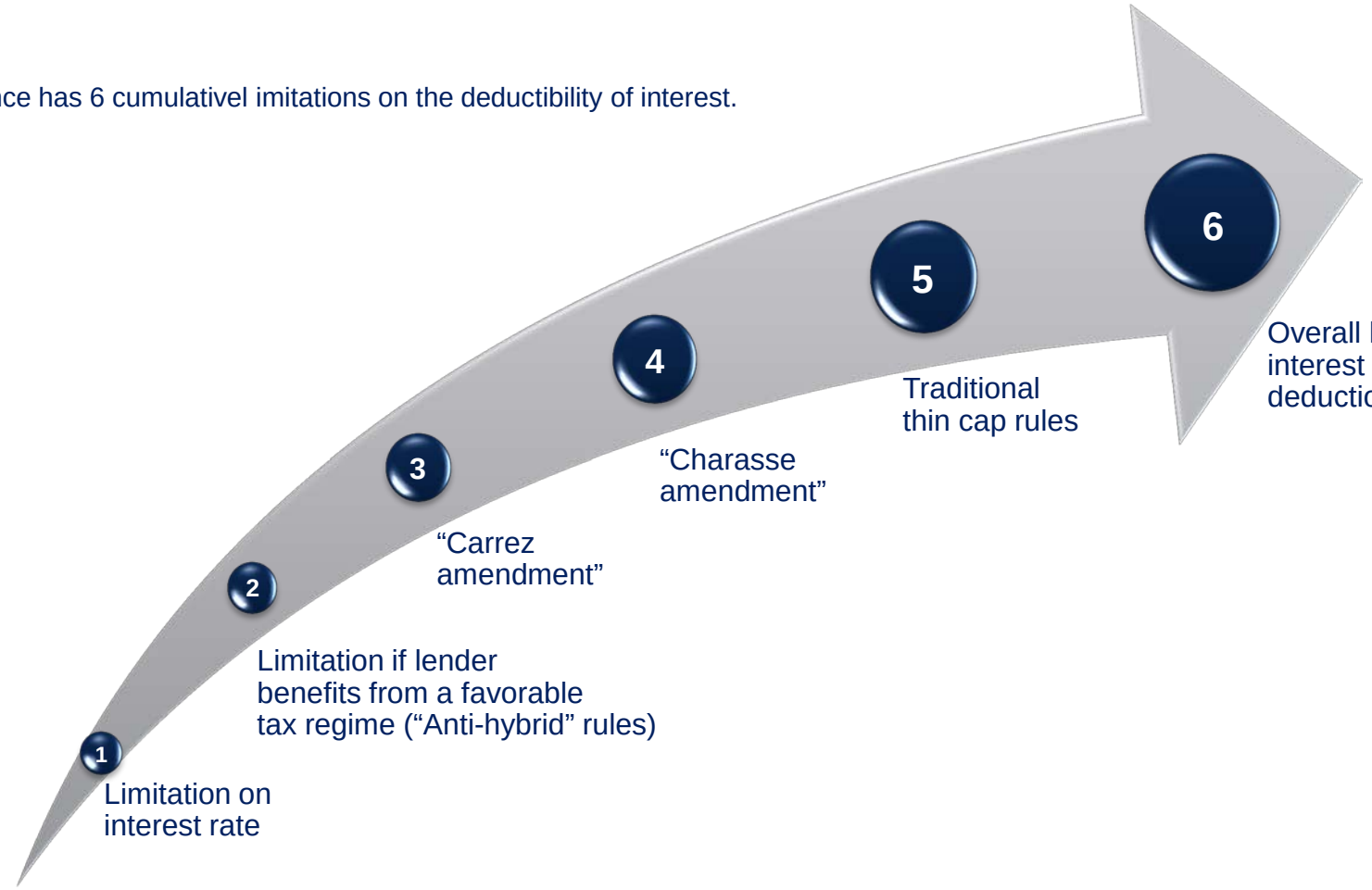
–*Uncertainty would derive anyway from subjective test.*

Appendix

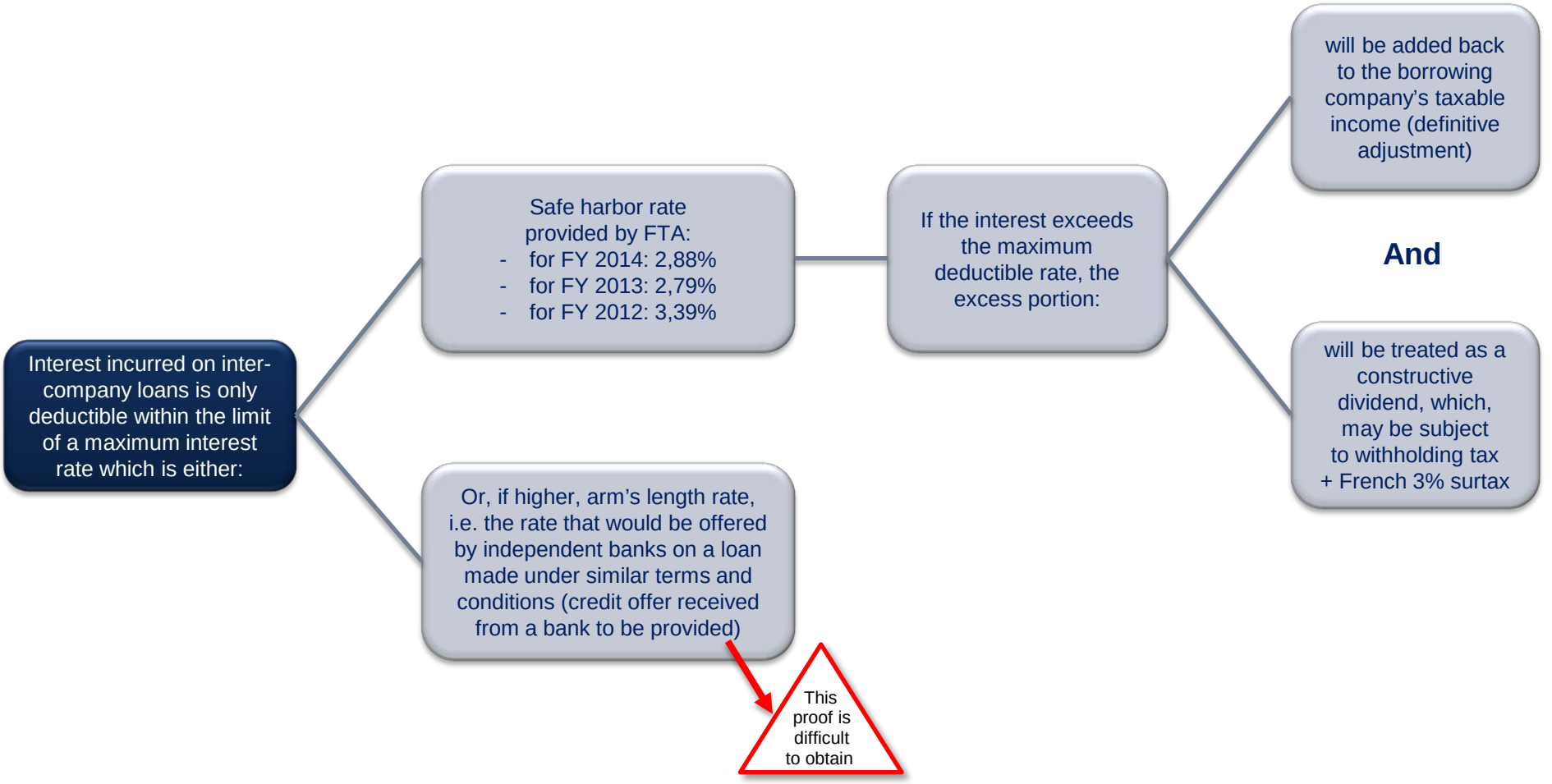
The French experience / limitations on interest deduction

French tax limitation of interest deduction

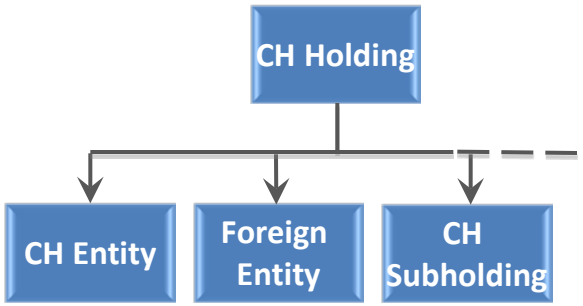
France has 6 cumulativel imitations on the deductibility of interest.



Limitation on interest rate test



Taxation of Swiss Holdings
Special Provisions as today



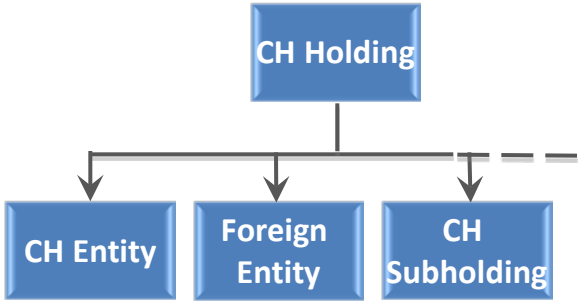
Features of Cantonal Holding Privilege

- Manufacturing, trading and service activities are generally prohibited
- Management of subsidiaries and debt financing of subsidiaries generally allowed
- Holding and exploitation of intellectual property to a certain degree allowed
- Ordinary tax base for annual capital tax (paid-up share capital, plus all open and taxed hidden reserves)
- Any corporate participations (including offshore companies) qualify for the privilege! (no „subject to income tax“ requirement)

Federal Tax	Special provisions	Taxation
Corporate Income Tax	• ordinary income taxation • Participation deduction for dividends from subsidiaries (at least 10% of subsidiary‘s capital or a fair market value of at least CHF 1m) • Participation deduction for capital gains on sale of shares of subsidiaries (interest in subsidiary at least 10% and was held at least 1 year)	• Ordinary tax rate 7.83% (effective) • Effectively exempts 95-100% of qualifying dividends and gains; applies to any corporate subsidiaries, including offshore companies
VAT, Stamp duties, WHT	• Full liability to all other federal taxes	

Cantonal Tax	Special regimes	Taxation
Corporate Income Tax	• Holding company privilege – Principal company purpose: Holding/ management of participations and – at least 2/3 of the assets consist of participations or – at least 2/3 of the income is dividend income	• Full income tax exemption (except for income from local real estate)
Capital tax		• Reduced capital tax (varies form canton to canton)

Taxation of Swiss Holdings
Special provisions under CTR III



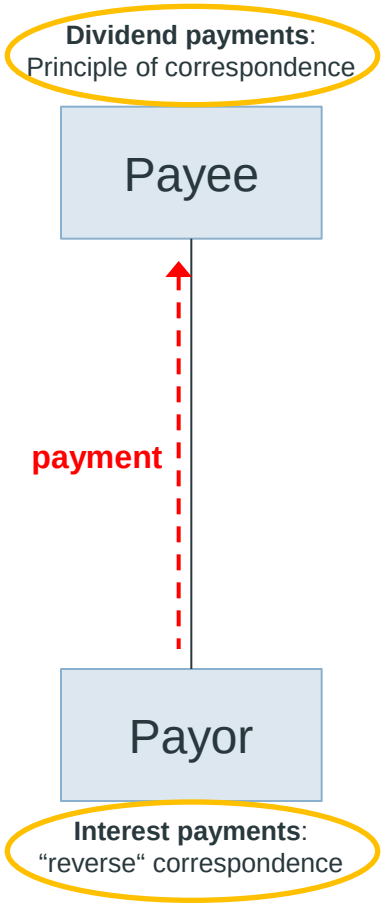
Corporate Tax Reform III: Background

- The Corporate Tax Reform III is heavily influenced by BEPS and will abolish all cantonal special income tax regimes, including the holding privilege
- On 5 June 2015, the Federal Council issued the draft legislation and the dispatch on the CTR III
- On 14 December 2015, the Council of States in principle approved the CTR III
- National Council is expected to vote on the reform on 28 February 2016
- The reform is expected to enter into effect in 2018/2019

Federal Level	Special provisions
Corporate Income Tax	• Ordinary income taxation 7.83% (effective) • Participation deduction for dividends from sub-sidiaries and capital gains on sale of share subsidiaries • As of today no notional interest deduction
VAT, Stamp duties, WHT	• Abolishment of the 1% stamp issuance included in the draft bill but rejected by the Council of State

Cantonal Level	Special provisions
Corporate Income Tax	• Ordinary income taxation (varies from canton to canton) • Introduction of patent box: Privileged taxation of income generated from patents and comparable rights, provided the R&D expenses occurred in Switzerland ("modified nexus approach") • Basis step-up: Introduction of tax-neutral appreciation of hidden reserves upon change into the ordinary taxation regime (or reduced taxation of later realization) • Reduction of corporate income tax rates expected
Capital Tax	• Ordinary capital taxation (varies from canton to canton) • Reduction of cantonal/communal capital tax on participations and patented IP by the cantons on a voluntary basis

BEPS Action 2: Hybrids
German Status



BEPS Action 2 (2015 Final Report)

•***Primary rule***: “*…that countries deny the taxpayer’s deduction for a payment to the extent that it is not included in the taxable income of the recipient in the counterparty jurisdiction or it is also deductible in the counterparty jurisdiction.*”

German Status

- **(Dividend) Payments** benefit from the German participation exemption for corporate tax only if the payment is not deductible at payor-level (*principle of correspondence*).
- Subject-to-tax- and switch-over-rules in tax treaties and German tax law.
- **2014 draft: (Interest) Payments** are non-deductible to the extent they are (i) not considered as income or are (ii) tax exempt at the level of the direct or indirect recipient because the underlying legal relationship is not treated uniformly as a provision of debt financing (principle of “reverse” correspondence).

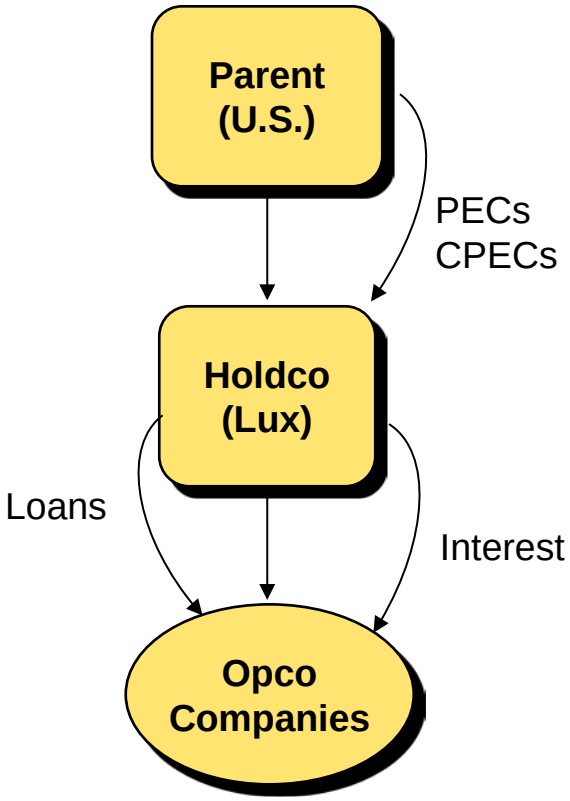
Sam Kaywood

Hybrid entities, hybrid debt and double dip financing

BEPS Action 2 – Scenarios Covered

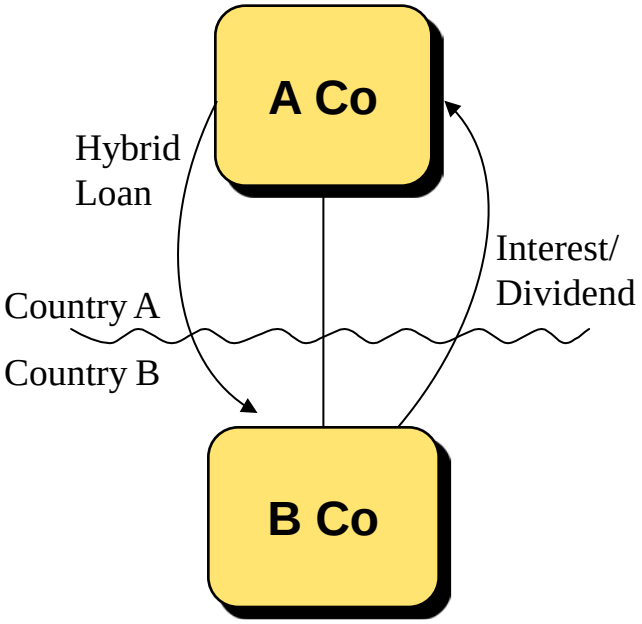
- Deduction / No Income (D/NI)
  - Hybrid financial instruments
  - Disregarded payments made by hybrids
  - Payments made to reverse hybrids
- Double Deduction (DD)
  - Deductible payments made by hybrids
  - Deductible payments made by dual residents
- Indirect D/NI
  - Imported mismatches

Financing Structures
Use of Hybrid Debt



- Lux HoldCo accrues “interest” expense on PECs/CPECs to offset against interest income from Opcos
- Can defer paying interest as long as desired
- When paid, interest can be treated as dividend for U.S. purposes, carrying out foreign tax credits
- APB 23 considerations

BEPS Action 2 – Hybrid Instruments
Hybrid Instruments (D/NI)



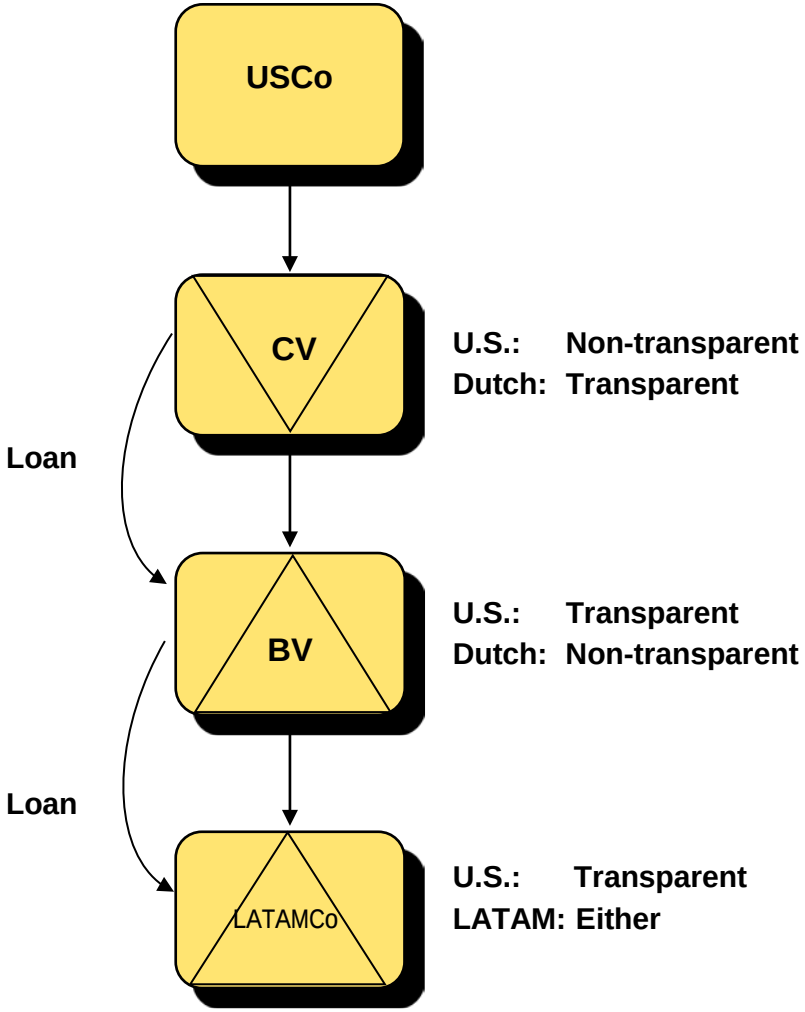
(Ex 1.1)

- B Co deducts "interest" under Country B law, while A Co receives a "dividend" exempt under Country A law.

<u>BEPS Recommendation</u>

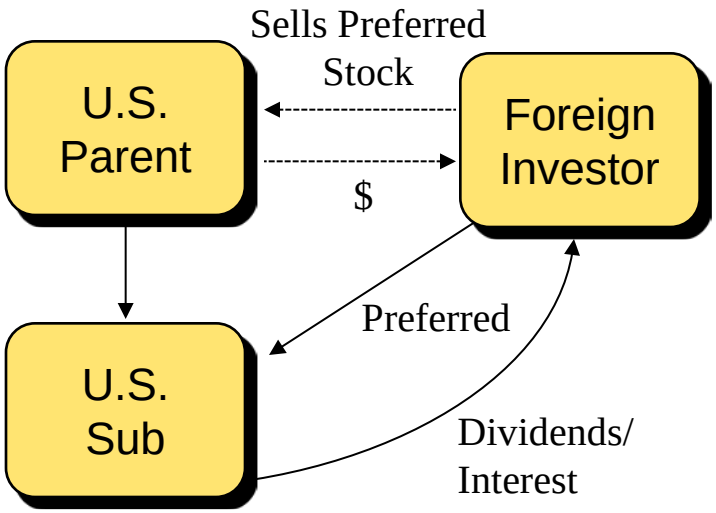
- **Primary Rule:** Country B should deny an interest deduction if Country A does not tax the income.
- **Defensive Rule:** Country A should deny participation exemption.
- Timing differences OK if for a reasonable time

BEPS Action 2 – Imported Mismatches BV/CV Structure (Indirect D/NI)



- CV is a non-taxable entity for Dutch tax purposes but it is CFC for US tax purposes.
- BV is a DRE for US purposes and a taxable entity for Dutch purposes
- Interest payments by LATAMCo to BV are offset by interest payments by BV to CV, except for a small spread.
- BV interest payments to CV are seen for Dutch tax purposes as made to USCo and are not subject to Dutch withholding under US/Dutch Treaty.
- BEPS treats the structure as an imported mismatch and recommend that the LATAM country disallow the deduction for interest paid to BV

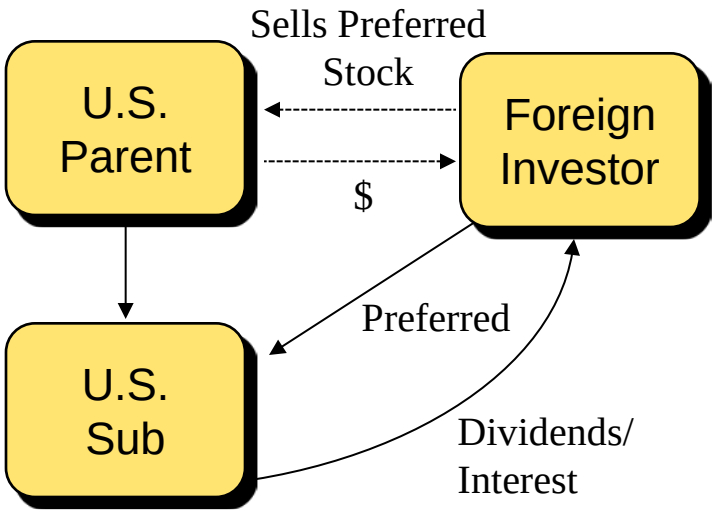
Action 2 – Hybrid Instruments Sale/Repo Agreements (D/NI)



U.S.

- U.S. Parent treated as borrowing money and pledging preferred stock in U.S. sub.
- Dividends paid to Foreign Investor on preferred stock treated as paid to U.S. Parent, followed by U.S. Parent paying interest to Foreign Investor.

Action 2 – Hybrid Instruments Sale/Repo Agreements (D/NI)



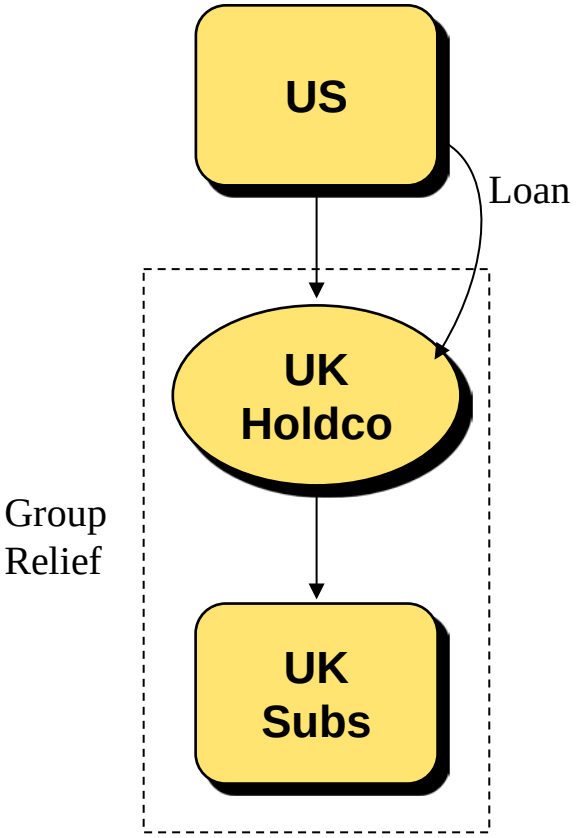
Foreign

- Dividends paid to Foreign Investor treated as exempt under participation exemption regime.

BEPs Recommendation

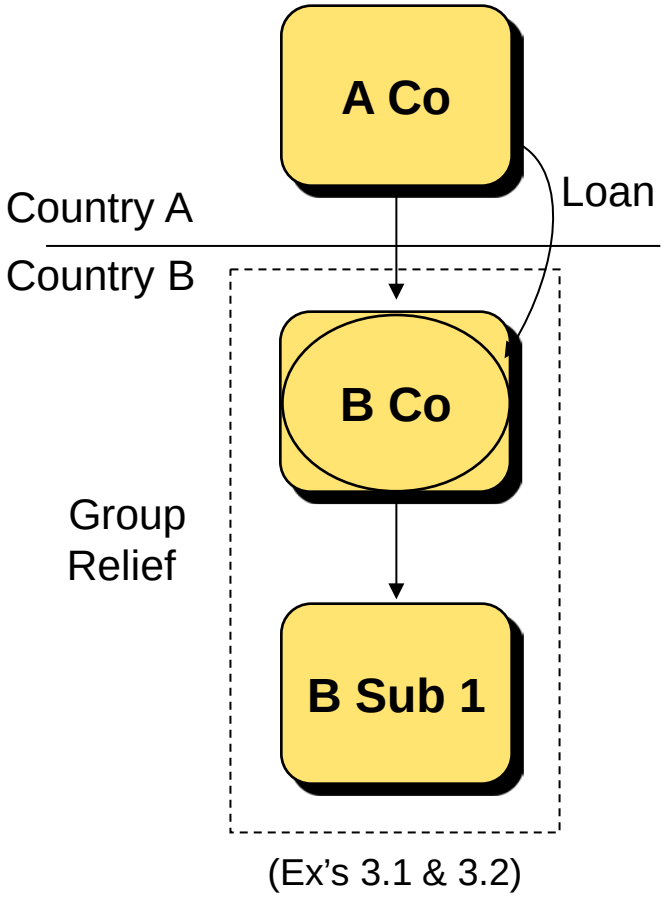
- **Primary Rule:** U.S. should deny deduction.
- **Secondary Rule:** Investor jurisdiction should deny participation exemption.

Action 2 –Payments Made by Reverse Hybrids (D/NI)



- Loan disregarded in U.S. – no interest income
- Interest deduction in UK used under group relief rules

Action 2 – Payments made by Reverse Hybrids (D/NI)

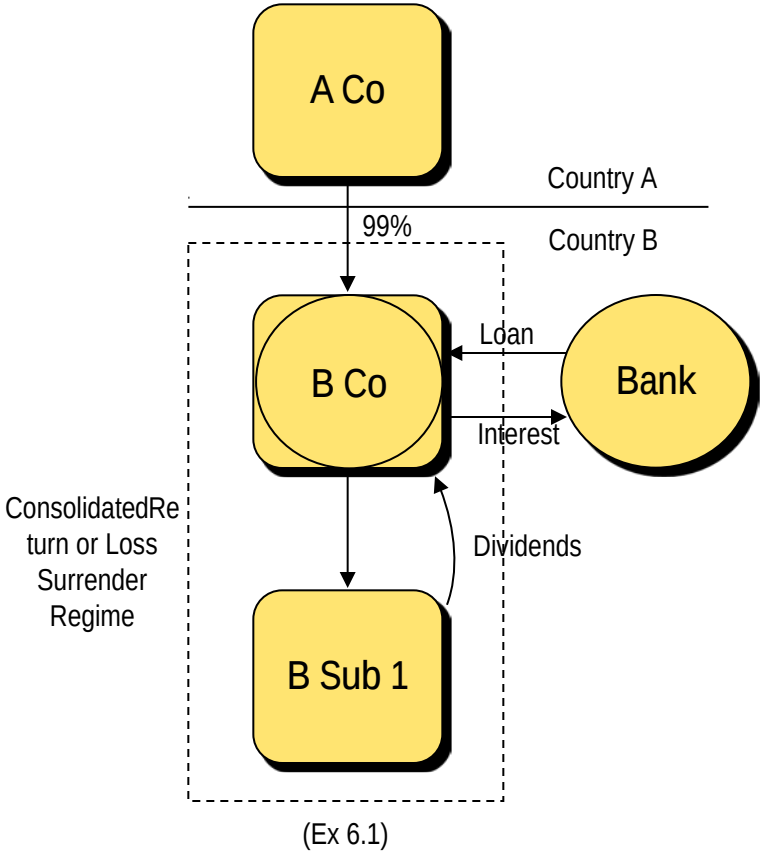


- Loan disregarded in Country A – no interest income
- Interest deduction in Country B used under consolidation or loss surrender regime.

<u>BEPS Recommendation</u>

- **Primary Rule:** Interest paid by B Co not deductible to the extent not taxed in hands of A Co.
- **Defensive Rule:** A Co must include interest in income to the extent deducted by B Co.

Action 2 – Hybrid Entities
Reverse Hybrid – Double Deduction

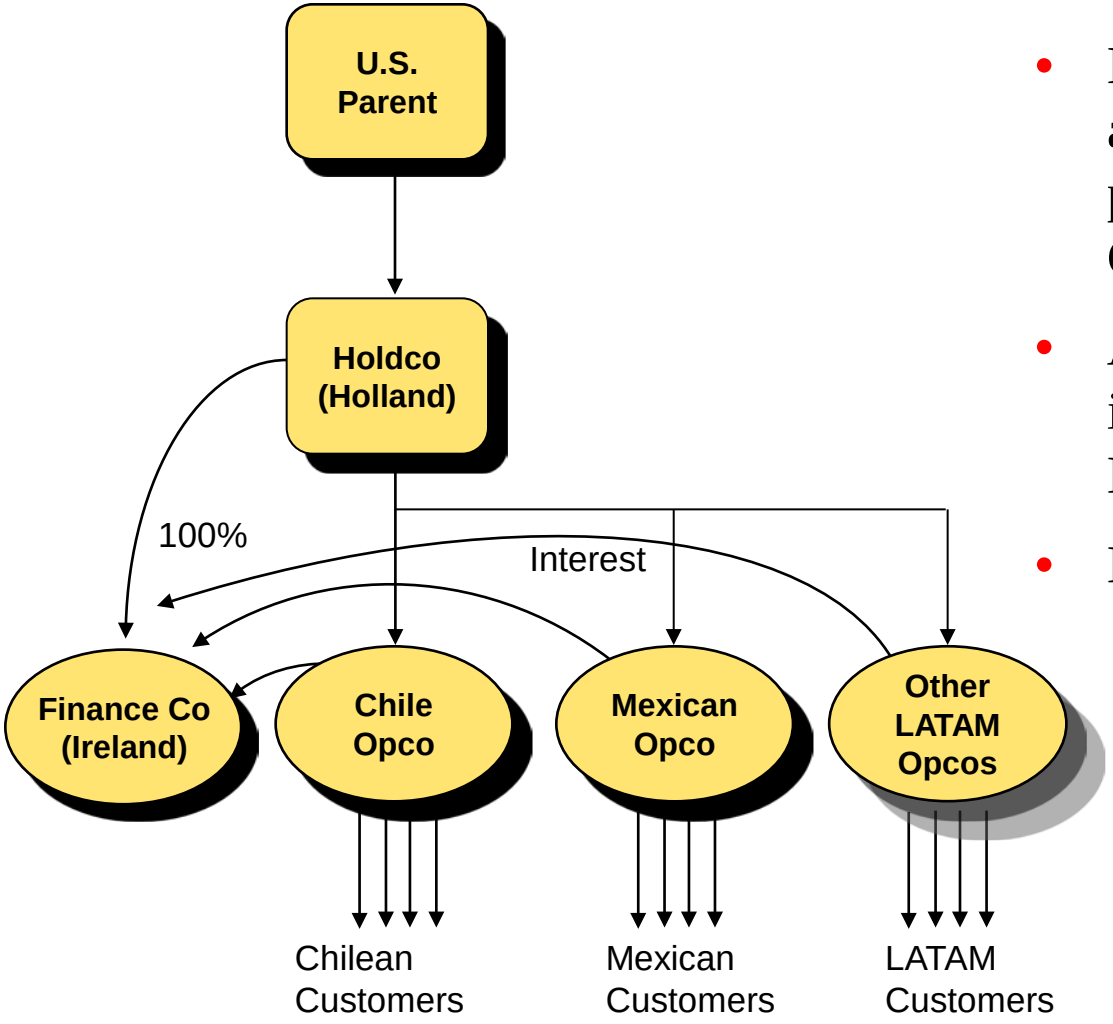


- B Co transparent for A purposes but a corporation for B purposes.
- A Co deducts interest paid to Bank under a consolidation or loss surrender regime
- A Co also deducts interest on foreign tax return.

<u>BEPS Recommendation</u>

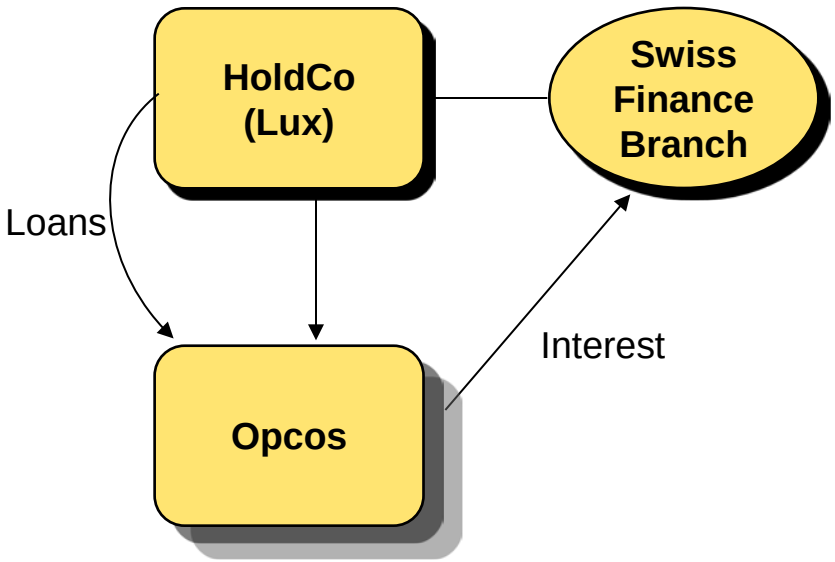
- **Primary Rule:** Country A should disallow a double deduction.
- **Defensive Rule:** Country B should disallow deduction if primary rule is not applied.

Action 2 – Hybrid Entities
U.S. Check-The-Box Strategies



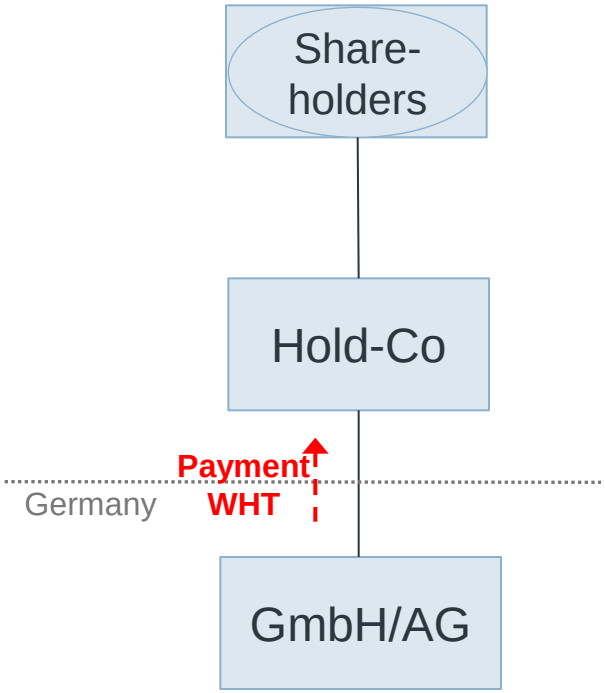
- No hybrid instruments. Entities are hybrids only for U.S. purposes, i.e., to avoid U.S. CFC rules
- Avails of relatively low tax rate in Ireland. Could be used in Belgium with NID
- Not covered by Action 2

Action 6 – Offshore Finance Branch



- Revise OECD Model Treaty for Opco jurisdiction to impose withholding at 15% if interest is taxed in Switzerland at a rate less than 60% of the Lux rate (similar to US-Lux Treaty)
- See Action 2 which would disallow a deduction for Opco (See Ex 1.8)
- See Draft Changes to U.S. Model Treaty, which would deny treaty benefits

BEPS Action 6: Treaty Abuse
German Status



Substance Requirements

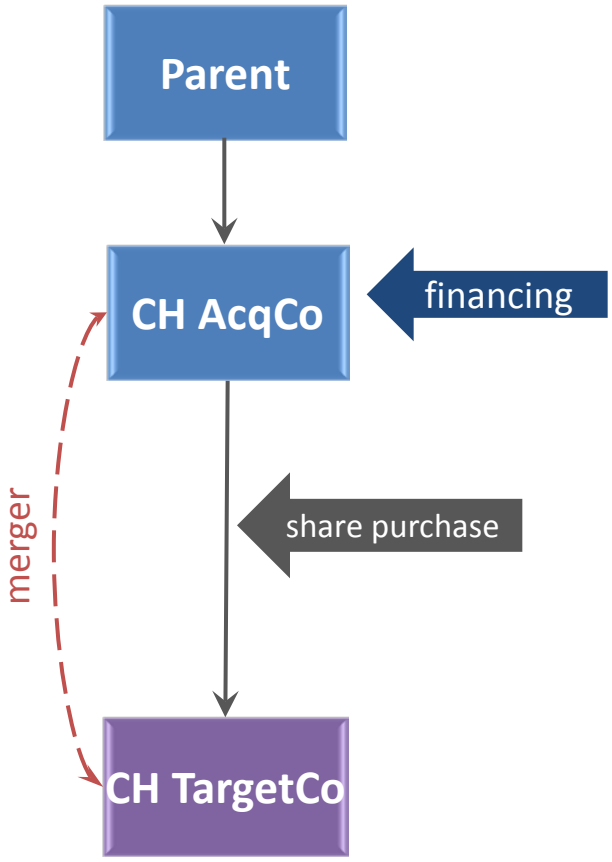
- No treaty benefits against levy of withholding tax available for a foreign company to the extent
  1. persons are its (direct/indirect) shareholders that would not be entitled if they received the income directly ("**Shareholder Test**"), ***and***
  2. its gross income does not stem from own business activity in the particular fiscal year ("**Earnings- and Substance-Test**"), ***and***
  3. ***either*** there are no business or other relevant reasons for interposing the foreign company with respect to such income, ***or*** the foreign company does not take part with a business set-up sufficient for its purpose in the general trade or business ("**Company Test**").
- Special exemptions available for listed companies and regulated funds having corporate form.

Debt Push-down strategies

Switzerland

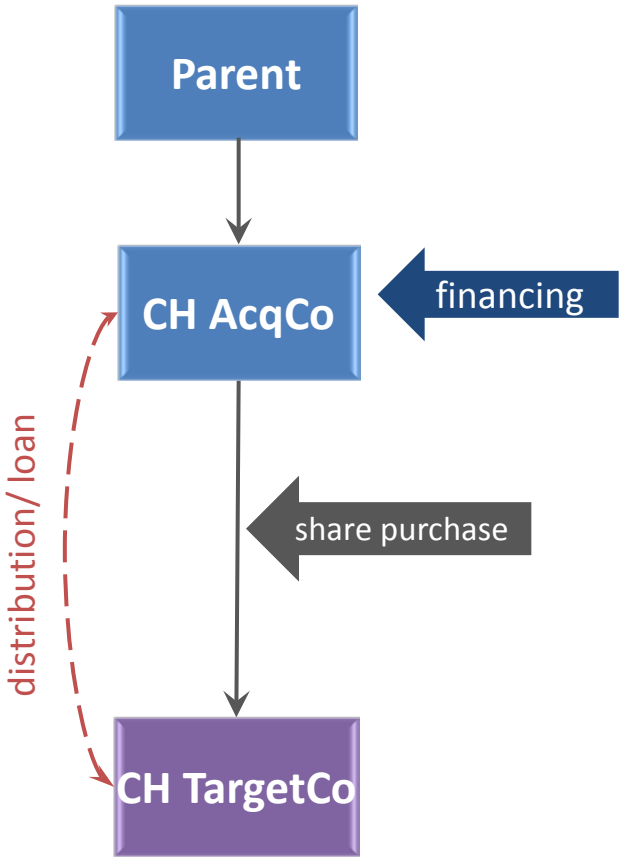
Peter Reinarz

Debt Push-down Switzerland 1/4



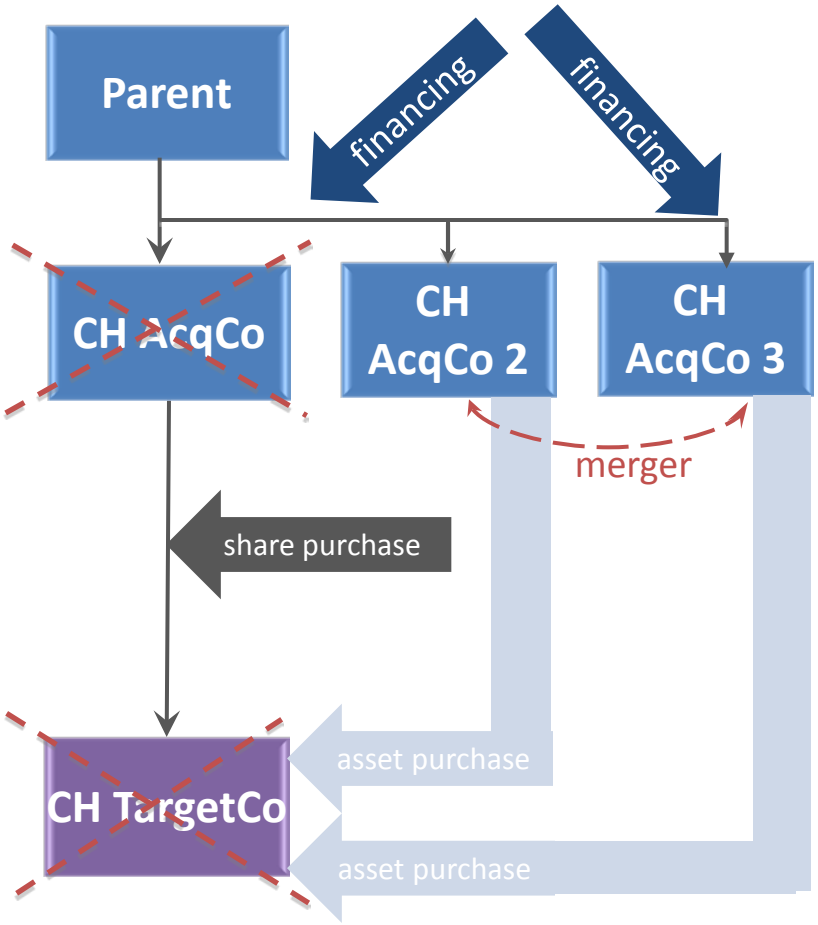
- No tax consolidation in Switzerland
  - Interest on CH AcqCo's acquisition debt is not deductible from CH TargetCo's operating income
  - CH AcqCo may not have effectively taxable income to utilize debt interest paid against
  - Dividends received by CH AcqCo benefit of participation relief; debt interest may in fact "dilute" participation relief
- Debt push-down via *merger (*up-stream/down-stream) between CH AcqCo and CH TargetCo?
  - Merger principally has "consolidation" effect, BUT:
  - Unwritten GAAR: If deduction of interest on acquisition debt is found to be the main driver of the merger, deduction may be denied based on tax avoidance doctrine!
  - Merger may trigger adverse income tax consequences for private individual sellers ("indirect full liquidation“)

Debt Push-down Switzerland 2/4



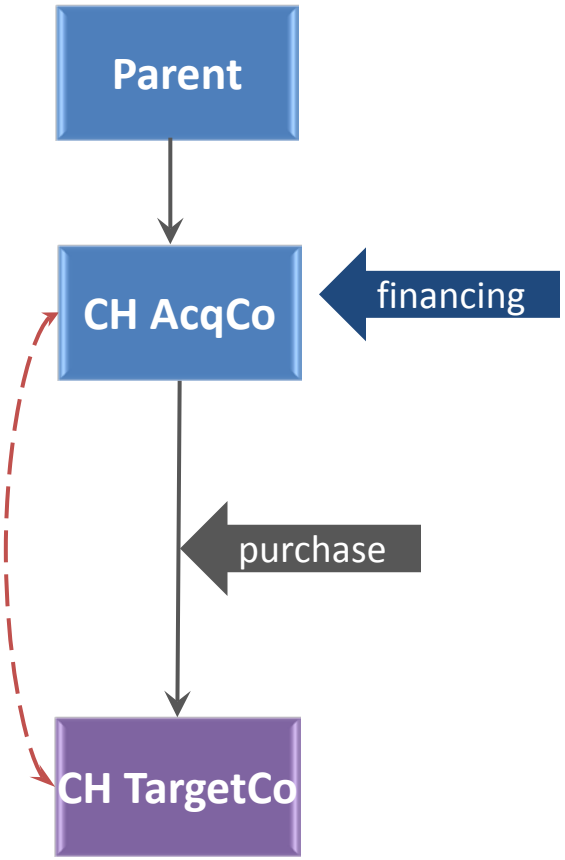
- Debt push-down by other means (equity-debt swap)?
  - E.g. distribution by CH TargetCo's distributable reserves against assumption of acquisition debt from CH AcqCo by CH TargetCo, or back-to-back loan
  - → may be workable, requires freely distributable earnings/reserves at CH TargetCo level, or room for share capital reduction!
  - CAVEAT: Distributions by CH TargetCo may trigger retroactive personal income tax to Swiss private individual sellers of CH TargetCo shares

Debt Push-down Switzerland 3/4



- Mixed share and asset deal
  - CH AcqCo buys CH TargetCo shares with bank loan 1
  - CH AcqCo 2 buys certain assets from CH TargetCo with bank bank loan 2
  - CH AcqCo 3 buys further assets from CH TargetCo with bank loan 3, etc.
  - After all of CH TargetCo's assets have been bought by CH AcqCos 2, 3, …, CH TargetCo may be dissolved, CH AcqCo may use proceeds to redeem bank loan 1
  - In final structure, CH AcqCos 2, 3, … will hold all of CH TargetCo's former assets, funded with bank loans; CH AcqCo may be dissolved; CH AcqCos 2, 3, ... may be merged
  - CAVEAT: Distributions by/liquidation of CH TargetCo may trigger retroactive personal income tax to Swiss private individual sellers of CH TargetCo's shares!

Debt Push-down Switzerland 4/4



- Further constraints on debt push-down to CH TargetCo
  - **Thin-capitalization** tax regulations: Apply to related party debt, including third-party debt "enhanced" by parent/related party (guarantee, keep-well, etc.)
  - **10/20/100 Non-Bank Lender rules**: Apply to direct debt funding by lender syndicates; breach of the rules results in deemed "Swiss bond", hence liability for 35% interest WHT (regulated banks and consolidated affiliates are not counted as potentially harmful lenders for the 10/20/100 lender thresholds for taxable "bonds")
  - **Legal limitations on up-stream and side-stream loans and collateral** (guarantees etc.): Admissible only up to the amount of freely distributable reserves; according to recent Supreme Court ruling, upstream/sidestream loans are locking-up profit reserves (dividend blocker!)

Debt Push-down
BEPS Action 4

Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

Best practice rules applying to
- interest on all forms of debt
- payments economically equivalent to interest
- expenses incurred in connection with the raising of finance

- **De minimis thresold** craving-out enitites with low level of interst expenses
- **Fixed ratio rule**: Limitation of net deduction of interest to a percentage (10% - 30%) of its EBITDA
- **Group ratio rule**: Allows entity to deduct interest up to the level of the net interest/EBITA ratio of its worldwide group; Uplift of 10% to the group's net third party interest possible
- **Carry forward/back of disallowed interest expenses /unused interest capacity**
- **Targeted rules** to prevent circumvention
- **Specific rules** addressing BEPS risks in the banking an insurance sector

→ Switzerland is unlikely to introduce further (other than thin capitalisation rules) limitations to the deductibility of interests and payments equivalent to interests

Debt Push-down
BEPS Action 5

Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

Required substantial activity for preferential tax regimes
Preferential tax regimes require substantial activity based on the nexus approach
Existing Swiss cantonal tax regimes (holding, domiciliary, auxiliary/mixed companies regimes) and certain federal tax practices (finance branches and principal companies) do not meet the substantial activity test

→ Switzerland will abolish its preferential tax regimes on cantonal level as well as certain federal tax practices; cantonal holding tax privileges for CH AcqCo will be abolished. The Corporate Tax Reform III package is currently discussed by the Swiss parliament.

Compulsory spontaneous information exchange on rulings
rulings related to preferential regimes
unilateral advanced pricing agreements (APAs) or other unilateral cross-border rulings in respect to transfer pricing
cross border rulings providing for a downward adjustment of taxable profits
permanent establishment rulings
related party conduit rulings (e.g. debt push-down)
any other type of ruling wehre the FHTP agrees that the absence of exchange would give rise to BEPS concerns

→ Switzerland will adopt the compulsory spontaneous information exchange on rulings. Rulings on debt push-down likely to be subject to exchange. Implementation is not expected before 2018

Debt Push-down
BEPS Action 6

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Treaty shopping: Minimum standards
Limitation-on-benefits (LOB) rule: Limitation of treaty benefits to entities that meet certain conditions in relation to its legal nature, ownership, general activities and state of residency
Principal purpose test (PPT) rule: Denial of treaty benefits if one of the principal purposes of transaction/arrangement is to obtain treaty benefits, unless that granting these benefits would be in accordance with the object of the relevant tax treaty

→ Minimum standard to be introduced by Switzerland: i) combined approach of LOB and PPT, ii) PPT alone, or iii) LOB rule, supplemented by specific rules targeting conduit financing; Other measures under review by the Swiss Federal Council

Debt Push-down
BEPS Action 6

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Other situations where a person seeks to circumvent treaty limitations: Recommendations
Splitting-up of contracts to avoid PE thresholds mainly in relation to construction contracts (Art. 5 OECD-MTC)
Hiring-out of labour cases where taxpayers attempt to obtain inappropriately benefits of Article 15 OECD-MTC
Transactions intended to avoid dividend characterization: Definition of dividend /interest could be amended in OCED-MTC
Dividend transfer transactions: Minimum holding period of 365 days may be included in Art. 10 para.2 sec. a OECD-MTC
Transactions that circumvent Art. 13: Extension to interest in other entities and introduction of a holding period of 365 days
Tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals: Determination by mutual agreement between the relevant contracting states (Art. 3 para. 4 OECD-MTC)
Anti-abuse rule for PE situated in third states: Where the residence stat exempts, or taxes at low rates, profits attributable to a PE situated in third states, the state of source should not be expected to grant treaty benefits

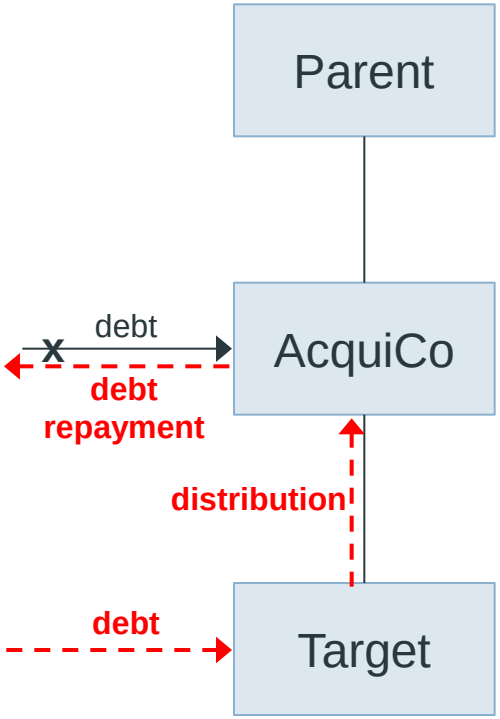
Dr Frank R. Tschesche

Debt Push-down Structures – Possible German Structures and Restrictions

5th Annual IBA Tax Conference, London, 9 February 2016

GvW Graf von Westphalen

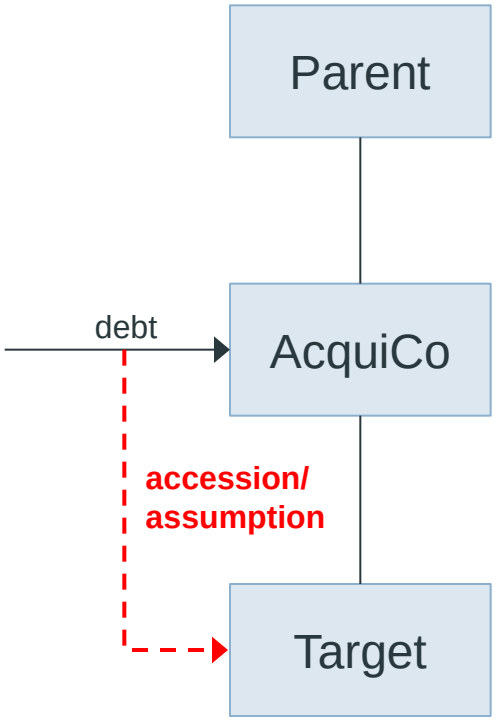
Debt Financed Distribution



Issues

- Distributable funds required:
  - reduction of share capital,
  - distributable profits,
  - creation by step-up in asset base.
- Distribution should result in a tax leakage unless tax equity account is debited.
- Debt collateral must be renewed.
- Alternatively, a back-to-back loan may be considered (up-stream).

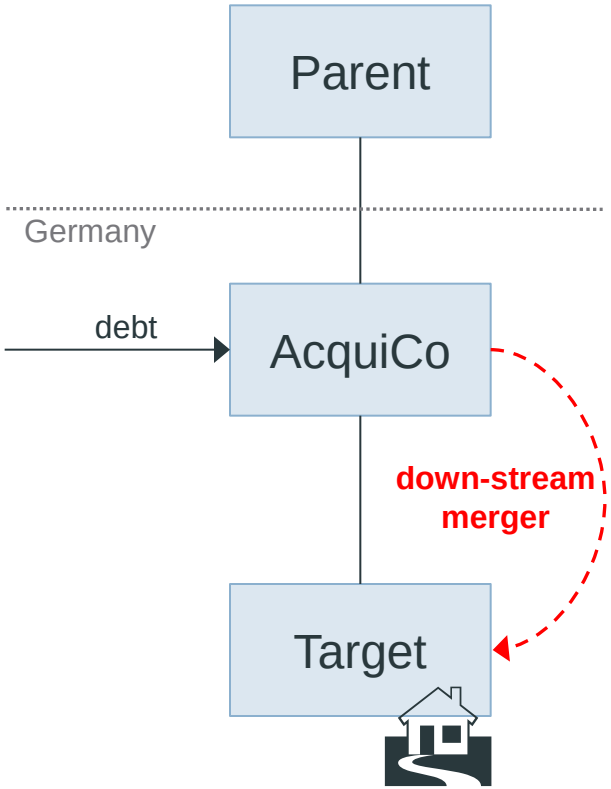
Loan Accession / Debt Assumption



Issues

- Accession/assumption should result in a hidden profit distribution.
- Situation taxwise comparable to the previous scenario (also tax equity account may be debited).
- Possible to avoid having to renew debt collateral.

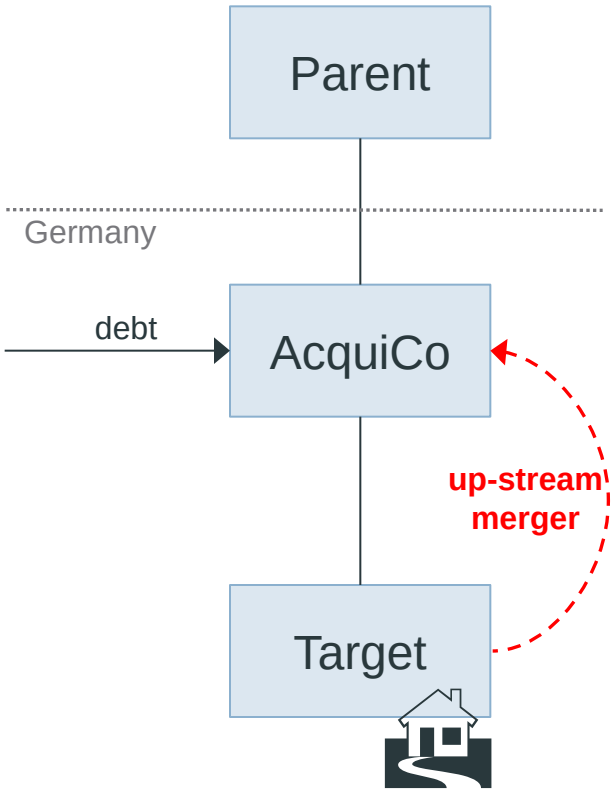
Down-stream Merger



Issues

- Merger effected under German Reorganisation Act (*Umwandlungsgesetz*). Transfer of AcquiCo's assets (if any) and liabilities (including the debt) to Target by act of law (principle of universal succession, *Gesamtrechtsnachfolge*).
- In principal tax neutral under German Reorganisation Tax Act (*Umwandlungssteuergesetz*). Potentially, a multi-level structure is required to achieve tax neutrality.
- If the asset values accounted for are not sufficient to meet the corporate law capital maintenance requirement a step-up of the Target's assets may be required.

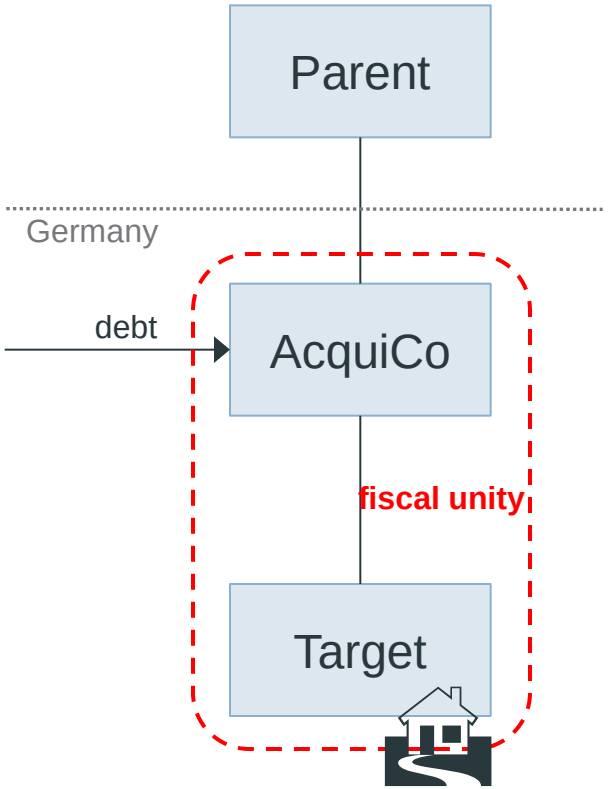
Up-stream Merger



Issues

- Merger effected under German Reorganisation Act. Target's assets and liabilities transfer to AcquiCo by act of law (principle of universal succession).
- In principal tax-neutral under German Reorganisation Tax Act.
- Forfeiture of tax loss carry forwards of the Target, if any.
- RETT triggered unless limited exception applies.

Fiscal Unity



Issues

- German law requires a profit- and loss-pooling agreement.
- Profit- and loss-pooling agreement requires loss absorption undertaking by AcquiCo (piercing of the corporate veil).
- Cross-border fiscal unities?
- Guaranteed dividend payment required for outside minority shareholders, if any (insofar the Target's income is subject to tax at Target level).
- Pre-fiscal unity tax losses of Target are "frozen".
- Creditors cannot directly enforce against assets of the Target.
- Implementation shortly after acquisition of Target may trigger RETT.

BEPS Action 4: Interest Deductions

***De minimis* monetary threshold to remove low risk entities**
Optional
Based on net interest expense of local group

+

Fixed ratio rule
Allows an entity to deduct net interest expense up to a benchmark net interest/EBITDA ratio
Relevant factors help a country set its benchmark ratio within a corridor of 10% - 30%

+

Group ratio rule
Allows an entity to deduct net interest expense up to its group's net interest/EBITDA ratio, where this is higher than the benchmark fixed ratio
Option for a country to apply an uplift to a group's net third party interest expense of up to 10%
Option for a country to apply a different group ratio rule or no group ratio rule

+

Carry forward of disallowed interest /unused interest capacity and/or carry back of disallowed interest
Optional

+

Targeted rules to support general interest limitation rules and address specific risks

+

Specific rules to address issues raised by the banking and insurance sectors

Source: OECD Action 4: 2015 Final Report, Figure 1.1., page 26.

BEPS Action 4: Interest Deductions

Best practice rule should apply to

1. Interest on all forms of debt
2. Payments economically equivalent to interest
3. Expenses incurred in connection with the raising of finance

These should include but not be restricted to:

- Payments under profit participating loans
- Imputed interest on instruments such as convertible bonds and zero coupon bonds
- Amounts under alternative financing arrangements, such as Islamic finance
- The finance cost element of finance lease payments
- Capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest
- Amounts measured by reference to a funding return under transfer pricing rules, where applicable
- Notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings
- Certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance
- Guarantee fees with respect to financing arrangements
- Arrangement fees and similar costs related to the borrowing of funds

Source: OECD Action 4: 2015 Final Report, annot. 36.

BEPS Action 4: Interest Deductions
German Interest Barrier Rule (*Zinsschranke*)

< € 3m *de minimis* p.a. threshold (§ 4h para. 2 sent. 1 lit. a ITA)
Based on net interest expense of the local business unit (*Betrieb*)

+

Fixed ratio rule (§ 4h para. 1 sent. 1 ITA)
Net interest expense up to taxable EBITDA (≈ 30% EBITDA) deductible

+

No-group exception (§ 4h para. 2 sent. 1 lit. b ITA)
Exception for business unit which is not or only partially part of a group to deduct all net interest expense

+

Group ratio rule (§ 4h para. 2 sent. 1 lit. c ITA)
Allows a business which is part of a group to deduct all net interest expense if its equity ratio at the end of the previous business year was not more than 2 % below its group's equity ratio

+

Carry-forward of disallowed interest / unused taxable EBITDA (§ 4h para. 1 sent. 3 and 5 ITA)

+

Targeted rules to support general interest limitation rules and address specific risks
- Corporations cannot rely on no-group exception if there is a harmful shareholder debt-financing (§ 8a para. 2 CTA)
- Corporations cannot rely on group ratio rule if there is a harmful shareholder debt-financing anywhere in the group (§ 8a para. 3 CTA)

German Interest Barrier Rule
German Constitutional Law / EU Law Concerns

German Constitutional Law

- German professional literature has expressed strong constitutional concerns against the German interest barrier rules for years.
- German Federal Fiscal Court has expressed "*serious doubts*" about the constitutionality due to interference with the so-called *objective net principle* (taxes must be levied based on the net financial capacity of the taxpayer) without justification.
- German Federal Ministry of Finance opposes German Federal Fiscal Court's view (non-application decree of 13 November 2014).

EU Law

- Some authors in German professional tax literature express EU law concerns (violation of the freedom of establishment/free movement of capital) because the effects of the interest barrier rule can be mitigated/avoided using a fiscal unity by German businesses (hidden discrimination).

EU State Aid & Interaction with BEPS

IP Box Regimes

Ailish Finnerty, Arthur Cox

EU State Aid – What is it?

- EU Commission: *"an advantage in any form whatsoever conferred on a selective basis to undertakings by public authorities"*

- Conditions for State Aid:
  - an intervention by the State or through State resources
  - gives the recipient an advantage on a selective basis
  - competition has been or may be distorted;
  - intervention likely to affect trade between Member States.

- State Aid investigations into tax rulings initiated to date:
  - Starbucks *(Netherlands)*
  - Fiat *(Luxembourg)*
  - Apple *(Ireland)*
  - Amazon *(Luxembourg)*
  - McDonald's *(Luxembourg)*

EU State Aid – Apple

- Focus - 1991 and 2007 rulings on profit allocation to Irish branches
- Significant potential exposure if case upheld
- Significant impact likely for other taxpayers – need to consider existing rulings
- Announcements issued to date on State Aid cases – blurring the lines with BEPS? Have the alleged recipients of State Aid received *advantages on a selective basis* or are the arrangements objectionable on other (BEPS) grounds?
- Difficult to assess EU Commission thinking in the absence of published judgments
- Hampering Member States in granting legitimate fiscal benefits to promote certain sectors / activities?

EU State Aid – Where to from here?

- Tip of the Iceberg?
- Compliance with OECD Transfer Pricing principles?
- Tax ruling – legitimate expectation?

- State Aid judgements to be analysed when issued
- All taxpayers should review rulings in place

- Future of Tax Rulings?
- Impact of BEPS?

- IP Box Regimes
  - OECD BEPS Reports
  - Ireland's Knowledge Development Box
  - Other IP Box Regimes

IP Box Regimes – OECD BEPS – Action 5

- Substantial activity requirement for preferential IP tax regimes
- Nexus approach – nexus between income receiving the benefit and expenditure contributing to that income
- Benefit available where R&D activity undertaken by taxpayer itself
- Only applies to patents and IP assets "functionally equivalent" to patents (eg. copyrighted software)
- Qualifying expenditure – directly incurred for actual R&D, not acquisition costs, building costs etc.
- 30% uplift in qualifying expenditures possible

Irish Knowledge Development Box

- Fully compliant with Action 5 Report / Nexus Approach
- Tax rate of **6.25%** applies to profits from certain IP where qualifying R&D carried out in Ireland
- IP – patented inventions and copyrighted software
- Applies from 1 January 2016
- An up-lift in the amount of qualifying expenditure is available, being the lower of:
  - 30% of the amount of the qualifying expenditure, or
  - the aggregate of acquisition costs and group outsourcing costs

Other Patent Box / IP Box Regimes

- Following IP regimes identified as inconsistent with nexus approach and countries now required to review possible amendments

Belgium	China
Columbia	France
Hungary	Israel
Italy	Luxembourg
Netherlands	Portugal
Spain	Switzerland (Nidwalden)
Turkey	UK

The possible impact of Brexit

5th Annual IBA Tax Conference February 2016

david.saleh@cliffordchance.com

CLIFFORD

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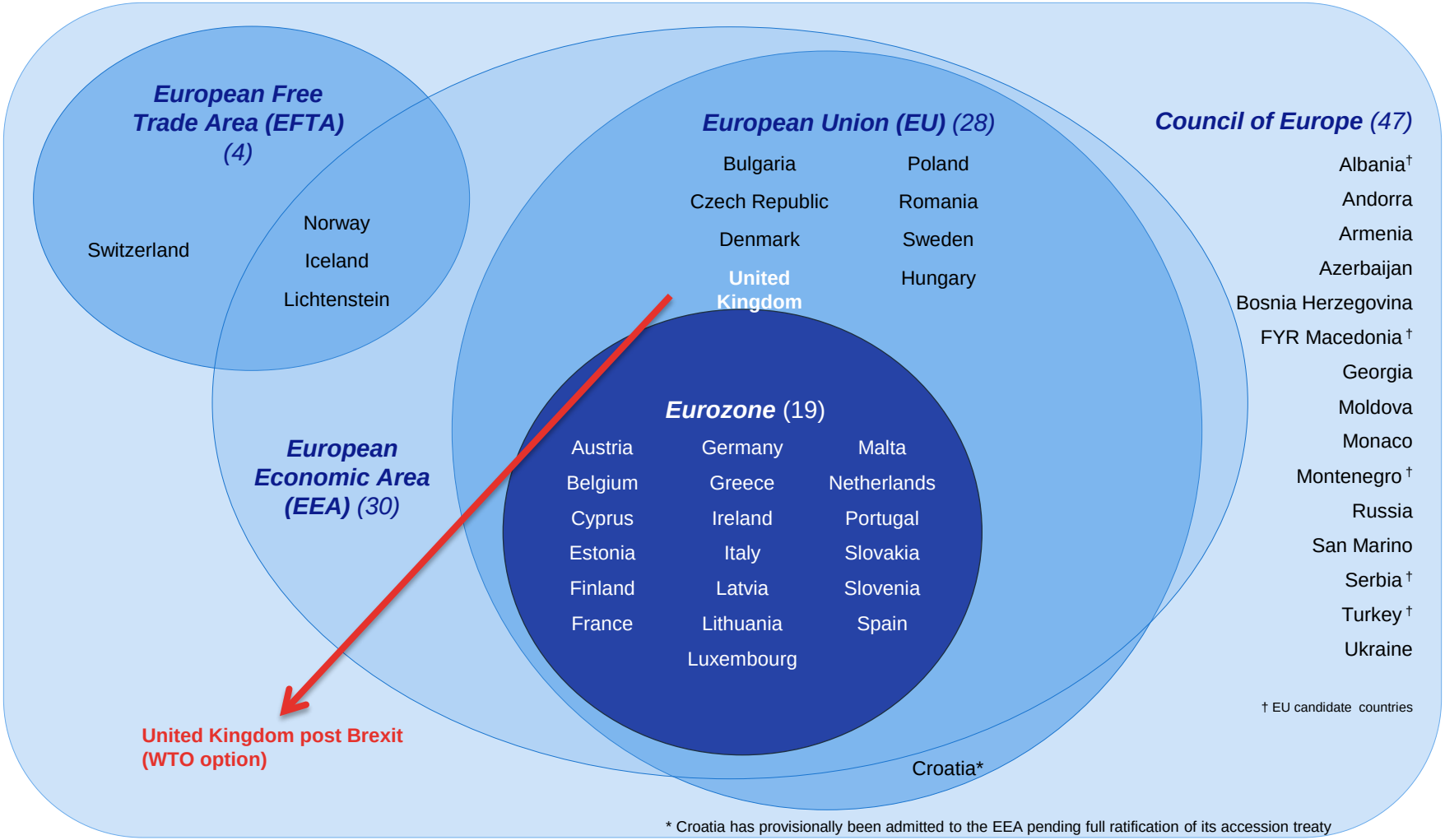
The UK in Europe



* Croatia has provisionally been admitted to the EEA pending full ratification of its accession treaty

British Crown Dependencies

Isle of Man
Channel Islands (Jersey, Guernsey, Sark)

EU Outermost Regions (OMRs)

E.g. Martinique; Canary Islands

EU Overseas Countries & Territories (OCTs)

E.g. British Virgin Islands; Aruba

Other

E.g. Gibraltar

What is the referendum question?

The question in the current draft of the EU Referendum Bill is:

“Should the United Kingdom remain a member of the European Union or leave the European Union?”

Alternatives to EU membership

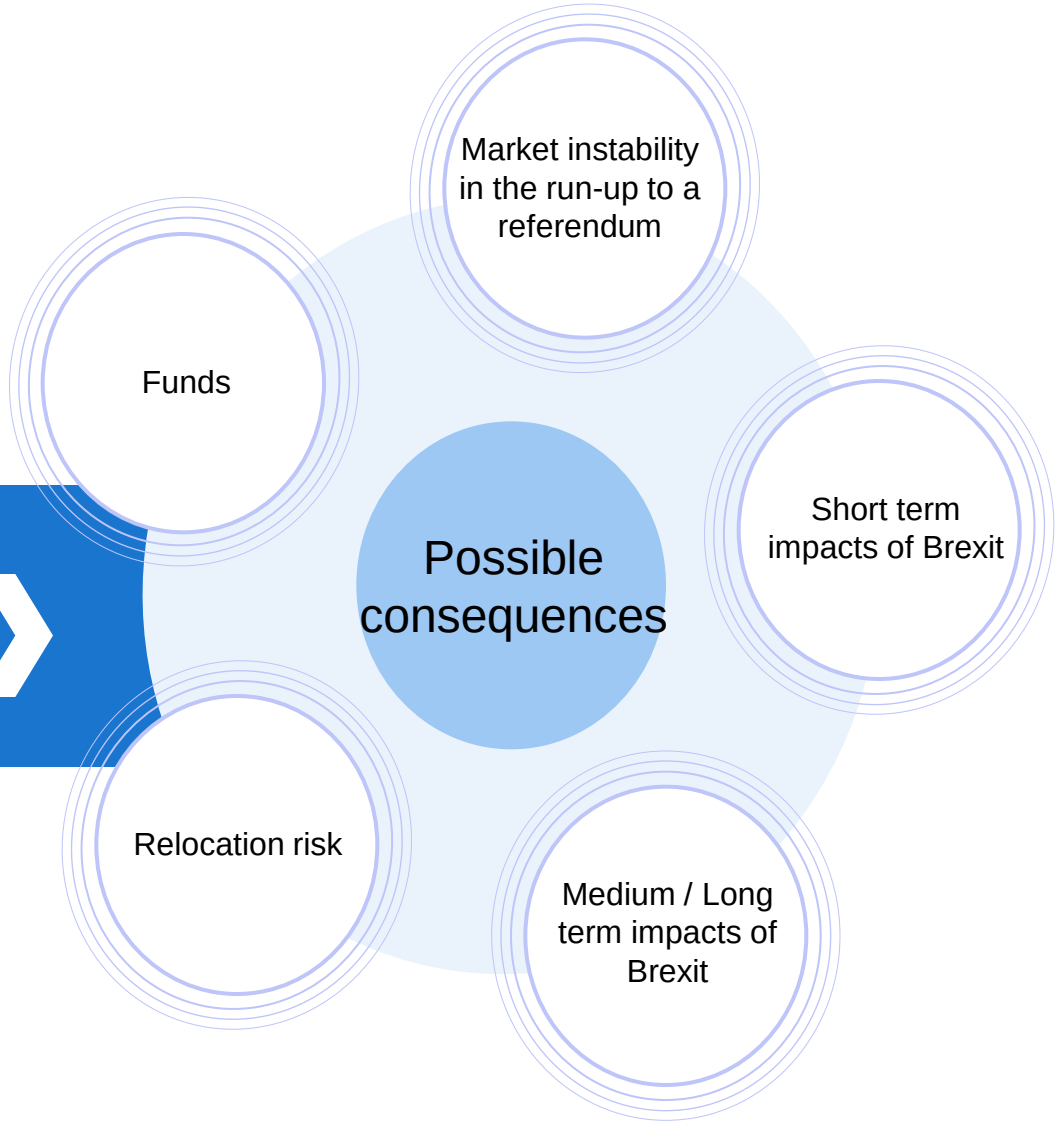
Yes | No | Partial

	Access to the EU Internal Market	Freedom to set own external trade policy	European Council Commission Parliament [1]	Court of Justice of the European Union [2]	Social and employment policy	Common Agricultural Policy	Contribute to the EU budget	Justice and Home affairs	Schengen area	Charter of Fundamental Rights	Free to regulate own Financial Sector	Membership of the euro
1 (UK) Status Quo or variation		Partial						Partial [6]		Partial [8]		
2 EU Minus		Partial						Partial [7]		Partial [9]		
3 EU Plus		Partial										
4 (Norway) EEA + EFTA	Partial [3]										Partial [9]	
5 (Swiss) Bilateral agreements + EFTA	Partial [4]											
6 (Turkey) Customs Union	Partial [5]	Partial										
7 UK/EU FTA												
8 WTO												

1 Membership of and voting rights on the European Council, Council of the European Union, the Commission and Parliament.
2 Nomination of a judge to both the Court of Justice of the European Union and the General Court of the European Union.
3 The EEA agreement provides for access to the EU's Internal Market although at present it does not offer full access to the Internal Market in financial services.
4 Bilateral Agreements and EFTA, page 35, *Britain and the EU,* Clifford Chance, August 2015.
5 Access to the EU Internal Market for goods without the need for Rules of Origin.
6 The UK has the right to opt in / out of certain measures.
7 The UK would have a right to opt in / out as it saw fit.
8 The UK has a protocol that clarifies that the CFR does not create rights in UK courts.
9 The UK would retain a protocol that clarifies that the CFR does not create rights in UK courts.

Financial Services

Worst case scenario
Disorderly Brexit in Q3 2018



The "four freedoms" in the context of financial services

The “four freedoms”

Goods

Free movement of goods (Art. 28 TFEU)

Relevant for

- Commodities settlement
- Asset finance
- Project finance
- Trade finance

Persons

Free movement of citizens (Art. 20-21 TFEU)

Free movement of workers (Art. 45 TFEU)

Relevant for

- Employee mobility
- Professional services (legal / accounting directives)

Services

Freedom of Establishment (Art. 49 TFEU)

Freedom to provide, receive services (Art. 56 TFEU)

Relevant for

- Banks (CRD IV)
- Payment Systems (PSD)
- Investment Services (MiFID; MiFIR)
- E-Money (EMD)
- Money Laundering (3 MLD)

Capital

Free movement of capital (Art. 63(1) TFEU)

Free movement of Payments (Art. 63(2) TFEU)

Tax

- Direct taxation is a member state, not EU competence, however taxes must comply with certain basic principles of EU law.
- The UK government would be able to apply tax law without reference to EU. For example, it could exercise its power to tax in a manner which would currently constitute state aid incompatible with Art. 107 TFEU.
- The UK and EU would be able to discriminate against each other by imposing tariffs and other measures.

Relationship between UK and EU laws

- Direct taxation - an area of competence for the Member States not EU harmonisation. However, the UK must exercise its power to tax in accordance with EU law.

- VAT is imposed by EU law and the UK must implement it in accordance with EU law.

- There have been a number of cases in which UK tax legislation has been successfully challenged before domestic courts and/or the CJEU on the basis that the legislation infringes EU law.

Relationship between UK and EU laws

In such cases the UK legislation has been disapplied and tax refunds issued by HMRC – in many cases at significant expense to the UK Exchequer. By way of example these cases include:

- Challenges to the UK controlled foreign company legislation
- Challenges to the UK 1.5% tax charge on the issue of shares and securities to clearance services or depositories, which was found to breach the EU Capital Duties Directive;
- Challenges to differential rates of UK insurance premium tax, which were found to constitute unlawful aid in breach of the Art 107 TFEU state aid rules; and
- Challenges to whether compound (or simple) interest is due to taxpayers in respect of overpaid tax when the UK has implemented EU law incorrectly.

Brexit – Opportunities and Risks

- Upon Brexit, the legal position as regards UK tax law would depend on what alternative settlement to full EU membership is agreed by the UK.
  - The UK Government could be free to implement tax legislation without the restrictions imposed by the TFEU fundamental freedoms and other EU legislation.
  - The UK Government could also be able to enact tax legislation, or exercise its power to tax, in a manner which would currently constitute state aid incompatible with Art 107 TFEU.
  - Any area of UK tax law (be it VAT law or otherwise) which is currently incompatible with EU law ought to become valid upon a full Brexit.

Brexit – Opportunities and Risks

- The UK courts would no longer be bound to follow principles of VAT law interpretation established by the CJEU upon a full Brexit so the overarching cornerstones of VAT law (such as the principles of fiscal neutrality, equivalence and non-discrimination) would fall away, and this would have a profound effect on the way in which VAT law is to be interpreted;
- Preferential EU rules applicable to certain cross-border transactions would not apply following a full Brexit (i.e. VAT may need to be charged on transactions where it is currently not charged and UK businesses may need to register for VAT in EU countries where they are currently not required to do so); and
- Companies would be advised to check whether the VAT provisions in their contracts need to be amended in light of a full Brexit (e.g. VAT may currently be defined by reference to the EU VAT legislation only, in which case the provisions may no longer apply in relation to UK VAT).

Brexit – Opportunities and Risks

- The remaining EU Member States would be free to exercise their taxing powers in a manner which, by accident or design, discriminates between local entities on one hand and UK entities (or local branches of UK entities) on the other hand e.g. a future EU Financial Transactions Tax could be implemented which taxes transactions relating to, or with persons in, the UK.
- The UK would lose its influence over tax-related developments within the EU. This could be relevant, for example, in relation to the proposal to introduce an EU Financial Transactions Tax, which the UK has so far lobbied against effectively.
- In the absence of some form of alternative free trade agreement, the UK and the EU would each impose tariffs on imports from the other.

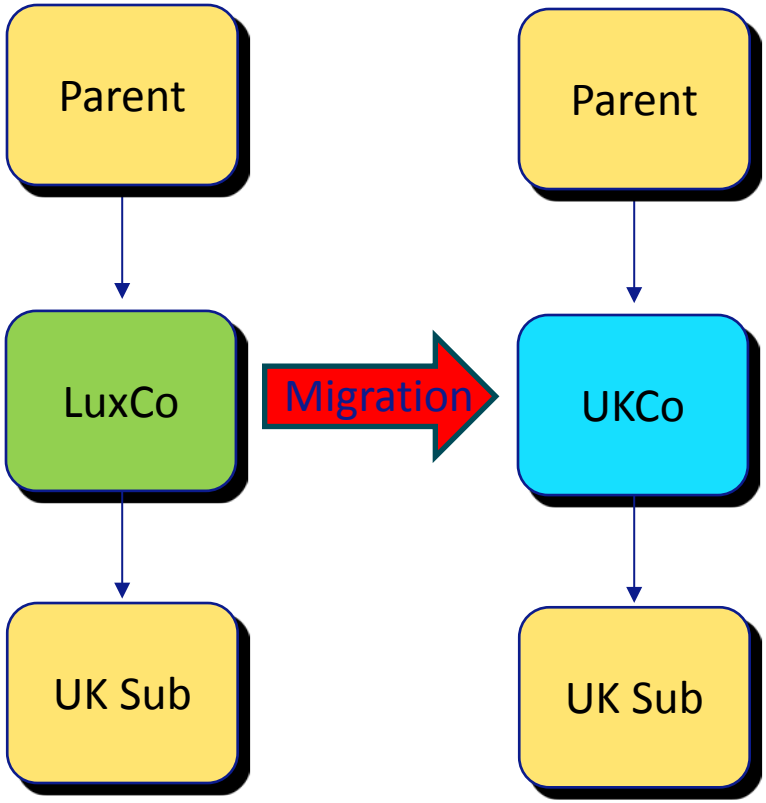
Brexit – Opportunities and Risks

- The newfound legislative freedom with which the UK Government would find itself would, of course, create potentially unwelcome uncertainty for UK companies such as:
  - A number of UK companies may currently take comfort from the limits placed on the Government's power to exercise its taxing powers by EU law. In some cases, these limits may be fundamental to those companies' decisions to base themselves in the UK;
  - There may be uncertainty as to the extent to which existing and future CJEU case law and EU jurisprudence would influence the decisions of UK courts after Brexit (especially in relation to VAT); and
  - UK companies may currently rely, under the tax laws of other Member States, on tax legislation which provides exemptions for entities established in other EU Member States, which they could lose the benefit of upon Brexit.

Wider Consequences

- The UK would continue to benefit from and remain subject to its extensive network of double tax treaties, including (where relevant) their non-discrimination provisions.
- The UK would also continue to have influence in international efforts to drive tax policy, including the ongoing OECD BEPS project.
- Depending on the nature of the alternative settlement to full EU membership agreed by the UK, the UK may be free to negotiate its own free trade agreements with other non-EU jurisdictions, which could result in fewer tariffs and duties on exports and imports between the UK and those other jurisdictions.

Migration of Lux Holdco to U.K.



Luxembourg:

- Migration vs conversion (Cartesio)
- Exit taxation
- real seat vs incorporation principle

UK:

Stibbe

BEPS and other developments in Luxembourg

Ayzo Van Eysinga

February 2016

Stibbe

Agenda

BEPS and other developments in Luxembourg:

1. Luxembourg new ruling procedure
2. Transfer pricing
3. Luxembourg IP regime (BEPS Action n°5)
4. Hybrid mismatch (BEPS Action n°2)
5. The amended parent subsidiary directive (GAAR)

Stibbe

BEPS and other developments in Luxembourg

1. The new ruling procedure

- **Background:**
  - Long-awaited reform in a context of unmanageable number of ruling applications to the Luxembourg tax authorities;
  - Demand of taxpayers for legal certainty;
  - International tax standards pushing for more tax transparency between jurisdictions (BEPS Action Plan, new EU Directive on automatic exchange of tax rulings, State Aid procedures, etc.).
- Set-up of a **tax ruling commission**
  - Publications of rulings in an anonymous/abridged format
  - In the future: less ruling applications <> more circular letters and reliance on published rulings
  - Pre-filing hearings + hearing at the request of the ruling commission

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BEPS and other developments in Luxembourg

1. The new ruling procedure

- Overview of the tax ruling procedure:
  - **The main conditions for the filling of ruling requests are:**
    - Identification of the applicant requesting the ruling along with information about any interested party;
    - Detailed description of the envisaged operation(s) which have not yet produced their effects;
    - Detailed analysis of the legal issues, as well as duly motivated assessment of the legal situation of the applicant.
  - **Rulings have a legally binding effect for a maximum period of 5 years**
  - **A ruling will however immediately loose its binding effect if:**
    - The envisaged operations were incorrectly described; or
    - The ruling is no longer in conformity with domestic, European or international tax law further to a subsequent change of legislation.
  - **Charge of an administrative fee for business taxation cases (ranging from EUR 3,000 to EUR 10,000).**

Stibbe

BEPS and other developments in Luxembourg

1. The new ruling procedure

No change in general policies followed by the Luxembourg tax authorities with respect to typical tax structures

Current ruling policy does not formally anticipate future BEPS impacts, except with respect to:

- Non-trading branches/deemed PE structures (i.e. the US non-trading branch);
- Downwards TP adjustments (i.e. informal capital contributions) ;
- Net worth tax planning structures.
- MRPS

BEPS and other developments in Luxembourg

2. Transfer Pricing

- Law dated 19 December 2014 formally introduced the **arm's length principle between associated companies** in article 56 Income Tax Law
- Scope
  - an enterprise participates directly or indirectly in the management, control, or capital of another enterprise, **or**
  - The same persons participate directly or indirectly in the management, control or capital of two enterprises
  - **And** in either case, the two enterprises are, within their commercial or financial relations bound by conditions agreed or imposed which differ from these which would be made between independent enterprises,

The profits of these enterprises are determined and taxed on the basis of the conditions agreed upon between independent enterprises

- Article 56 LITL is a "copy/paste" of article 9 of the OECD Model Tax Convention
- Applicable as from 1st January 2015
- A Grand-Ducal Decree should be issued to specify actual documentation requirements

BEPS and other developments in Luxembourg

3. Intellectual property regime (BEPS Action 5)

- **International context**
  - BEPS Action 5: Agreement on Modified Nexus Approach for IP Regimes (2015 report)
  - Criterion of **substantial activity** for the application of IP preferential regimes (report issued by the OECD forum on Harmful Tax Practices on September 2014)

- **Luxembourg reaction:**
  - Luxembourg IP abolished as per July 1, 2016.
  - Grandfathering period of 5 years until 30 June 2021
  - Automatic exchange of information for IP acquired or developed after February 6th 2015 (date of the OECD compromise on Modified Nexus Approach)
  - Intention to implement a new IP regime based on Modified Nexus Approach

BEPS and other developments in Luxembourg

4. Hybrid mismatch (BEPS Action 2)

- Law of 18 December implementing Directive 2014/86/EU on anti-hybrid instruments
- Dividends distributed by EU companies to a Luxembourg holding company will no longer benefit from the Luxembourg participation exemption if the dividends are tax deductible in the EU member State distributing entity.
- This Law t does not affect the debt qualification of certain debt instruments that are broadly used in Luxembourg, such as preferred equity certificates ('**PECs**') or convertibles preferred equity certificates ('**CPECs**').
- **Impact on CPECs/PECs planning in Luxembourg**
  - "The recommendation is not intended to impact on questions of timing in the recognition of payments (§88 Draft Discussion Paper)
  - No immediate threat on PECs and CPECs

BEPS and other developments in Luxembourg

5. European General Anti-Abuse Rule (GAAR)

- Law of 18 December implementing Directive 2015/121/EU on the European GAAR

- This rule denies the benefit derived from the tax exemption which applies to:
  - dividends paid by a Luxembourg company to another EU Company listed in Art.2 of the Parent-Subsidiary Directive.
  - dividends distributed by an EU company to a Luxembourg company.

  Note: This rule does not affect the taxation of capital gain from the sale of shares under the Luxembourg parent subsidiary regime nor to dividends paid to or by eligible companies located outside the EU

- Such denial applies to an arrangement or a series of arrangements that are not "genuine" and that have been put in place "*for the main purpose or as one of the main purposes of obtaining a tax advantage that defeats the object of the Parent-Subsidiary Directive*". An arrangement is defined as not genuine if it is not implemented for valid commercial reasons that reflect economic reality.

- The principle of a general anti-abuse rule was already embedded in Luxembourg law, but with a more narrow scope. The current interpretation of the existing Luxembourg anti-abuse rule law is that a structure is considered abusive if it has been implemented for the sole purpose of obtaining a tax advantage. The rule proposed by the Bill makes instead a reference to a "main purpose", which is general, and as such, it is given a broader scope.