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Major Tax Overhaul Adopted in U.S. And Its Effect on Cross Border Investors

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INTRODUCTION

Dating back to the enactment of Subpart F of U.S. tax law in 1962, the United States has been a leader in the development of tax policy affecting international transactions. While some believe that the United States lost its leadership position during the development of B.E.P.S., the enactment of the Tax Cuts & Jobs Act ("T.C.J.A.") in late December 2017 should dispel that view. Among other things,

- Corporate tax rates were cut to 21%,
- The scope of controlled foreign corporation rules was expanded,
- A dividends received deduction ("D.R.D.") was adopted for inter-company dividends received from 10%-owned foreign subsidiaries,
- Deductions were given for the use of foreign derived intangible income generated by U.S. businesses from operations in the U.S.,
- Taxation was accelerated for the earnings of controlled foreign corporations deriving profits through the use of intangible property abroad.

These and other changes in U.S. tax policy are discussed in this article.

BROADENED SCOPE OF SUBPART F

Subpart F is applicable to C.F.C.'s and their U.S. Shareholders, as defined below. It is the principal anti-deferral regime of relevance to a U.S.-based multinational corporate group. Under Subpart F, U.S. Shareholders of a C.F.C. are taxed on their pro rata shares of certain C.F.C. income (referred to as Subpart F income) automatically even if no dividend is received from the C.F.C. Within certain limitations, dividends that are paid subsequently by a C.F.C. are deemed to come from previously taxed earnings of the C.F.C. and are not taxed when received.

A C.F.C. generally is defined as any foreign corporation in which "U.S. Shareholders" own (directly, indirectly, or constructively) shares representing more than 50% of the corporation's voting power or value. Certain rules of attribution are applied to treat shares owned by one person as if owned by another. Shares can be attributed between individuals, corporations, partnerships, trusts and estates. Consequently, shares owned in one company can be attributed from a shareholder to another company owned by that shareholder for the purposes of determining, *inter alia*, whether the other company is a U.S. Shareholder of a C.F.C. and whether two companies are related because one controls the other or both are under common control. Although ownership of shares is attributed from one person to another for the foregoing purposes, that attribution does not cause the ultimate U.S. Shareholder to be taxed under Subpart F on the income of the C.F.C. In other words, income follows legal ownership, notwithstanding ownership by attribution.

Under prior law, a "U.S. Shareholder" was a U.S. person that owned shares of the foreign corporation having 10% of the voting power. For this purpose, U.S. persons included U.S. citizens, U.S. residents, U.S. corporations, U.S. domestic trusts or estates, and U.S. partnerships and L.L.C.'s. In applying the attribution rules, shares could not be attributed from a foreign corporation that is a shareholder of a U.S. corporation to that U.S. corporation, a rule often used to decontrol a C.F.C. In addition, before Subpart F could apply to a C.F.C. and its U.S. Shareholders, a foreign corporation was required to be a C.F.C. for at least 30 days during the taxable year.

The T.C.J.A. made several changes to the provisions of Subpart F. First, the definition of a U.S. Shareholder was expanded so that a person that does not own 10% of the voting shares can be considered to be a U.S Shareholder if shares representing 10% of the value of the foreign corporation are owned. As long as one test is met, the U.S. person is considered to be a U.S. Shareholder.

Second, shares in a foreign affiliate that are owned by a foreign parent can be attributed to a U.S. subsidiary of the foreign corporation. As a result, foreign based groups with members in many countries, including the U.S., may find that all members based outside the U.S. are at risk of becoming controlled foreign corporations for certain U.S. tax purposes with the U.S. affiliate treated as if it were the parent company of the group. This can broaden the scope of information reporting, but not the imposition of tax. Earlier this year, the I.R.S. announced that it is reviewing the scope of the provision with a goal of limiting its application.

Finally, a foreign corporation is no longer required to be a C.F.C. for at least 30 days in order for Subpart F to apply to its U.S. Shareholders. This provision affects many tax plans put in place for high net worth individuals having children who live in the U.S. Those plans typically involved the use of foreign blocker corporations that protected U.S. situs investment assets from the imposition of U.S. estate taxes for a non-U.S. parent. At the same time, the plans allowed the children to have a tax-free step-up in the cost basis for underlying investment assets if the foreign blocker were liquidated promptly after the parent's death.

CROSS-BORDER INTERCOMPANY DIVIDENDS RECEIVED DEDUCTION

Generally, U.S. citizens, residents and domestic corporations are considered to be U.S. persons subject to tax on worldwide income. To eliminate double taxation of income, the U.S. allows a credit against Federal income tax for foreign income taxes paid on foreign source income. For taxpayers that are corporations, an indirect credit was allowed under prior law for foreign income taxes paid by foreign corporations when the U.S. corporation owned shares in a foreign corporation representing 10% or more of the voting power of the first-tier subsidiary and several lower levels in a chain of ownership. The pool of taxes associated with post 1986 earnings were deemed paid on a proportional basis as the earnings in that pool were distributed. The indirect foreign tax credit reached down to the 6th level of foreign subsidiary, so long as the U.S. corporation indirectly owned at least 5% of the lower tier subsidiaries.

The T.C.J.A. abandons the indirect foreign tax credit and moves to a D.R.D. system. A 100% deduction is allowed for the foreign-source portion of dividends received from 10%-owned foreign corporations. To be entitled to the D.R.D., a U.S. corporation must hold the 10% interest more than 365 days in the 731-day period beginning on the date that is 365 days before the ex-dividend date in the declaration.

The D.R.D. is not available for hybrid dividends. These are amounts for which a deduction would be allowed under the D.R.D. rules except that the specified 10%-owned foreign corporation received a deduction or other tax benefit in any foreign country in connection with the dividend payments. Also, if a C.F.C. with respect to which a domestic corporation is a U.S. Shareholder receives a hybrid dividend from a related C.F.C., the hybrid dividend is treated as Subpart F income of the recipient C.F.C. None of the exceptions to taxation under Subpart F are applicable.

The indirect foreign tax credit remains in effect to eliminate double taxation for U.S. corporations that are taxed under Subpart F in connection with foreign subsidiaries that are C.F.C.'s.

ONE-TIME TRANSITION TAX ACCOMPANIES TRANSITION TO D.R.D.

In order to create a level playing field for all earnings accumulated abroad in C.F.C.'s and other non-U.S. corporations in which a U.S. corporation owns sufficient shares to claim an indirect foreign tax credit, all post 1986 earnings of those foreign corporations are treated as if distributed on the last day of the most recent taxable year beginning prior to January 1, 2018. If the foreign corporation is a C.F.C., all U.S. Shareholders as defined above report the income. If the foreign corporation is not a C.F.C., only 10% shareholders report the income, provided that at least one such shareholder is a U.S corporation. The total tax is computed on the tax return for 2017, but the taxpayer can elect to pay the tax in eight annual instalments that are back-loaded. Forty percent of the total tax is paid in equal instalments over the first five years, and the balance is paid in escalating instalments over the last three years.

The rate of U.S. tax on the amount included in income is reduced by means of a notional deduction. The rate is 15.5% to the extent that the earnings have been invested in cash or cash equivalents, based on the balance sheet of the C.F.C. owned. The balance of the earnings is taxed at a rate of 8%. Corporations may claim an indirect foreign tax credit for foreign income taxes paid by the C.F.C. in connection with the post-1986 pool of earnings. However, the pool available for credit of foreign income taxes is reduced to reflect the reduction in the tax rate of the U.S. Shareholder. Similar reductions apply to dividend withholding taxes and foreign personal income taxes.

U.S. TAX IMPOSED ON GLOBAL INTANGIBLE LOW-TAX INCOME OF C.F.C.S, BUT AT A REDUCED RATE

The T.C.J.A. enacts a global intangible low-taxed income ("G.I.L.T.I.") regime that is designed to decrease the incentive for a U.S.-based multinational group to shift corporate profits to controlled subsidiaries operating in low-tax jurisdictions. This treatment is particularly important because the T.C.J.A. has modified U.S. tax law to provide a dividends received deduction ("D.R.D.") for dividends received from foreign subsidiaries. Without G.I.L.T.I., a U.S.-based group could erode its U.S. tax base by shifting profit-making activities to its C.F.C.'s that could generate low-tax profits abroad and distribute them to the U.S. parent on a tax-free basis under the D.R.D.

The G.I.L.T.I. regime applies to U.S. Shareholders of C.F.C.'s, as defined above. G.I.L.T.I. applies only to income that is not already taxed in the U.S. either at the level of a C.F.C. or its U.S. Shareholders. Consequently, the first step in computing G.I.L.T.I. is to eliminate the items of income for a C.F.C. that produce current tax. These include the following items of income:

- Business income that is subject to net-basis taxation in the U.S.;
- Dividends from a related C.F.C. that are not subject to tax in the U.S. at either the level of the

C.F.C. or the level of its U.S. Shareholders because of Subpart F; and

- All other income of a C.F.C. that result in an immediate U.S. tax under Subpart F for its U.S. Shareholders.

The remaining income is referred to as "Tested Income."

In determining how much Tested Income is treated as G.I.L.T.I., actual economic drivers for generating income are ignored. Instead, all items of C.F.C. income are deemed to arise from either depreciable tangible property used in the business or intangible property used in the business. Inventory, work in progress or supplies are excluded in the computation. If the C.F.C. is a foreign bank, the financial assets of the bank also are ignored.

The investment in tangible depreciable property is deemed to generate a 10% yield computed with reference to the adjusted basis of the property. That is reduced by interest expense allocated to the investment in the tangible depreciable property. The balance of the income is attributable to intangible property, which in turn, gives rise to G.I.L.T.I.

At this point, the positive and negative G.I.L.T.I. results for each C.F.C. owned by the U.S. Shareholder are aggregated. The U.S. Shareholder reports the net amount of G.I.L.T.I. on its U.S. Federal tax return.

When a U.S. Shareholder is a corporation, several additional computations are required. First, a deemed foreign tax credit is allowed for foreign income taxes attributable to G.I.L.T.I. The starting point in determining those taxes is to identify the C.F.C.'s total foreign income taxes paid. The second step is to remove the foreign income taxes attributable to income not included in Tested Income. What remains are "Tested Foreign Tax Credits." The third step is to determine the portion of the total Tested Foreign Tax Credits that are attributable to the 10% yield on depreciable tangible property. What remains are Tested Foreign Tax Credits attributable to G.I.L.T.I.

Because the foreign tax credit in this scenario relates to taxes actually paid by the C.F.C. but attributed to the corporate U.S. Shareholder – sometimes called a deemed-paid or indirect credit – the taxes for which the credit is claimed must be added to the amount otherwise reported as taxable. This is referred to as a gross-up. Its purpose is to equate the deemed credit to a direct foreign tax credit of a branch of the U.S. corporation. There, the payment of the creditable tax does not reduce taxable income – just as the Federal income tax does not reduce taxable income.

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The taxes attributable to G.I.L.T.I. are placed in a separate foreign tax credit limitation basket. U.S. tax law requires foreign-source income to be divided into various "baskets" to prevent foreign income taxes on certain income in one category from reducing U.S. tax on other income in a different category. One such category is G.I.L.T.I. Because G.I.L.T.I. is thought of as being an item of low-tax income, the separate basket ring-fences the income and creditable taxes so that the U.S. tax on G.I.L.T.I. cannot be offset by excessive taxes on income in other baskets.

One problem with the foreign tax credit for G.I.L.T.I. is that a portion of the deemed-paid tax cannot be claimed as a foreign tax credit. The foreign tax credit is limited to 80% of the taxes deemed paid. The portion that cannot be credited is lost forever, as no carryback or carryforward is provided for unused G.I.L.T.I.-related foreign tax credits.

Another problem with the foreign tax credit for G.I.L.T.I. is that the allocation is based on fixed percentages of hypothetical categories of income. If a foreign corporation has other items of Subpart F income that would attract foreign tax credits under prior law, a portion of those credits may be redirected to G.I.L.T.I. Once redirected, the amount of credits available to offset Subpart F income in the other basket is reduced. This results in two hits to the foreign tax credit: the reduction in credits in other baskets and the inability to fully utilize credits in the G.I.L.T.I. basket.

Once the gross amount of G.I.L.T.I. is determined, a U.S. corporation is entitled to a 50% deduction based on the amount of G.I.L.T.I. included in income. Because the rate of corporate tax in the U.S. is 21%, a corporate U.S. Shareholder's effective tax rate on G.I.L.T.I. plus the foreign tax credit gross-up generally will be 10.5%.

FOREIGN DERIVED INTANGIBLE INCOME DEDUCTION FOR DOMESTIC OPERATING INCOME OF U.S. COMPANIES THAT IS RELATED TO FOREIGN USERS

At the same time the T.C.J.A. accelerated tax under the G.I.L.T.I. regime for certain profits derived abroad from active business operations, it also provided a deduction for U.S. corporations operating in the U.S. that (i) sell, lease, licence, or provide products, (ii) furnish the use of intangible property for use outside the U.S., or (iii) provide services to customers or clients that are located abroad. The deduction relates to foreign derived intangible income ("F.D.I.I.") and shares many of the technical concepts of the G.I.L.T.I. regime, albeit in the context of exports.

F.D.I.I. is the portion of a U.S. corporation's deemed intangible income derived from serving foreign markets, determined by a formula. The F.D.I.I. of any U.S. corporation is the amount that bears the same ratio to the "deemed intangible income" of the corporation as the "foreign-derived deduction eligible income" of the corporation bears to its total "deduction eligible income". Three new terms must be understood to compute the F.D.I.I deduction. These are "deemed intangible income", "deduction eligible income", and "foreign-derived deduction eligible income".

Deemed Intangible Income. This term means all deduction eligible income in excess of deemed tangible income return. Deduction eligible income is, with respect to any U.S. corporation, the excess of (i) gross income (excluding certain income items taxed in connection with operations conducted outside the U.S. directly or through a C.F.C.) over (ii) allocable deductions (including taxes).

Deemed Tangible Income. This term means a 10% return on the average basis in depreciable tangible property used in a trade or business in the U.S. and of a type for which a depreciation deduction is allowed.

Foreign-Derived Deduction Eligible Income. This term means deduction eligible income derived in connection with property that is sold by the taxpayer to any person who is not a U.S. person when the sale is made for use, consumption, or disposition outside the U.S. by the purchaser, or services provided by the taxpayer to any person not located in the U.S. or with respect to property not located in the U.S. The I.R.S. is given broad discretion in determining whether the taxpayer has met its burden of proof in establishing that property has been sold for use outside the U.S. or services have been performed for persons or with regard to property located outside the U.S. The terms "sold," "sells," and "sale" include any lease, license, exchange, or other disposition. Foreign use means any use, consumption, or disposition outside the U.S.

A U.S. corporation may claim a 37.5% deduction for the foreign-derived deduction eligible income when computing taxable income. The intent is to impose a 13.125% rate of tax on these profits. This deduction is not available to individuals who operate a business through a limited liability company.

BASE EROSION AND ANTI-ABUSE TAX

The T.C.J.A. introduced a minimum tax provision for large corporations that significantly reduces their U.S. tax liability through the use of cross-border payments to related persons. Known as the Base Erosion and Anti-Abuse Tax ("B.E.A.T. Regime"), the provision is viewed to be an act against inbound base erosion through intercompany service fees, interest, rents, and royalties ("Base Erosion Payments") paid to 25% foreign related persons.

The B.E.A.T. Regime generally applies to corporate taxpayers that have average annual gross receipts of $500 million or more during the testing period (the "gross receipts test") and whose deductible payments to related parties ("Base Erosion Payments") equal or exceed 3% of their total allowed deductions (2% for

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certain banks and securities dealers).

The B.E.A.T. Regime is not limited to U.S. corporations but can apply to foreign corporations as well with respect to income that is effectively connected with the conduct of a U.S. trade or business. However, for the purposes of determining whether the foreign corporation meets the gross receipts test, gross receipts are only included if they are taken into account when calculating the taxpayer's U.S. effectively connected income.

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If applicable, the B.E.A.T. Regime compares a tax of 10% (5% in 2018) imposed on modified taxable income of a U.S. corporation with the 21% tax imposed on regular taxable income. If the tax on modified taxable income exceeds the regular tax, the excess is added to the regular tax for the year.

Modified taxable income under the B.E.A.T. Regime is broader than the concept of taxable income for regular tax purposes. It is determined by adding the following items of deductible expense to the corporation's taxable income:

- Deductions allocated to Base Erosion Payments in connection with payments made to 25% foreign related parties;
- Depreciation and amortisation deductions related to property purchased from 25% foreign related parties; and
- A specified portion of net operating losses from earlier years.

For this purpose, a foreign entity is considered to be a 25% related foreign entity with regard to a corporation if the foreign person meets any of the following criteria:

- it is treated as owning shares in the U.S. corporation that represent at least 25% of the voting power or the value of all shares issued and outstanding;
- it is related to the corporation or to a 25% foreign owner of the corporation under certain U.S. tax rules that generally require more than 50% common ownership between two persons; or
- it is treated as related to the taxpayer under arm's length transfer pricing principles of U.S tax law.

Payments to foreign subsidiaries of U.S. corporations are caught under the third criterion.

Certain payments that reduce U.S. tax are expressly removed from coverage under the B.E.A.T. Regime. These include the purchase price for inventory and certain services that are generally of a kind that can be charged to a related party without a mark-up over costs. The I.R.S. is authorised to issue regulations that are necessary to prevent the avoidance of the purposes of the B.E.A.T. Regime. Examples of abusive transactions include the use of unrelated persons, conduit transactions, or other intermediaries, or transactions or arrangements that are designed, in whole or in part, to improperly recharacterise payments for the purpose of avoiding the B.E.A.T. Regime.

LIMITATIONS PLACED ON BUSINESS INTEREST EXPENSE DEDUCTIONS

Prior to the T.C.J.A., U.S. subsidiaries of foreign corporations were subject to an earnings stripping rule that applied when interest was paid to related parties outside the U.S. in circumstances where withholding tax was reduced or eliminated. A cap was placed on the deduction for interest expense paid to a related party where full 30% withholding tax was not collected, typically under the terms of an income tax treaty. The cap applied when the total net interest expense exceeded 50% of what is essentially E.B.I.T.D.A. and the debt-to-equity ratio exceeded 1.5 to 1.

The T.C.J.A. modifies the scope of those rules so that a ceiling is placed on the deduction for all business interest expenses. For taxable years beginning after 2017, the deduction for business interest is limited to the sum of business interest income and 30% of what is essentially E.B.I.T.D.A. for the taxable year. The amount of any business interest not allowed as a deduction for any taxable year may be carried forward indefinitely, subject to certain restrictions applicable to partnerships.

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Beginning in 2022, the ceiling is tightened by replacing the E.B.I.T.D.A. base with an E.B.I.T. related base. At that point, depreciation, amortization, and depletion will no longer be added back to income when determining the base on which the 30% cap is computed.

Certain businesses are not covered by the ceiling. These include, *inter alia*, taxpayers with less than $25 million of average annual gross receipts for a three-taxable-year period, ending with the prior taxable year and an electing real property trade or business.

OTHER REVISIONS AFFECTING CROSS -BORDER GROUPS

The T.C.J.A. made several other revisions to U.S. tax law affecting cross border investors. The following list contains the more important changes:

- When valuing intangible property that is sold, transferred, or licensed to a related party, a taxpayer must consider realistic alternatives to the transaction as cast and the methodology utilised by the taxpayer must apply the aggregate basis of valuation rather than an asset-by-asset method.
- An exception was eliminated to immediate gain recognition in connection with a transfer to a related party outside the U.S. that existed under prior law for tangible assets used in an active trade or business.
- Gain or loss derived by a non-U.S. person from the sale or exchange of a partnership interest will be treated as effectively connected with a U.S. trade or business to the extent that the transferor would have effectively connected gain or loss had the partnership sold all of its assets on the date of the sale or exchange. In addition, the transferee is required to withhold 10% of the amount realized unless the transferor can certify it is not a non-resident alien or a foreign corporation. The effective date for the withholding tax rules has been deferred.
- Deductions are disallowed for payments of royalties and interest to a related party in a cross-border transaction where the recipient does not incur tax on the receipt of the payment. The I.R.S. is given broad authority to expand the scope of the provision.

CONCLUSION

As the foregoing discussion indicates, the T.C.J.A. introduces many new concepts into U.S. tax law that have an immediate effect on global trade. From reduced tax rates, to F.D.I.I., to the D.R.D., and the G.I.L.T.I. provisions, new rules must be considered when planning cross-border operations or investments. These rules are not a linear expansion of existing rules. Rather they reflect a sea change in the way taxable income is measured. Certain provisions will generate lower taxes – corporate tax rates have been reduced and the F.D.I.I. deduction reduces those rates further for domestic operating income that exploits foreign markets. The D.R.D. will allow funds to be repatriated free of U.S. income tax and free of the hassle of the foreign tax credit. However, deductions for interest expense will be capped and operations of foreign subsidiaries will be taxed immediately under G.I.L.T.I. Clearly, certain companies will be winners and others will be losers. Even with economic modelling based on relatively accurate data inputs, it will difficult to foretell winners and losers with a degree of certainty. Without modelling, it will be impossible.

U.S. business is entering a period of great opportunity and substantial uncertainty. We will know more in two years.

What's on the Agenda?

By Paul Kraan
Van Campen Liem (Netherlands)

Dutch government releases fiscal policy paper

INTRODUCTION

In the Netherlands, a new conservative-liberal government presented itself in the fall of 2017. Upon that occasion, the newly formed coalition released its political agreement, essentially a paper setting out its proposed policies for the upcoming - four year - government period. Included in this policy paper were a number of proposed fiscal measures, notably the intention to abolish the levy of Dutch dividend withholding tax.

In the meantime, a new Dutch State Secretary for Finance (responsible for matters of taxation) has taken office. On 23 February 2018, the State Secretary presented his fiscal policy agenda (hereafter: the *Agenda*) to parliament. In essence, this Agenda describes the contours - and timing - of the various proposed tax measures in more detail, while putting these measures within the broader perspective of international developments as well.

On the 23rd of February, the State Secretary also sent a separate note to parliament, setting out his approach towards tax evasion and tax avoidance. The fact that this occurred on the very same date is not a coincidence: although his Agenda clearly reflects the government's ambition to enhance the Dutch fiscal investment climate - and thus to maintain the position of the Netherlands as an attractive jurisdiction for setting up holding companies - the State Secretary also sends out the signal that the Netherlands remains a loyal member state of the European Union (E.U.) and the Organisation for Economic Co-operation and Development (O.E.C.D.).

As such, when designing his tax policies, the State Secretary must also take into account international developments, such as the recent (5 December 2017) publication of the E.U. blacklist for non-cooperative countries, and in particular the contents of the Anti-Tax Avoidance Directive (A.T.A.D.), which must be implemented in the years to come. The A.T.A.D. contains a wide variety of measures, all of which aim to convert 'soft law' developed within the framework of the O.E.C.D.'s Base

Erosion and Profit Shifting (B.E.P.S.) project into concrete legislation.

The Agenda has no formal legal status: legislative proposals amending the 1969 Corporate Income Tax Act (C.I.T.A.) and the 1965 Dividend Tax Act (D.T.A.) may be expected to be submitted to the Dutch parliament in due course. Since the announced changes are said to occur gradually over the next three years, specific details regarding the proposed measures will become available only as and when the Agenda gets implemented. Nonetheless, it seems clear that the Agenda may already be considered as a 'blueprint' for such future legislative proposals.

What's on the Agenda?

This article highlights the proposed changes that will affect the Dutch international tax system.

END OF THE DUTCH FISCAL UNITY

The fact that the Agenda was published on the 23rd of February may not be a coincidence, as this was the day after the European Court of Justice (E.C.J.) confirmed the Opinion of the Advocate General in

OVERVIEW DUTCH FISCAL POLICY AGENDA

2018	2019	2020	2021

CIT
• CIT rates:
  • 20% ≤ €200k
  • 25% > €200k
• PPT for foreign taxpayer regime
• Fiscal unity regime amended
 	
Dividend withholding tax
• Broadened domestic exemption for treaty countries
• PPT for dividend WHT
• 'Holding' cooperatives in scope
	CIT
	• CIT rates:
	  • 19% ≤ €200k
	  • 24% > €200k
	• Loss carry forward limited to 6 years (was 9 years)
	• Real estate for own use limited depreciation
	
	General anti-avoidance rules
	• Substance requirements
	  • Dedicated office space (at least 24 months)
	  • Payroll >€100k
	• CFC rules
	• Earnings stripping rules
	• Amended APA/ATR practice
		CIT
		• CIT rates:
		  • 17.5% ≤ €200k
		  • 22.5% > €200k
		• New fiscal unity regime (group relief)
		• Fiscal investments funds cannot invest in real estate
		
		Dividend withholding tax
		• Dividend withholding tax to be abolished
		• Introduction of tailored withholding tax on dividend payments to low tax jurisdictions, E.U. black list countries and in abusive structures
		
		General anti-avoidance rules
		• Anti-hybrid rules to discourage CV-BV structures and hybrid loans (PPLs)
		• MLI targeting treaty abuse and permanent establishment
			CIT
			• CIT rates:
			  • 16% ≤ €200k
			  • 21% > €200k
			
			Withholding tax
			• Extension of tailored withholding tax to interest and royalty payments to low tax jurisdictions, E.U. black list countries and in abusive structures

case C-398/16 (*X nb*). In doing so, essentially the E.C.J. ruled that even though member states may not be required to allow cross-border tax consolidation (and thus set off of losses), taxpayers may still apply certain specific elements of a purely domestic tax consolidation system in relation to their subsidiaries resident in other E.U./ E.E.A. member states. Clearly, this opens the door for taxpayers to apply this 'per element' approach in many different situations.

What's on the Agenda?

Some of the main elements will be removed from the Dutch fiscal unity regime as these were only meant to apply in purely domestic situations. The State Secretary aims to have this 'reparative' legislation enacted as a matter of urgency, as previously announced with retroactive effect from the date of publication of the Advocate General's Conclusion, *i.e.*, 25 October 2017.

However, the State Secretary recognizes that eventually such 'emergency repair' measures will need to be followed by an entirely new group relief system that is more robust and future (E.U.) proof. As regards the design (and the moment of introduction) of this definitive solution, further discussions will be held with the Dutch business community, interest groups and scholars, all with a view on preserving a good fiscal business climate.

One way or the other, in the longer run, the Netherlands must probably give up its system of tax consolidation and switch to a - more sustainable - group relief system.

CIT RATE REDUCTION

Pursuant to the Agenda, as was already announced in the fall, the Dutch CIT rate will be reduced from the current 25 percent to 21 percent as from 2021. This should bring the statutory rate more in line with the new U.S. federal income tax rate, as well as rates in certain neighbouring countries. However, this reduction will not take place at once, but only gradually, with the applicable rate going down to 24 percent in 2019 and then to 22.5 percent in 2020.

Since the current CIT rate system also contains a lower rate for small profits (up to 200,000 Euro) the Agenda confirms that this step-up rate will also go down gradually, from the present 20 percent to 16 percent as from 2021. In the meantime, the lower rate will go down to 19 percent in 2019 and 17.5 percent in 2020.

With a view on financing these rate cuts, the Agenda mentions that certain limitations (other than those required under the A.T.A.D.) will be introduced as well, with effect from 1 January 2019. Notably, this concerns a restriction of the term for loss carry forward. While at present, losses can still be carried forward for nine years, based on the Agenda, the carry forward of losses will be restricted to six years. The term for carry back will remain one year.

Furthermore, depreciation on real estate will be restricted - if the property is used within the business of the owner, its fiscal book value may not be lower than the fair market value as annually determined for (local) tax purposes.

WITHHOLDING TAX REFORM

Back in the fall of 2017, the incoming government coalition announced that it intended to abolish the current Dutch withholding tax on dividend distributions (levied at a statutory rate of 15 percent) with effect from 1 January 2020.

This announcement caused quite some surprise, particularly as the outgoing government coalition (headed by the same prime minister) had just submitted a legislative proposal to parliament based on which the existing dividend tax regime would be reformed with effect from 1 January 2018.

Meanwhile, the latter piece of legislation has indeed been enacted. One of its main features is a significant extension of the scope of the exemption

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for corporate shareholders. Where a domestic company owns at least 5 percent of the shares of another Dutch company, such shareholder is eligible for application of the Dutch participation exemption on any dividends it receives from its subsidiary. Hence, the latter is not required to withhold dividend tax on such distributions either. As regards corporate shareholders based in another E.U. member state, a similar exemption was introduced upon implementation of the E.U. Parent Subsidiary Directive in the early nineties. Subsequently, the European Court of Justice ruled that the qualifying percentage in intra-E.U./E.E.A. situations may not exceed the 5 percent threshold for exemption which applies in domestic situations.

Until the recently enacted tax reform, this exemption only applied to corporate shareholders based in the Netherlands or another E.U./E.E.A. country. However, this exemption has now been extended to cover any jurisdiction that has concluded a double tax treaty with the Netherlands. Although the relevant treaty must contain a clause governing the taxation of dividends (meaning that an agreement which merely provides for exchange of information does not qualify for exemption), the contents of such clause are not relevant: the new unilateral exemption applies just as well where the treaty contains certain additional criteria for treaty application or provides for a reduction of the statutory withholding rate only.

Thus, even though the recipient of the dividend must be considered tax resident in the other treaty state, whether any applicable 'limitation on benefits' (L.O.B.) test (such as the detailed L.O.B. clauses included in the Dutch treaties with Japan and the United States) is met as well is not relevant for application of the Dutch domestic exemption.

Furthermore, under the new rules, the Netherlands unilaterally grants an exemption to corporate shareholders owning a qualifying interest of 5 percent in their Dutch subsidiaries, even if the applicable tax treaty provides for a reduced withholding rate (e.g. 5 or 10 percent). This still applies to a number of Dutch tax treaties, notably those with Canada and China. Even though the treaty between the United States and the Netherlands already provides for zero withholding, this percentage is not applicable in all cases, meaning that previously the reduced 5 percent treaty rate was the fall back scenario. After the recent reform, U.S. corporations can simply rely on the Dutch unilateral exemption when receiving dividends from the Netherlands.

Clearly, the recent introduction of this unilateral exemption has significantly improved the position of the Netherlands as a European 'hub' for multinational enterprises headquartered in treaty countries, amongst which are some of the world's largest economies - and important trade partners - such as Canada, China, Japan and the United States.

Nonetheless, since the new government also wants to increase the attractiveness of the Netherlands as a location for (listed) top holding companies, it has expressed the intention to take the (next) step and thus to abolish dividend tax. This should not just persuade foreign enterprises to migrate their headquarters to the Netherlands, but also preserve the 'Dutch face' of multinationals that have their roots in the Netherlands. The recent example of Unilever shows that this strategy already seems to have the desired effect (even though, supposedly, tax reasons did not play a role in its decision).

In any event, pursuant to the Agenda, the abolition of dividend tax is still envisaged, with effect from 1 January 2020. However, as from the same date, a conditional (tailored) withholding tax will be introduced which applies to profit distributions to affiliates resident in a jurisdiction included in the E.U. blacklist of 'non-cooperative' countries. Such source tax would also apply to jurisdictions with 'extremely low' tax rates, as well as in 'abusive situations'. At present, both concepts are still to be defined and the applicable withholding tax rate has not yet been determined. It does seem plausible, however, to assume that it will range between the current 15 percent withholding rate and the new - higher – CIT rate of 21 percent.

As a next step, effective from 1 January 2021, this conditional withholding tax on dividends would be extended to cover intercompany interest and royalty payments from Dutch taxpayers to low-tax jurisdictions in abusive situations. Historically, the Netherlands has never applied a withholding tax on outgoing interest and royalty payments, meaning that the mere intention to introduce one is already a break with past practice and principles. However, in light of the increased international pressure on the Netherlands to counter abusive structures whereby a Dutch company (which may lack adequate substance) is used as a conduit (flow-through vehicle) for financial streams ending up in tax havens, the present Dutch government is keen to stay ahead of these discussions and take legislative action. This intention should be put within the context of international developments, notably the B.E.P.S. action plan from the O.E.C.D. and the various initiatives taken at E.U. level.

Again, the proposed withholding tax on interest and royalty payments is conditional and would only apply to intercompany payments to companies which are tax resident in a jurisdiction listed on the E.U. blacklist or a jurisdiction with an extremely low tax rate. The term "jurisdiction with a low tax rate" is yet to be defined. The tax rate of the conditional interest and royalty withholding tax is also yet to be determined but the rate could be reduced under applicable tax treaties or other arrangements.

Last but not least, it seems noteworthy that the - recently introduced - unilateral exemption is subject to the application of domestic anti-abuse rules. Essentially, these domestic rules codify the 'principle purpose test' (P.P.T.) as laid down in the new 'multilateral instrument' (M.L.I.) which has been developed by the O.E.C.D. within the context of its B.E.P.S. program. Even though the abolition of dividend tax would imply that it will no longer be necessary to rely on any exemption, still the P.P.T. may continue to play a role in determining whether a certain structure may be considered abusive.

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RULING PRACTICE AND SUBSTANCE REQUIREMENTS

The Netherlands has a long standing tradition of providing taxpayers with certainty in advance on their tax position by granting them rulings upon request. The importance of this practice is still recognised today, as the Agenda stipulates that it improves the fiscal investment climate in the Netherlands, whilst at the same time providing the tax authorities with a useful instrument to determine tax positions in advance.

Nowadays, rulings can either take the form of an Advance Tax Ruling (A.T.R.) or an Advance Pricing Agreement (A.P.A.). The former concerns the tax consequences of a certain structure or transaction, the latter transfer pricing matters.

Both types of rulings can be described as a written compromise on the interpretation of certain legal provisions as they apply to a specific taxpayer within the context of a proposed (set of) arrangement(s). Such agreements are normally concluded on a case-by-case basis. Within the Dutch Revenue Service, a separate department (known as the 'ruling team') is responsible for handling requests for an A.T.R. and/ or A.P.A. The current A.T.R./A.P.A. practice is laid down in various decrees from the State Secretary for Finance, providing certain technical and administrative guidelines that the tax authorities, as well as taxpayers, must comply with.

Rather than being a prerequisite for obtaining specific tax treatment (essentially deviating from applicable law), rulings should be perceived as confirmation of the views and interpretation of the Dutch tax authorities regarding a specific fact pattern in view of legislation in force and applicable case law. Consequently, rulings should not provide advantageous tax treatment to individual taxpayers. As recent developments have shown, this process is closely monitored by the European Commission, which aims to take away any such (alleged) advantages by applying the E.U. state aid doctrine.

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Even though rulings are not publicly disclosed, automatic exchange of information regarding rulings may take place with the respective foreign tax authorities. Within the E.U., the automatic exchange of information between member states on tax rulings has been enhanced through amendment of the directive on administrative cooperation between member states (Directive 2011/16/EU). On this basis, automatic exchange of information regarding rulings may have taken place since 1 January 2016.

Substance requirements

In order to apply for an A.T.R. or an A.P.A., a company must meet certain specific conditions with respect to its substance in the Netherlands and the economic risks that it is exposed to, specifically within the context of an A.P.A. The relevant list of substance requirements was first published in 2004.

At the time, this test only served to qualify for the ruling process. However, even then, it was perceived by tax practitioners as a list of 'safe harbour' criteria with a more general application as regards a company's tax residency in the Netherlands. After all, even though a company incorporated under Dutch law is considered to be resident in the Netherlands for domestic tax purposes, it may well be considered tax resident in another jurisdiction under the application of a bilateral tax treaty. For example, where such company is found to have its place of effective management in that other jurisdiction.

Over the past decade 'substance' has increasingly become more relevant in international tax policies. Consequently, international business has become more accustomed to complying with those requirements through verifying whether local substance is and remains adequate.

On their part, by imposing further demands concerning the level of substance that must be retained, the Dutch tax authorities have sought to counter criticism of the Netherlands as a 'flow-through' jurisdiction. Dutch based entities performing intra-group financing or licensing activities and seeking to benefit from a tax treaty concluded by the Netherlands or the E.U. Interest and Royalty Directive must now meet minimum substance requirements similar to those that already applied to companies seeking to obtain a tax ruling.

Essentially, this is an 'upgrade' of these substance requirements, which are now laid down in specific regulations. If it cannot be confirmed that the minimum substance requirements are met, spontaneous exchange of information with the relevant foreign tax authorities may follow. The purpose of such spontaneous exchange of information with foreign source countries would be to help them assess whether the Dutch based company receiving the interest, royalty, rent or lease payments from their country is the beneficial owner of such payment. They would then be entitled to exemption from local withholding tax or a reduction of the applicable rate under the applicable tax treaty and/or the E.U. Interest and Royalty Directive.

Substance requirements regarding the minimum amount of equity to be retained largely depend upon the specific activities of the company. For instance, a company applying for an A.T.R. confirming the application of the participation exemption may be required to finance a minimum part (e.g. 15%) of its investment in the relevant subsidiary with equity.

As regards group financing and licensing activities, the minimum equity requirement is closely related to article 8c CITA. This anti-conduit rule was introduced in 2001, as a first attempt to discourage activities that lack economic reality. Essentially, article 8c CITA provides that interest and royalty payments from and to related entities are not taken into account for tax purposes (and thus excluded from the fiscal P&L) if the taxpayer is not exposed to genuine risk with regard to the relevant loan or license agreements.

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In the Agenda, the need to meet minimum substance requirements is again recognised as the question arises whether providing certainty in advance is preferable in all situations. In this respect, the new State Secretary for Finance has expressed his intention to further expand these requirements. It is envisaged that the substance requirements that have recently been introduced in connection with the codification of the P.P.T. (see section 4 above) must also be satisfied in order to obtain certainty in advance. This would imply that, in order to be eligible for an A.T.R. and/or A.P.A., a company must incur salary expenses amounting to at least €100,000 and have a suitable office space at its disposal for at least 24 months.

Furthermore, the State Secretary has stated that his aim is to expand the situations in which information is exchanged with a source country if the Dutch taxpayer does not meet these (additional) substance requirements. This should be achieved by expanding the group of taxpayers of which information will be exchanged to include international holding companies.

Although the timing is still to be determined, the aim is to introduce these amendments to the substance requirements shortly, and they could enter into force as early as 1 January 2019.

IMPLEMENTATION OF THE A.T.A.D.

Earnings stripping rule

As anticipated, the Agenda confirms that the earnings stripping rule that is part of the A.T.A.D. package will be implemented in the C.I.T.A. with effect from 1 January 2019. This means that, going forward, net borrowing costs will be deductible only up to 30% of earnings before interest, tax, depreciation and amortization (E.B.I.T.D.A.), with limited possibility to carry forward.

For implementation into Dutch tax legislation, the government has chosen to adopt a threshold (*de minimis* rule) of 1 million Euro, meaning that small and medium sized businesses should not be affected. However, the earnings stripping rule will have an impact on Dutch entities that are part of a highly leveraged group, as there will be no group-ratio exception in the Netherlands. Furthermore, there will be no grandfathering rule, meaning that as from the date of implementation, the new restriction will apply to existing loans as well.

The good news is that the Agenda includes the intention to abolish certain existing limitations on interest related to the (acquisition) financing of subsidiaries (articles 13l and 15ad CITA). However, the anti-base erosion rule as laid down in article 10a CITA is likely to survive the implementation of the earnings stripping rule in the Netherlands.

C.F.C. rule

As a part of the A.T.A.D. package, with effect from 1 January 2019, member states must also implement some form of Controlled Foreign Corporation (C.F.C.) rule into their tax codes. Under the A.T.A.D., a foreign entity (or branch) is considered a C.F.C. if the taxpayer has an interest exceeding 50 percent in that foreign entity (control test) and the tax due in the foreign jurisdiction is less than 50 percent of the corporate income tax that would have been due if the foreign entity was a domestic taxpayer (low taxed test).

As the Netherlands has always had an exemption system (*i.e.*, applied the principle of capital export neutrality), the Dutch business community, as well as most scholars and practitioners, are somewhat critical about having such an odd C.F.C. rule in the tax code. Therefore, its implementation is being closely monitored. Further discussions with stakeholders will follow and the Agenda reveals how the State Secretary envisages this to be done.

Essentially, the A.T.A.D. allows two methods for determining C.F.C. income. One of these models (B) entails a transfer pricing approach, by adjusting transactions with the C.F.C. on the basis of the arm's length principle. Since this is embedded in Dutch tax law, according to the State Secretary a change of law would not be strictly necessary to properly implement the A.T.A.D.

Nonetheless, in case a C.F.C. does not carry out genuine economic activities locally and its jurisdiction has a low statutory tax rate or is included in the E.U. blacklist for non-cooperative countries, the State Secretary embraces the alternative model (A). That model is more far stretching, as it entails inclusion of non-distributed earnings resulting from certain categories of income, e.g., interest, royalties, dividends, capital gains and financial leasing.

The Agenda, therefore, confirms that, in principle, a C.F.C. can be considered to carry out genuine economic activities if it meets the additional substance requirements described in section 4 above (meaning that the C.F.C. incurs salary expenses amounting to at least €100,000 and has adequate office space at its disposal for at least 24 months). This approach implies an objective test, to be applied in line with E.U. case law.

Anti-hybrid rule

Finally, the A.T.A.D. demands taking certain measures against hybrid mismatches, which the Netherlands aims to implement with effect from 1 January 2020. Given the wide variety of mismatches and the technical complexity of such legislation, prior public consultation is considered necessary. According to the Agenda, the Netherlands also aims to include anti-hybrid rules in its bilateral tax treaties, either directly or through the application of the Multilateral Instrument (M.L.I.).

SUMMARY

In the coming years, the Dutch fiscal investment climate for multinational companies and investment funds will be further enhanced through the abolition of dividend withholding tax and the reduction of general CIT rates. The recent example of Unilever already demonstrates that this strategy might be fruitful.

Also, despite implementation of C.F.C. rules for abusive structures, exemption of profits derived through foreign branches or subsidiaries will remain a cornerstone of the Dutch tax system.

The Netherlands also continues to embrace international initiatives to address tax avoidance and is currently implementing the A.T.A.D. and introducing closely related legislation. Having a focus on structures and transactions that lack any economic substance, these will be combatted via tailored C.F.C. rules and conditional source taxes.

Finally, now that the E.C.J. has recently decided that taxpayers may apply specific elements of domestic tax consolidation systems to their affiliates resident in other E.U./E.E.A. member states, some of these elements will be removed from the Dutch fiscal unity regime (*i.e.*, also in purely domestic situations). In the longer term, the Netherlands may entirely give up its system of tax consolidation and switch to a more sustainable group relief system.

Post Clearance Audit Powers of the Philippine Bureau of Customs

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The Philippine Bureau of Customs (B.O.C.) has recently revived its Post Clearance Audit Group (P.C.A.G.) that conducts compliance audits on importers' records of importation relating to their past shipments of goods to the country.

Said compliance audit is essentially a control mechanism done at the back-end of cargo clearance. It aims to facilitate trade by generally allowing release of low risk imports with minimum customs intervention at the border. The B.O.C., however, retains the option to verify the truthfulness and accuracy of goods declarations by looking at the pertinent records of the importer-auditee.

The Post Clearance Audit[1] (P.C.A.) was introduced[2] in the Philippines in 2001 and was originally carried out by the B.O.C. Post-Entry Audit Group[3] (P.E.A.G.). During its time, the P.E.A.G. was able to contribute quite significant revenue collections from its conduct of P.C.A. which resulted in payment of additional duties and taxes arising from deficiency assessments, penalties and voluntary disclosures from importers.

Towards the end of 2013, the P.E.A.G. was dissolved under Executive Order (E.O.) No. 155[4] and its functions were transferred to the Fiscal Intelligence Unit (F.I.U.) under the Department of Finance (D.O.F.) with a primary role of conducting an independent audit on importers with the end goal of further boosting revenues. As there were uncertainties and grey areas in the implementation of subsequent D.O.F. issued rules and procedures, the objectives of E.O. 155 were purportedly not fully met.

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1 Previously referred to as Post Entry Audit.

2 Republic Act No. 9135 (signed April 27, 2001), entitled "An Act Amending Certain Provisions of Presidential Decree No. 1464, Otherwise known as the Tariff and Customs Code of the Philippines, As Amended, and for other Purposes," specifically Sections 3515 and other related sections mandated the Bureau of Customs to conduct audit examination, inspection, verification and/or investigation of transaction records of importers and brokers.

3 Under Section 1 of E.O. 160 (signed January 6, 2003), a new office in the Bureau of Customs is hereby created and shall be known as the Post Entry Audit Group (hereinafter referred to as P.E.A.G. for brevity) which shall be under the direct supervision and control of the Commissioner of Customs.

4 E.O. 155 (signed December 18, 2013) amends E.O. 160 mandating the D.O.F. F.I.U. to perform the functions of the P.E.A.G.

Accordingly, the Customs Modernization & Tariff Act[5] (C.M.T.A.), which took effect last June 16, 2016, reverted to the B.O.C. the power to examine and audit a company's books and import records.

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E.O. 46 series of 2017 (signed last October 20, 2017), as implemented by Customs Memorandum Order (CMO) No. 32-2017[6], created an empowered post clearance audit group (P.C.A.G.) that is expected to aggressively commence its customs audit as soon as the forthcoming implementing rules and regulations on P.C.A. are issued.

The P.C.A.G., which is directly under the supervision of the B.O.C. Commissioner, is headed by a B.O.C. Assistant Commissioner who shall exercise direct supervision and control over the management of its operating units, which include the Trade and Information and Risk Analysis Office (which recommends to the B.O.C. Commissioner potential priority audit candidates) and the Compliance Assessment Office (which conducts the actual audit).

The P.C.A.G. is mandated to conduct an audit examination, inspection, verification and investigation of records pertaining to any goods declaration within three years from the date of final payment of duties and taxes or customs clearance. This shall include statements, declarations, documents, and electronically generated or machine-readable data, for the purpose of ascertaining the correctness of the goods declaration and determining the liability of the importer for duties, taxes and other charges, including fine or penalty.

CRITERIA FOR AUDIT SELECTION

With the C.M.T.A.'s goal of facilitating the easier flow of goods, a great deal of responsibility is placed on the importers. Importers are responsible for declaring the details of their imports such as, among others, the value, classification, and rate of duty applicable to imported goods. Compliance with the rules, on the other hand, is checked by the B.O.C. either at the border or through the P.C.A. system.

The importers targeted for P.C.A. are selected based on a "computer-aided risk management system" that takes into consideration the highest level of risk to (and the greatest impact upon) customs revenue and other priority objectives of the administration.

The selection criteria are based on, but not limited, to the following:

- Relative magnitude of customs revenue from the firm
- The rates of duties of the firm's imports
- The compliance track record of the firm
- An assessment of the risk to revenue of the firm's import activities
- The compliance level of trade sector
- Non-renewal of an importer's customs accreditation

Customs brokers may be audited to validate audits of their importer-clients and/or fill in information gaps revealed during an audit of their importer clients. Locators in the Economic Zones and those enjoying duty and tax incentives are likewise not exempt from B.O.C. compliance audit.

Once selected for P.C.A. by the B.O.C., the audit process will be triggered by the issuance of a B.O.C. Audit Notification Letter[7] (A.N.L.) sent to the importer-auditee.

[5] C.M.T.A. or Republic Act No. 10863 is an Act amending the Tariff and Customs Code of the Philippines.

[6] CMO 32-2017 dated December 20, 2017 reactivates the Post Clearance Audit Group (formerly the Post Entry Audit Group) of the Bureau of Customs.

[7] Audit Notification Letter is issued by the Commissioner of Customs to the company identified for audit.

The coverage of the compliance audit is 3 years (10 years in case of fraud) from the date of the A.N.L. counted backwards.

Post Clearance Audit Powers of the Philippines Bureau of Customs

AREAS OF ANTICIPATED CUSTOMS ISSUES

The main aim of the P.C.A. is to verify a company's past import transactions for the purpose of determining whether the:

- Value of the imported goods declared by the importer is correct and reflected the price actually paid or payable by the importer to the supplier;
- Required dutiable[8] adjustments are included thereto;
- Imported goods are valued using the appropriate customs valuation method;
- Goods are properly described, and the correct tariff classifications are used;
- Quantities of goods, as reported, are correct;
- Declarations as to country of origin are correct
- Special or preferential tariff rates are correctly applied, and importer is qualified to avail of special/ preferential rates;
- Required import records are kept; and
- Other compliance requirements a met.

Apart from the above focus areas, the B.O.C. also, as a matter of procedure, compares specific figures contained in an auditee's records with that of their own data. Discrepancies would usually require the submission of a reconciliation document from the auditee.

Any deficiency duty assessment issued by the B.O.C. after audit would normally include a deficiency V.A.T. (on importation) assessment since the import V.A.T. base, under the rules[9], includes, as components, the dutiable value[10] and customs duty. Thus, any under declaration of customs duty shall, as a consequence, result to undervaluation of the V.A.T. and vice versa.

TRANSACTION VALUE OF IMPORTED GOODS

Section 701[11] of the C.M.T.A. reiterated the adoption of the World Trade Organization (W.T.O.)[12] "Transaction Value" (T.V.) system as basis for valuing imported goods for duty purposes.

Generally, in an arm's length transaction, imports shall be assessed using the Transaction Value (T.V.) of the imported article (Method 1). However, when a higher comparable value exists to cast reasonable doubt[13] as to the truthfulness or accuracy of a given value declaration and the subsequent verification done establishes that any of the elements or conditions of Method 1 is not present or complied with, the importation shall be assessed using the alternate

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[8] "Dutiable" means proper additions to the duty base or to the "price paid or payable" for purposes of computing customs duty.

[9] SEC. 107. Value-Added Tax on Importation of Goods. - (A) In General. - There shall be levied, assessed and collected on every importation of goods a value-added tax equivalent to ten percent (10%) (now 12%) based on the total value used by the Bureau of Customs in determining tariff and customs duties plus customs duties, excise taxes, if any, and other charges, such tax to be paid by the importer prior to the release of such goods from customs custody: Provided, That where the customs duties are determined on the basis of the quantity or volume of the goods, the value-added tax shall be based on the landed cost plus excise taxes, If any.

[10] "Dutiable value" simply refers to the duty base upon which the applicable duty rate is applied. It is composed basically of Cost, Insurance, Freight and other dutiable charges.

[11] Section 701. Transaction Value System—Method One.— The transaction value shall be the price actually paid or payable for the goods when sold for export to the Philippines adjusted in accordance with the provisions of this section…

[12] The Philippines has been a W.T.O. member since 1 January 1995 and a member of GATT since 27 December 1979.

[13] "Reasonable doubt" refers to any condition that creates a probable cause to make the Commissioner of Customs believe that the invoice value of the imported goods as reflected by the importer in his customs declaration is inaccurate *(Sherwin F. Tiu vs. The Secretary of Finance, CTA Case No. 5731, March 7, 2000).*

methods of valuation in their order of priority: (Method 2—transaction value of identical goods; Method 3 —transaction value of similar goods; Methods 4—deductive method; Method 5—computed value subject to reversal of Methods 4 and 5 at the option of the importer if it can be done as determined by the Commissioner of Customs; and Method 6—fallback).

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Generally, the B.O.C. would utilize reference values to alert customs to do a value verification check either upfront through a system created for the purpose (which in turn may trigger a valuation query on the applicability of the method of valuation used by the importer) or pursuant to a P.C.A. Once a valuation issue is raised, the burden of proof to justify the correctness of a declared value is shifted to the importer.

Specific issues that are likely to focus on during P.C.A. include the following adjustments to the price paid or payable:

(1) Commissions and brokerage fees

Selling commissions incurred by the buyer with respect to the imported merchandise constitutes part of the T.V. On the other hand, buying commission does not, since the buyer usually pays his agent a fee that is independent of the payment for the goods. However, if already included in the price, buying commission cannot be deducted. Brokerage fees, on the other hand, if paid by the seller, will be normally included in the invoice price as part of the price actually paid or payable.

(2) Cost of Containers and Packing

The value of these items refers to the cost incurred by the buyer of goods rather than their actual values. Re-usable pallets and containers such as 20- and 40- foot shipping containers, aircraft pallets, and the familiar wooden pallets on which cargo is often stacked, strapped or shrink-wrapped for ease of handling by forklift trucks are not includable as part of the customs value of the goods.

(3) Assists

This particular component refers to the value, apportioned as appropriate, of certain goods and services supplied, directly or indirectly, by the buyer to the seller free of charge or at a reduced cost for use in connection with the production and sale for export of the imported goods to the extent that such value has not been incorporated in the price actually paid or payable.

They include a) Materials, components, parts and similar items incorporated in the imported goods; b) Tools, dies, moulds and similar items used in the production of the imported goods; c) Materials consumed in the production of imported goods; and d) Engineering, development, artwork, design work, and plans undertaken elsewhere than in the Philippines and necessary for the production of imported goods;

The value of an assist for items is basically the cost of acquisition if the same is acquired by the buyer from an unrelated seller or the cost of its production if produced by the buyer or a person related to the buyer.

In the case of engineering, development, artwork, design work and plans, the value is (a) the cost of obtaining copies of the assist, if the assist is available in the public domain; (b) the cost of the purchase or lease, if the assist was bought or leased by the buyer from an unrelated person; (c) the value added outside the Philippines, if the assist was produced in the Philippines.

Having determined the value of an assist, the next step is to prorate that value to the imported merchandise.

(4) Royalty or license fees

Customarily, importers would compute the customs duty of their imported goods based on the amount appearing on the commercial invoice. This, however, is not necessarily correct under the T.V. system which looks primarily at the price agreed upon between the buyer and the seller and essentially captures all payments related to the imported goods.

Importers should be aware that royalty (and license fee) payments (for intangibles rights such as, among others, patent, trademark or copyright) made by them to their foreign suppliers may be dutiable as additions to the "price paid or payable" for purposes of determining the dutiable value and V.A.T. base of the imported goods *vis-à-vis* the customs duty and V.A.T. liabilities on importation.

> ***Post Clearance Audit Powers of the Philippines Bureau of Customs***

Under the C.M.T.A., royalty or license fee payments are dutiable only when 1) they are related to the goods being valued (Relationship Test), 2) paid by the buyer, directly or indirectly, to the seller (Payment Test), and 3) the payment is a condition for the sale of imported goods (Condition Test).

a. Relationship Test

In applying this test, there must be a careful examination of exactly what the royalty or license fee is being paid for. Hence, there is a need to analyse the relationship between the payments and the imported goods. The most essential point in assessing the relationship of goods (the tangible) is whether the importer could have purchased the tangible without the purchase of the intangible rights. If there is no connection between the payments and the imported goods, the two should be considered unrelated and thus, not part of the T.V.

b. Payment Test

The payment test determines whether the royalty or license fees were directly or indirectly paid by the buyer to the seller. This is in relation to the aspect that adjustments for royalty or license fee payments shall be made to the T.V. to the extent that they are actually paid or payable to the supplier. Hence, in order to be liable, the requirement that the fees must be paid directly or indirectly to the seller presupposes that such payment ultimately redounded to the benefit of the seller. Without such benefit, any payment should not be considered as part of the T.V., and therefore, not liable.

Notably, where a buyer makes payment to a party related to the seller, there arises a presumption that the payments are part of the price actually paid or payable to the seller. Such presumption may, however, be overturned through the presentation of contrary evidence.

c. Condition Test

If an importer pays a third party for the right to use intangible property and such payment is not a condition of the sale of the goods for exportation to the Philippines, then the payment will not be considered an addition to the T.V. of the imported merchandise. Conversely, if the payment is made as a condition of sale of the goods, an addition should be made.

The mere fact that the payment of the royalty (or license fee) is a term of the contract between the parties does not mean that payment of the royalty is a condition of the sale if the buyer had a genuine choice whether to take the goods with or without the rights. Thus, the question to be determined is whether the purchase could have been made without the payment of royalty or license fee.

The above tests must be satisfied separately and the absence of any one of the conditions should result to non-dutiability of the royalty payment.

Ultimately, a royalty or license fee is liable depending on whether a) the fee bears directly on the goods being imported, such as, when a payment is calculated as a percentage of the price at which the goods are sold or resold, and b) the sale of the goods to the importer is inextricably intertwined with the payment thereof, regardless to whom it is paid and under what circumstances it was paid. In other words, the matter will have to be decided on a case to case basis.

Royalty (and license fee) arrangements are most likely to be scrutinized (in fact the favourite area) by the B.O.C., particularly during the conduct of a P.C.A. The default position of the B.O.C. during P.C.A. is that all royalty and license fee payments are dutiable. The burden of proving otherwise is with the importers.

(5) Proceeds of subsequent resale

Any proceeds resulting from the subsequent resale, disposal, or use of the imported goods that accrue, directly or indirectly, to the seller are liable.

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Thus, for instance, if the importer of the goods is required to pay the supplier an amount of the former's net profit on the resale, the amount thus paid is proper additions to the T.V. of the imported goods.

(6) Cost of transport of the imported goods from port of exportation to the port of entry in the Philippines.

(7) Loading, unloading and handling charges associated with the transport of the imported goods from the country of exportation to the port of entry in the Philippines.

(8) Cost of Insurance

Considering the above adjustments required to be included for purposes of customs appraisement, the T.V. of an imported article is not necessarily equal to the invoice value, unless the invoice reflects the above dutiable elements.

LIMITATIONS ON THE USE OF T.V. OF IMPORTED GOODS

One of the conditions on the applicability of Method 1 or the T.V. of the goods is that the buyer and the seller must not be related, or if related, such relationship did not influence the price of the goods. Under the C.M.T.A., the parties are deemed related if they are (1) Officers or directors of one another's business, (2) Legally recognized partners in business, (3) Employer and employee, (4) Directly or indirectly owning, controlling or holding 5% or more of the outstanding stock or shares of both of them, (5) Directly or indirectly controls the other, (6) Both of them are, directly or indirectly, controlled by a third person, or (7) Related by affinity or consanguinity up to the fourth civil degree.

The fact that the buyer and seller are related though should not result to an outright rejection of the T.V. declared by the importer. The existence of a relationship, however, serves to alert the B.O.C. to the fact that there may be a need to inquire as to the circumstance surrounding the sale. Each import transaction is assessed independently.

Thus, the B.O.C., as a matter or procedure, would check, either whether the value declared for purposes of customs appraisement was undervalued resulting in effect, to short payment of customs duties and V.A.T. on importation.

Assuming that the issue (price has been influenced by the relationship) is raised by the B.O.C., the importer can establish arm's length by demonstrating that: (1) an examination of the "circumstances of sale" indicates that the relationship between the parties did not influence the price actually paid or payable, or (2) the transaction value of the imported articles approximates certain "test values".

The "test value method" may be based upon previously accepted T.V. of identical goods, deductive value, or computed value. In practice, however, "test values" are, in most instances, not available. Consequently, the "circumstance of sale" condition is often times resorted to by related party importers to justify their prices.

If the importer fails to refute the allegation, the B.O.C. may proceed to determine the customs value by applying, in their sequential order, alternative methods of valuation as discussed above.

The circumstances of sale test examine the relevant aspects of a transaction, including the way in which the buyer and seller organize their commercial relations and the way in which the price in question was arrived at, to determine whether relationship influenced the price. Under this test, the importer may prove, among others, any of the following: a) the price has been settled in a manner consistent with the "normal pricing practices" of the industry in question, b) the price is settled in a manner "consistent with sales to unrelated party" and c) the price is adequate to ensure recovery of all costs plus a profit.

There is a similarity between the customs method of valuation and the arm's length standard in transfer pricing (T.P.) rules. It may thus be stated that customs values may, but not necessarily, indicate an arm's length outcome[14].

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RECORD KEEPING REQUIREMENTS

As a control measure, all importers are required under the C.M.T.A. to hold at their principal place of business all the records of their importations and/or books of accounts, business and/or computer systems and all other customs commercial data, in whatever form, including payment records relevant for the verification of the accuracy of the transaction value declared by the importers/customs brokers on the import entry.

The documents required to be held are as follows:

- Company or entity structure *(e.g. articles of incorporation or partnership, organizational structure, management and key personnel, capital composition, stock and transfer book, principal and/or subsidiaries and their capital composition).*
- Ordering and purchase documentation *(e.g. sales and other related agreements, such as distribution, royalty, agency, warranty, terms of payment, and the like; correspondence relating to the import transaction including purchase orders, vouchers, confirmations, pro-forma invoice, acknowledgement receipts, notices, advisories etc.; product description or specifications, brochures, manuals, catalogues, pamphlets etc.).*
- Shipping, importation, exportation, and transportation documentation *(e.g. import/ export entry, invoice/ consignment notes, import and export licenses/permits, bill of lading, shipping instructions, certificates of origin/ eligibility, inspection and loading, freight and insurance contracts, packing lists.*
- Manufacturing, stock, and resale documentation *(e.g. records of production, inventory, costing, and sales).*
- Banking and accounting information *(e.g. letters of credit, remittance advice, credit card transactions, telegraphic money transfers).*
- Charts and code of accounts, ledgers, financial statements, accounting instruction manuals, and systems and program documentation that describes the accounting system used by the importer.

The above documents must be retained for a period of three (3) years from the date of filing of the import entry.

Customs brokers are likewise required to keep copies of the importation records covering transactions that they handle.

PENALTIES IMPOSABLE DURING P.C.A.

Under the C.M.T.A., any importer who, after being subjected to compliance audit, is found to have incurred deficiencies in duties and taxes paid for imported goods, shall be penalized according to 2 degrees of culpability, namely:

[14] In an attempt to converge the 2 rules, the Technical Committee of Customs Valuation (TCCV) of the Word Customs Organization issued Commentary 23.1 during its 31st session in October 2010 which essentially provides that business documentation developed for T.P. purposes may contain useful information for Customs and the use of T.P. study as a possible basis for examining the circumstances of the sale should be considered on a case by case basis.

Based on this pronouncement, the TCCV, approved new instruments that contained case studies, i.e., Case Study 14.1 during its 42nd (April 2016) session and Case Study 14.2 during its 45 (October 2017) session, in Brussels, on the use of T.P. documentation in assessing customs values, taking important steps toward better coordination between these two subject areas.

- *Negligence*[15]. The applicable penalty is an administrative fine of 125% of the revenue loss.
- *Fraud*[16]. The applicable penalty is an administrative fine equivalent to six (6) times the revenue loss and/or imprisonment of not less than 2 years, but not more than 8 years.

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Aside from the administrative fine, a 20% interest (per annum) on deficiency duties, taxes and other charges (plus fines and penalties, if any) can now be imposed under the C.M.T.A. The interest is counted fifteen (15) days from receipt of demand letter by the importer arising from audit findings on deficiency duties, taxes and other charges as well as fine or penalty, if any.

For failure to keep the required records of importation, the penalties are as follows:

- Suspension or cancellation of accreditation as Importer or Broker with the Bureau;
- Surcharge of twenty percent (20%) on the dutiable value of the goods which is the subject of the importation for which no records were kept and maintained;
- Hold delivery or release of subsequent imported articles to answer for the fine and any revised assessment;
- Criminal prosecution punishable with imprisonment of not less than three (3) years and one (1) day but not more than six (6) years, and/or a fine of one million pesos (PhP1,000,000.00); and
- Waiver of the right to contest the results of the audit based on records kept by the Bureau.

AUTHORITY OF THE B.O.C. COMMISSIONER TO COMPROMISE

Under the C.M.T.A., the B.O.C. Commissioner, subject to the approval of the D.O.F. Secretary, may compromise any administrative case involving the imposition of fines and surcharges, including those arising from the conduct of a post clearance audit. This contemplates a prior disclosure reported by importers arising from plain errors or innocent mistakes in the goods declaration resulting to deficiency in duties, taxes and other charges on past importations.

Excluded from the coverage are cases a) already pending with any other customs office, b) already filed and pending in courts; and c) goods declaration involving Fraud.

The prior disclosure (P.D.) provision of the C.M.T.A. is basically a compliance and revenue measure. Under the draft implementation rules and regulations on P.C.A., the benefits are as follows:

For P.D. availment <u>prior</u> to receipt of A.N.L.

- Payment of basic deficiency duties and taxes due
- *Plus, a **reduced penalty of 5%** of the basic deficiency (as compared to* administrative fine of 125% of the revenue loss for cases involving negligence)

For P.D. availment <u>after</u> receipt of A.N.L.

- Payment of basic deficiency duties and taxes due
- *Plus, a **reduced penalty of 10%** of the basic deficiency (as compared to* administrative fine of 125% of the revenue loss for cases involving negligence)

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[15] The term "negligence" shall refer to failure to exercise reasonable care and competence, through act or acts of omission or commission, in ensuring that a statement made is correct resulting in a deficiency in taxes and duties paid.

[16] The term "fraud" shall refer to the commission or omission of any act resulting in material false statements such as, but not limited to, the submission of false or altered documents in connection with any importation knowingly, voluntarily and intentionally done to reduce the taxes and duties paid or to avoid compliance with government regulations related to the entry of Regulated, Prohibited or Restricted goods into Philippine customs territory through Misdeclaration, Misclassification or Undervaluation.

For P.D. availment on a) Royalties, and b) other proceeds on any subsequent resale that accrues directly or indirectly to the seller of goods

- Payment of basic deficiency duties and taxes due *without penalty.*
- *Provided, the applicant files for P.D.P.* ***within 45 days*** *from date of payment to the seller.*
- *If after 45 days, the 5% (No A.N.L.) or 10% (with A.N.L.) rate shall apply.*

WHAT TO EXPECT FROM THE B.O.C. MOVING FORWARD

The present B.O.C. Commissioner has recently presented his 5-point program to further introduce radical reforms in the B.O.C. This program covers the goal of eradicating corruption, ensuring trade facilitation, strengthening anti-smuggling efforts and enhancing the personnel incentives, rewards system as well as compensation benefits for B.O.C. personnel. He has implemented a "One-Strike" policy at the B.O.C. that removes District Collectors and officers who consistently fail to reach their monthly collection targets due to incorrect classification or undervaluation of goods under their jurisdiction. He has also recently ordered the filing of cases against erring importers and customs brokers.

To increase revenue collections, on the other hand, the B.O.C. will, among others, aggressively pursue the collection of additional duties, taxes or penalties from P.C.A. and towards this end, a Joint Task Force with the Bureau of Internal Revenue (Local Inland Revenue Service) will be created precisely to intensify the government's effort to improve the collection of duties and taxes.

With all these developments and programs for the B.O.C., importers should expect closer monitoring of their importation activities through intensified examination of imported goods either at the border or thru P.C.A.

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SURVIVING A B.O.C. AUDIT

The importer is responsible for using reasonable care to enter, classify and determine the value of imported merchandise and to provide any other information necessary to enable the B.O.C. to properly assess duties, collect accurate statistics, and determine whether other applicable legal requirements, if any, have been met.

An importer's failure to exercise reasonable care could result in the delay of the release of its merchandise and, in some cases, could result in the imposition of penalties.

Since, however, the declaration on the entry is based on self-assessment, the burden of proof to show that the declaration is untruthful lies with the B.O.C. However, once a deficiency assessment is issued by the B.O.C., the burden is again shifted to the importer to dispute the findings.

As importers may soon undergo P.C.A., the logical thing for them to do is to prepare themselves by carefully planning the duty aspects of their intended importations. If importations had already been made, the next logical thing to do is to review the company's possible exposure and risk areas to a potential deficiency duty assessment and adopt corrective measures to strengthen its compliance with existing B.O.C. rules and regulations.

Audit readiness is the key to survive a P.C.A. To avoid the payment of unnecessary additional import costs for shipments to the Philippines, importers should ensure informed compliance with importation laws, rules and regulations. The time tested best practice is to conduct a regular self-assessment for the purposes of determining errors in the past that could result to potential exposures to penalties. This approach should enable importers to adopt corrective measures such as, among others, the availment of a prior disclosure.

The Taxation of Image Rights

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INTRODUCTION

Last year's revelations in the press from the so called "Paradise Papers", a number of documents obtained from the hacking of the computer systems of a law firm and other related entities, has once again brought tax into the press. In addition, a number of high profile cases involving footballers in Spain and press reports in the U.K. have highlighted the use of structures for the exploitation of image rights. These tax planning arrangements, when implemented correctly, are usually legal so do not constitute evasion. However, in the current climate where, in the U.K., the distinction now appears to be drawn between tax planning and tax avoidance rather than avoidance and evasion, tax authorities and governments are under increasing pressure to clamp down on what was previously considered to be acceptable tax planning.

This article looks at the taxation of image rights associated with professional sportspersons with particular reference to the developments in the U.K. during 2017.

IMAGE RIGHTS STRUCTURES AND PRACTICE

When looking at image rights it is first necessary to define what constitutes an image right. The U.K. concept of an image right is actually a bundle of different intellectual property rights such as contractual rights, trademarks, copyrights, etc. Other countries may have different views as to whether an image right exists or there is a collection of rights, etc. For example, article 18.1 of the Spanish Constitution indicates that image rights are recognised alongside other personal rights, such as honour and privacy. In Guernsey (part of the Channel Islands) it is possible to register an individual's image rights. The benefits of doing so remain to be seen but this may prove useful in support of any challenge as to the existence of an image right.

Image rights structures have been around for a number of years and their use has increased considerably. At a basic level an individual will assign or licence the right to exploit their image to a company. That company will then exploit the rights by entering into contracts with others. Depending upon the jurisdiction in which the company is located, the status of the individual and the contractual arrangements the profit generated by the company may then be taxed at a reduced rate or not at all. The tax savings can, therefore, be considerable.

The number of football players based in the U.K. setting up companies to exploit image rights has increased by around 80% in the past two years with more than 180 players in the English Premier League now appearing to have companies that may receive income from the exploitation of image rights. A little over 100 of those companies are reported to hold a total of £60m and are reported to have avoided at least £21m in tax[1]. Such companies can be used to provide pension type benefits or create a capital payment after retirement.

Image rights companies are particularly attractive to overseas players who can receive funds outside the U.K. after ceasing to play in the U.K. often without further taxes. Foreign players with an international earning potential may be able to set up a company outside the U.K. and take advantage of the U.K.'s non-domicile regime. This can allow payments for image rights, etc. that arise outside the U.K. to be paid to an offshore company without incurring any U.K. tax charge (subject to the Remittance Basis Charge). It is not uncommon, therefore, to see endorsement contracts to cover exploitation of a player's image in certain areas of the world with the U.K. specifically excluded. Such companies may be set up in tax havens although the need for access to tax treaties and the reluctance of some sponsors to be associated with a company in a tax haven make this less likely. It is, however, still possible to have the best of both worlds by using structures such as the one it is suggested was set up for a well-known football manager which allowed a small amount of income to be taxed in Ireland at a rate of 12.5% with the balance flowing through to a company in a tax haven such as the British Virgin Islands.

With a growing number of such structures the payments to image rights companies was the subject of a challenge by H.M.R.C. in the U.K. during 2011. After lengthy negotiations it was believed by football clubs and their advisers that an agreement had been reached with H.M.R.C. in 2015 that allowed clubs to treat up to 20% of the salaries paid to players as a payment for the use of their image rights. Documents published as part of the football leaks revelations included an email from an adviser indicating that the position had been "agreed formally with the clubs" and that, although nothing would be formally published, all clubs had been provided with details of the agreement with H.M.R.C. However, when asked about these arrangements, H.M.R.C. denied agreeing any deal with the clubs in 2015. In early 2017 they stated that they are currently investigating more than 100 players over their use of "tax avoidance schemes". This does not specifically mean that they are investigating image rights companies as it is known that a number of individual players are caught up within enquiries into other tax arrangements, but it can be concluded that image rights payments are included in the enquiries.

The use of image rights companies as highlighted in the football leaks papers led Meg Hillier, the Labour MP and chairperson of the House of Commons Public Accounts Committee, to say "I am frankly amazed that H.M.R.C. can seemingly rubber-stamp such a practice which, on the face of it, seems solely designed to minimise tax. Although this is legal it is certainly not in the spirit of the law". This increasing pressure on H.M.R.C. to challenge such structures led to an announcement in the U.K. Budget statement in March 2017 that H.M.R.C. would "*publish guidelines for employers who make payments of image rights to their employees to improve the clarity of the existing rules*".[2]

The exploitation of image rights arrangements has also been the subject of challenge in other countries. In Spain there have been some high-profile cases involving international football players and the application of what was understood to be the "15% safe harbour" regime. In the past it was understood that a split of 15/85 would not be challenged but, again, the perceived abuse of this regime and particularly aggressive tax avoidance arrangements have resulted in a level of uncertainty in dealing with the Spanish tax authorities with regard to image rights.

In the U.S.A. the approach of the tax authorities appears to be a little clearer even though, in practice, there may be some difficult negotiations required with the IRS. In the case of *Retief Goosen*[3] the issue was how streams of income would be treated for US tax purposes. It was held that certain income streams

[1] Reported in the Sunday Times,11th December 2016

[2] Para 4.13 of the Spring Budget 2017 Policy Paper published 8th March 2017

[3] Retief Goosen, Petitioner v. Commissioner of Internal Revenue, Respondent

would be allocated 50/50 to personal services and royalty income whilst other income streams were allocated to a US source based on the facts although treaty relief was not available.

The Taxation of Image Rights

DEVELOPMENT IN THE TAXATION OF IMAGE RIGHTS

In July 2017 the Entertainment, Sports and Media Group of the I.C.A.E.W. in the U.K. published a document "Image rights – a whole new ball game". This document set out the way in which image rights work in practice in the U.K. and the tax implications arising from such arrangements. It was identified that image rights had become an integral part of football and were part of the negotiations entered into whenever a player switched clubs or signed a new contract and that a club would often agree to pay a proportion of the salary to a player's image rights company.

The tax benefits were indicated but the only issue identified within the document was the problem of valuing the image rights which, the author comments, was "subjective".

Emphasis was placed on H.M.R.C.'s acceptance that image rights are separate after the Sports Club case[4] and it is commented that the agreement with the 20% cap was a temporary arrangement for the 2016/17 season. What is not addressed in the document, however, is the question of whether payments made are actually for the exploitation of image rights or relate to an employment. For example, is a simple split of a salary within the 20%/80% agreement sufficient?

Could the Rangers case be applied?

The tax case involving Glasgow Rangers football club[5] involved the use of trust arrangements to avoid tax on payments to employees. This has been a long running case in the U.K. with the final Supreme Court decision in favour of the H.M.R.C. being delivered on 5th July 2017. Within paragraph 39 of the decision, the court set out the principle that employment income paid from an employer to a third party is still taxable as employment income. H.M.R.C.'s view is that this principle applies to a wide range of "disguised remuneration tax avoidance schemes no matter what type of third party is used". Guidance published on 29th September 2017 stated that H.M.R.C. intended to use the decision to take action against a number of schemes[6]. Whilst the guidance does not specifically refer to image rights structures it could be argued that payments made to an image rights company negotiated as part of the salary of a player could be challenged on these grounds.

This view appears to follow that of the Australian courts. In the long running case involving the Australian rules football club known as the Brisbane Lions[7] the courts have concluded that payments to players and coaching staff for the use of image rights were taxable wages and therefore liable to payroll taxes.

H.M.R.C. GUIDANCE

H.M.R.C. published additional guidance on image rights payments on 16th August 2017[8]. The actual guidance document is very short and doesn't actually contain much in the way of "guidance". It is identified that payments for the use of an individual's image rights can be taxed in different ways. The guidance then goes on to indicate that tax may be charged in one of three ways.

- Payments made to a self-employed individual are taxable as professional income.
- Payments to employees for the duties of an individual's employment must be taxed as earnings subject to tax deductions at source and not as payments for the use of image rights. It is the employer's obligation to ensure that deductions are made.

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[4] Sports Club plc and others v CIR [2000] STC 443

[5] *RFC 2012 plc (in liquidation) (formerly The Rangers Football Club plc) (Appellant) v Advocate General for Scotland (Respondent) (Scotland)* [2017] UKSC 45

[6] H.M.R.C. Guidance - Disguised remuneration: A Supreme Court decision (Spotlight 41)

[7] *Brisbane Bears – Fitzroy Football Club Limited v Commissioner of State Revenue [2017] QCA 223*

[8] H.M.R.C. Guidance - Tax on payments for use of image rights

The Taxation of Image Rights

- Image rights payments made to a U.K. company will give rise to a liability to U.K. corporation tax on profits. Income received by the individual from their company is taxable in accordance with the type of income received (i.e. dividends, salary, etc.).

The guidance does not go into further detail but refers the reader to the H.M.R.C. Employment Income Manual[9] which contains additional guidance on image rights payments[10].

H.M.R.C. defines "image rights" as likely to be dependent upon a bundle of different rights. It is noted that image rights contracts are popular with sportspersons but are likely to allow for the exploitation of an individual's public appearances, copyrights, trademarks, etc. as well as an individual's name, likeness, etc. They do not accept that there is a single asset and it is therefore necessary to analyse the rights being exploited to determine the tax position.

The next section of the manual comments on payments to an image rights company (I.R.C.). It is noted that, in recent years, the assignment of an asset described as "image rights" to an I.R.C. has become common practice. However, in H.M.R.C.'s view, it is not correct to regard the transfer of a registered trademark, such as a person's name, caricature, etc., as a transfer of "image rights". It is noted that an individual may agree to perform services in connection with the "image rights" which are exploited by the I.R.C. resulting in the payment of royalties or license fees. The justification often quoted by advisers for arrangements such as this is the Sports Club case referred to above. H.M.R.C., however, note that this was a decision by the Special Commissioners published in anonymous form. As the Inland Revenue (the predecessor to H.M.R.C.) did not appeal this decision it did not proceed to the courts and H.M.R.C. therefore regard the decision as "*informative rather than having created precedent*"[11]. This leads to the conclusion that the Sports Club case cannot be relied upon and that other factors need to be considered before H.M.R.C. will accept an I.R.C. is effective for tax purposes.

The Sports Club case

The Special Commissioners when considering the Sports Club case recognised there was no property in a person's image and the description of the arrangements in the case as "image rights agreements" was misleading. The arrangements were therefore referred to as "promotional agreements". These promotional agreements led to payments being made to the I.R.C.'s of the two players involved by the club in respect of promotional services provided by the players.

The case before the Special Commissioners was whether the payments were earnings from the employment of the players by the club (and so chargeable to income tax as employment income) or, if not, benefits in kind (and so treated as earnings from the employment). In order to consider these points, the following questions were identified.

1. Did the promotional agreements have independent values?
2. Were the promotional agreements a "smokescreen" for additional remuneration?
3. Were the payments under the agreements emoluments from the employments?

The Special Commissioners decided that the promotional agreements were capable of and did have independent values and were genuine commercial agreements. As a result, in light of the specific facts of the case, the payments were not earnings from the employment with the club.

The Special Commissioners also decided that a "benefit" cannot include something in return for "good consideration under a separate commercial contract". The payments were not, therefore, benefits in kind and should not be regarded as earnings of employment.

H.M.R.C., whilst accepting the decision, consider that it is based on the specific facts and should not be regarded as a precedent to justify the arrangements of other taxpayers. H.M.R.C. will still consider whether the payments to an I.R.C. should be regarded as

[9] H.M.R.C. Internal Manual – Employment Income Manual published at www.gov.uk/hmrc-internal-manuals/employment-income-manual
[10] H.M.R.C. Employment Income Manual published at www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00731
[11] P.H.M.R.C. Employment Income Manual published at www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733

income arising from an employment. The decision in the Rangers case may assist H.M.R.C. with this argument in future cases. The Brisbane Lions case, while having no jurisprudence in the U.K., may also assist in forming H.M.R.C.'s views.

Other H.M.R.C. guidance

H.M.R.C. have also provided their views on whether deduction of tax should be made from payments made to an I.R.C. Royalties and other income arising from intellectual property which has a source in the U.K. are liable to U.K. income tax[12]. H.M.R.C. believe some of the intellectual property rights that form the image rights assigned to an I.R.C. will meet the definition of intellectual property within s.579(2) ITTOIA. The payer may then be placed under an obligation to deduct tax from any payment made under Part 15 of the Income Tax Act 2007.

In addition, s.906 of the Income Tax Act 2007 places an obligation to deduct tax on the payer of a payment for the use of intellectual property to a non-U.K. resident. The definition of intellectual property for these purposes was expanded by Finance Act 2016 (with effect from 28th June 2016) to cover a wide range of payments and follows that contained in the O.E.C.D. model tax treaty. In particular, H.M.R.C. will consider the commentary to Article 12 of the O.E.C.D. Model Tax Treaty when determining whether a payment gives rise to an obligation to deduct tax at source. If the payment is from the U.K. to a country with which the U.K. has a tax treaty, then the obligation to deduct tax may be reduced or eliminated. The availability of relief under a treaty will, however, be denied if the parties are connected and the payment is made under tax avoidance arrangements. Anti-abuse provisions within a treaty must also be considered.

Having set out the view that they consider the payments made to an I.R.C. as, potentially, relating to more than one type of income H.M.R.C. will seek to apply tax to each element of the payment in accordance with U.K. tax law. Where the payment is considered to be a royalty then an obligation to deduct tax will be placed on the payer and H.M.R.C. will pursue the payer where this has not been done. Where a payment is determined to be employment income then an obligation to deduct payroll taxes will arise and H.M.R.C. will, again, pursue the payer where this has not been done. It is in the area of employment taxes that H.M.R.C. are now pursuing clubs and players.

H.M.R.C. REVIEW OF IMAGE RIGHTS PAYMENTS

When looking at whether a payment constitutes employment income H.M.R.C. have made it clear that they are only looking to a situation where a payment purporting to be for image rights is made under an employment relationship such as between a club and a player. Agreements with a third party (such as individual endorsement contracts) should not, therefore, give rise to employment income although H.M.R.C. may still seek to collect tax from the payer if they believe the payments constitute a royalty or challenge any arrangements where the payment is connected with an employment.

H.M.R.C. consider that a player is employed by a club to be a member of a team which entails far more than just being a player. Remuneration under a contract of employment will arise from the performance of the duties of the employment which may include promotional services as well as playing for the club. These duties may be split between two (or more) contracts but may constitute one arrangement. H.M.R.C. therefore believe there must be a commercial justification for distinguishing between payments for performance of the duties of the employment and payments for promotional services through an I.R.C. Agreements for promotional services are generally negotiated to run alongside a contract of employment. Renegotiation of the employment contract may also result in a renegotiation of the image rights agreement leading to an impression that the total payments are considered by the employer to be an overall package. In particular, H.M.R.C. consider the employer (i.e. the club) to have proper regard to the commercial revenues expected to be achieved from exploiting a player's image. The actual payments, as well as the contractual terms, will therefore need to

[12] Part 5 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA)

reflect commercial terms and so the previous practice of making a payment of up to 20% of remuneration is clearly at an end. H.M.R.C. have given some examples of the records that a club may keep[13]. The list includes evidence of the consideration of the commercial activities to be performed, business plan, individual negotiations, independent advice, etc. What is sufficient will, however, depend upon the individual case.

H.M.R.C. ENABLER PENALTIES

Although not specifically relating to image rights it is worth mentioning the new penalties recently enacted in the U.K. to cover those who enable a person to avoid taxation[14]. Under this new legislation, a civil penalty may arise on any party who enables a person to be deliberately non-compliant in relation to tax. The definition of an enabler is quite wide and includes a party to a contract if it is reasonable to conclude that the party should have known the arrangements they were entering into could be used to evade tax. Senior representatives at a club may therefore be caught by these provisions if they do not take care to ensure any image rights payments are made on a commercial basis.

GEOVANNI

As has already been mentioned H.M.R.C. are investigating more than 100 players. Whilst not all of these are related to image rights arrangements it is becoming clear that this is an area H.M.R.C. are targeting. In addition, it appears that the target of the enquiries is the obligation of the club to deduct tax rather than the structures themselves. One such case that is going before the tax tribunal in the U.K. is that involving the Brazilian player Geovanni[15]. The actual case has yet to be heard but most of the background detail to the case is set out in the decision of the tribunal to an application to vary directions[16].

H.M.R.C. have challenged the arrangements between Hull City football club and Geovanni whereby a payment was made for use of image rights to an I.R.C. H.M.R.C.'s view is that the payments were a "sham", should be considered part of the remuneration of the employment and taxed as employment income.

THE FUTURE

The Spanish courts have been very active in challenging arrangements of football players. Some large settlements have been paid and even jail sentences handed down although, so far, less than 24 months so not being served.

This contrasts with the Australian approach where draft guidelines published in July 2017 suggest a safe harbour approach similar to that previously applied in Spain[17]. Under the Australian proposal payments of up to 10% of income from a player's contract could be treated as arising from the "use and exploitation of their 'public fame' or 'image' under licence". The payment may be directed to a private trust or company where it may attract a lower tax rate. It is expected that the guidelines will be finalised in June 2018, but they do seem to be a reversal of the approach being taken in countries such as the U.K. and Spain.

In conclusion, the area of taxation of image rights is attracting a lot of attention. Anyone involved in advising clients who may be affected by image rights payments should therefore be advised to review their current arrangements and plan carefully for the future.

[13] H.M.R.C. Employment Income Manual published at www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00739

[14] Schedule 16 Finance (No.2) Act 2017

[15] Hull City AFC (Tigers) Limited v H.M.R.C.

[16] First Tier Tribunal decision at www.bailii.org/uk/cases/UKFTT/TC/2017/TC06065.html

[17] Practical Compliance Guideline 2017/D11

Z.E.C.: A Great Trading Regime

By José María Cusí Navarro
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INTRODUCTION

It is broadly known that territories called "D.O.M."s (in French, *Département d'Outre-Mer*, which roughly translates to "overseas land") are islands that provide tax incentives as a way to attract foreign investment to compensate for their distance from the continent. This would be the case for the British Virgin Islands, the Channel Islands (Jersey and Guernsey), the Isle of Man, etc. The problem for these islands is that most of them are labelled by many countries as tax havens and thus give rise to anti-avoidance provisions and other adverse tax consequences.

It is also important in this changing and challenging world in which we live and work to have as much certainty as possible. It is public knowledge that the European Commission considers that many companies in Ireland should pay billions of Euros because of an abuse of the attractive Irish trading regime. This has arisen from counting on the blessing of the Brussels authorities to avoid unexpected large tax liabilities and a desire for E.U. based solutions which are more convenient than trading regimes in non-E.U. countries such as the Fribourg or Zug canton based Swiss companies.

Moreover, sharp tax planning does not only require a spreadsheet showing a low tax burden, but also consideration of substance with regard to the B.E.P.S. regulations such as to consider the quality of services and infrastructure and to have employees motivated.

So, if a company seeks an attractive trading regime, but not in a tax haven island, a stable and reliable E.U. jurisdiction approved by the European Commission, a place employees will want to work in, well connected infrastructure and geographically convenient as an alternative to companies engaged in business within Africa (e.g. oil, gas, mining companies, etc.) then there is one suitable solution: the Canary Z.E.C. regime.

Z.E.C. stands for "Zona Especial Canaria". The Canaries are a group of seven extremely beautiful islands[1] with mild weather the full year-round.

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[1] Gran Canaria, Tenerife, Lanzarote, Fuerteventura, El Hierro, La Gomera y La Palma

The islands belong to Spain and thus can claim all Spanish tax treaties[2] (96 at the moment) as well as all the European Directives. The islands are geographically located west of the north of Africa.

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ADVANTAGES OF THE CANARIES Z.E.C.

The remarkable thing about the Canaries, besides the aforementioned climate, its beautiful cities and wonderful beaches is that the islands are well connected to Spain and the rest of continental Europe by air (e.g. 4 daily flights to London). They are also well connected to Africa.

Tax wise, subject to fulfilling certain requirements addressed later in this article, a company operating under the Z.E.C. regime can benefit until 2026[3] from a 4% tax rate and a 90% reduction of the tax base.

Moreover, unless the shareholder is resident in a country or territory statutorily classified by Spain as a tax haven, as long as a simple threshold is met consisting of a 5% and one-year shareholding in the company in the Canaries, no dividend withholding tax applies to profits distributed to the shareholder.

BRIEF SUMMARY OF THE APPLICABLE REQUIREMENTS

In order to qualify for the Z.E.C. regime, two groups of requirements must be met:

i. Formal requirements; and
ii. Substance requirements.

Formal Requirements

In order to qualify as a Z.E.C. company, there is a mandatory registration process to go through. The first step is to qualify the business activity intended to be carried out in the Canaries. To that purpose there is a long list of approved business activities which only excludes those that do not require a geographical link to the Canaries (financial activities being excluded in all cases). Once the business purpose has been determined it is necessary to register the Z.E.C. company in a special registry[4], which requires the prior formal approval of the *Consejo Rector* (Governing Council).

To proceed with the registration an application must be filed together with a brief summary of the aimed business activities, proof of solvency, feasibility, international competitiveness and contribution to the economic and social development of the Canaries.

The company must create a minimum number of jobs in the area of the Z.E.C. within the period of six months following its registration and must maintain at least the same number as an annual average of employees during the period in which the regime applies.

Finally, for a company to qualify for the Z.E.C. regime, it must have both its business domicile and its seat of effective management in the geographical area of the Z.E.C. Moreover, it must have at least one local (i.e. Canaries resident) director and its business purpose must be the carrying out of one of the numerous activities qualify for the Z.E.C. regime.

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[2] Spain has currently treaties in force with the following countries: Albania, Algeria, Andorra, Argentina, Armenia, Australia, Austria, Azerbaijan, Barbados, Belgium, Bolivia, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cuba, Cyprus, Czech Republic, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Georgia, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kuwait, Kyrgyzstan, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mexico, Moldova, Morocco, Netherlands, New Zealand, Nigeria, Norway, Oman, Pakistan, Panama, Peru (about to enter into force), Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Sweden, Switzerland, Tajikistan, Thailand, Trinidad And Tobago, Tunisia, Turkey, Turkmenistan, Russia, Ukraine, United Arab Emirates, United Kingdom, United States, Uruguay, Uzbekistan, Venezuela, Vietnam.

[3] However, an extension of this regime by the European Commission is foreseeable as in the past.

[4] The so-called *Registro Oficial de Entidades de la Zona Especial Canaria*.

Substance Requirements

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A certain degree of substance is required to qualify for the Z.E.C. regime, although substance is mandatory B.E.P.S. wise anyway when setting up companies abroad, should one intend to invoke local tax incentives. With regard to the substance requirements, within the first two years from the registration date, the Z.E.C. entity must invest in tangible or intangible fixed assets[5]. The amount must be at least €100,000 for the two big islands (Gran Canaria and Tenerife) or €50,000 for the remaining islands. In the computation of the amount of the investment, any contributions made under the roll-over relief regime shall be disregarded.

Finally, the substance requirement varies depending on the type of island as there are two groups. For the two largest islands (being Gran Canaria and Tenerife) it is mandatory to have at least 5 employees within the first six months after the foregoing registration. The number of employees is at least 3 for the remaining islands.

TAX REGIME

Z.E.C. Company Taxation

A Z.E.C. company is a regular Spanish company subject to the regular corporate income tax rate applicable in Spain, currently being 25%.

However, should a company meet the aforementioned requirements, it can benefit from a 4% tax rate on a tax base of at least €1,800,000 plus €500,000 of additional tax base at the low rate per each employment created with a cap of €25,000,000 of tax base.

There is also another limitation to the application of the 4% tax rate, which is indexed to the turnover and that has been recently amended to improve the former legislation. This second limitation is that the reduction of the gross tax due of a Z.E.C. company cannot exceed a certain percentage of the company's turnover. This limitation was 10% in the case of service companies and 17.5% in case of industrial companies but, as a result of recently passed legislation, it has been improved and unified to 30%.

The Z.E.C. regime is compatible with another attractive local tax incentive known as R.I.C. (Reserva para Inversiones en Canarias or Canaries Investments Reserve) which, subject to certain requirements, allows a 90% reduction of the tax base. Nevertheless, this tax incentive can only apply on the remaining part of tax base, if any, that does not benefit from the Z.E.C. regime. However, a joint combination of the two tax incentives can lead to a negligible rate of effective tax, much lower than other jurisdictions frequently used for trading purposes. The application of the deduction may not, however, produce a negative tax base.

R.I.C. Requirements

In order to take advantage of the R.I.C. regime the following requirements must be met:

i. The R.I.C. must be shown in the balance sheet with absolute separation and appropriate title, and shall be unavailable during the mandatory holding period in which the assets invested in;

ii. R.I.C.'s amounts must be realised within a three year period in any of the investments listed below.

The investments referred to above are as follows:

A) Initial investments consisting of tangible or intangible fixed assets.

In the case of Small Size Entities, the investment may be the acquisition of used fixed assets, as long as the goods acquired did not benefit previously from the R.I.C. regime.

B) Job creation directly linked to the investments under A) above, which should take place within a six

[5] These assets are subject to certain holding period requirements.

month period from the date on which the investment is put into operation. For the purposes of this, the following should be noted:

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- Job creation shall be determined on the basis of the average number of employees during the 12 months prior to the date of entry into operation of the investment, as long as this increase is maintained for 5 years, (3 years in the case of a Small Sized Entities).
- To determine the company's total average work-force and its average increase, those employed must fall within labour legislation, taking into account the number of hours hired in relation to full-time work.

C) The acquisition of tangible or intangible fixed assets that cannot be considered as an initial investment because they do not meet any of the conditions set out in point A above. This would include investment in assets that contribute to the improvement and protection of the environment in the Canary Islands and research and development expenses determined by the regulation.

D) Subscription of:

1. Shares of companies issued on incorporation or capital increase that carry out their business activity in the Canary Islands, provided that they comply with certain regulatory requirements (Royal Decree-Law 15/2014).
2. Shares of Z.E.C. entities on their constitution or capital increase, as long as the corresponding regulatory requirements and conditions are met together with the following additional conditions.
    - The amount of the issued or increased capital must exceed €750,000.
    - At least 10% of the issued or increased capital must be subscribed by a person or entity that does not realise amounts destined to R.I.C. and will be immediately disbursed after the granting of the deed of incorporation or capital increase.
3. Any financial instrument issued by financial institutions provided that the funds collected for the purpose of implementing the R.I.C. are used to finance private projects in the Canary Islands' eligible investments as long as the issue of the financial instrument is supervised by the Canary Islands Government and includes a binding report from the Spanish of Tax Administration.
4. Public debt securities issued by the Autonomous Region of the Canary Islands, the Canary Islands Local Corporations or their public companies or Regional Organisms, provided that they are used to finance investments in infrastructure and equipment, or to improve and protect the environment in the Canary Islands, up to a limit of 50% of the allocations made in each financial year.
5. Securities issued by public entities that proceed to the construction or operation of infrastructure or equipment of public interest for the public administrations in the Canary Islands, when the financing obtained through the aforementioned issue is exclusively used for such construction or operation, up to a limit of 50% of the allocations made in each financial year.
6. Securities issued by entities that proceed to the construction or management of infrastructure or equipment of public interest for the public administrations in the Canary Islands, when the corresponding administrative concession or enabling administrative title has been obtained, when the financing obtained from this issue is exclusively used for such construction or operation, up to a limit of 50% of the allocations made in each financial year and in accordance with the terms provided for by

the corresponding regulations.

The assets in which the investment takes place must be located or received in the Canary Islands. The assets must also be used in the same territory for the development of the taxpayer's economic activities, except for those which help to improve and protect the environment in the Canary Islands.

Realisation shall be deemed to have taken place, even in the case of acquisition by financial leasing, at the time when the assets become operative.

The assets in which the investment reserve referred to in points A and C above, as well as those acquired by the investees referred to in point D above, must remain in operation in the acquirer's business undertaking for at least five years without being transferred or leased to third parties. Should its useful life be shorter than that period, this requirement shall not be considered to have been breached when another asset is acquired in replacement for its net book value within six months of its removal from the balance sheet. It is also necessary to meet the statutory requirements for the application of the 90% reduction of the tax base that the R.I.C. grants as provided for in the legislation and which remains in operation for the time necessary to complete the relevant period. In the case of land acquisition, the term to be observed shall be of 10 years.

Shareholders' Taxation

An additional advantage derived from the Z.E.C. regime is the possibility to pay dividends to resident and non-resident shareholders under a full exemption of withholding tax with the sole requirement of a 5% shareholding held for a continuous period of at least 1 year. For non-resident shareholders, it is additionally required that they are not resident in a country or territory statutorily considered by Spain as a tax haven[6].

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For interest from loans granted to the Z.E.C. entity by its shareholder then, should the shareholder be resident in another E.U. member state, an exemption of interest withholding tax would apply. If a tax treaty exists, non-E.U. resident shareholders could claim the treaty rate.

Finally, for capital gains realised upon the disposal of an interest in the Z.E.C. entity by a non-resident but treaty resident shareholder on the transfer of its prorated share of the Z.E.C. entity, the treaty could apply and, if the substantial shareholding or real estate company clause applies, a 19% rate of taxation would accrue. Otherwise an exemption could be claimed.

A Great Alternative for African Business

Without prejudice to other issues such as the risk of a permanent establishment and the tax consequences derived therefrom, the Z.E.C. regime is being used by many large multinational groups with business interests in Africa for many reasons.

On the one hand this is due to Spain having income tax treaties with 9 African countries[7] and, because Spain is a member of the European Union and that allows the Z.E.C. entity to claim all the benefits of the applicable E.U. Directives. Additionally, the Canaries are well connected with 3 continents (Europe, Africa and America) and have the necessary infrastructure, including an American School. Finally, the Canaries do provide a degree of safety together with a standard of living which cannot be achieved, in general, on the African continent.

In conclusion, the Z.E.C. is a great and suitable option for and is being used by companies in the business of oil, gas, shipping, mining, etc. The Canaries provide the advantages thanks, in most cases, to its convenient geographical location, especially with respect to north western Africa.

[6] Spain has a closed list concept of tax haven being said list elaborated and approved by Spanish Royal Decree 1080/1991. However, since 2003, any jurisdiction that enters into an exchange of information agreement or subscribes to an income tax treaty including the exchange of information clause shall be automatically removed from the black list and that shall no longer be considered as a tax haven.

[7] Those countries being: Algeria, Cape Verde (about to enter into force), Egypt, Morocco, Namibia (about to enter into force), Nigeria, Senegal, South Africa and Tunisia.

NUMERICAL EXAMPLES OF THE APPLICATION OF THE Z.E.C. REGIME

A US group decides to set up a Spanish limited liability company (an S.L., which is a foreign eligible entity for US "tick the box" purposes as opposed to an S.A. which ranks as a corporation) in the Canaries and meets all the applicable requirements to claim both the Z.E.C. and the R.I.C. regime.

The Z.E.C. SL has a turnover of €50,000,000 and a profit of €7,500,000.

Case A. Z.E.C. SL has 10 employees and is not keen on reinvesting in local assets.	
Z.E.C. SL's Turnover	50,000,000
Z.E.C. SL's Profit of the Year	7,500,000
Tax Base Subject to 4% CIT rate	6,800,000
Limitation Applicable to Tax Base at 4%	12,000,000
Final Applicable Tax Base at 4%	6,800,000
Resulting Gross Tax Due on €6,800,000 tax base	272,000
Remaining Tax Base Subject to Spanish General CIT Rate	700,000
Gross Tax Due on Remaining Tax Base (25% of €700,000)	175,000
Overall Tax Due by Z.E.C. SL (272,000 + 175,000)	447,000
Effective Tax Burden of Z.E.C. SL	**5.96%**

Case B. Z.E.C. SL has 10 employees and is keen to reinvest €500,000 in local assets.	
Z.E.C. SL's Turnover	50,000,000
Z.E.C. SL's Profit of the Year	7,500,000
Tax Base Subject to 4% CIT rate	6,800,000
Limitation Applicable to Tax Base at 4%	12,000,000
Final Applicable Tax Base at 4%	6,800,000
Resulting Gross Tax Due on €6,800,000 tax base	272,000
Remaining Tax Base (7,500,000 – 6,800,000) eligible to R.I.C.	700,000
Tax Base Adjustment upon R.I.C. (90% of 500,000)	450,000
Remaining Tax Base Subject to Spanish General CIT Rate	250,000
Gross Tax Due on Remaining Tax Base (25% of €250,000)	62,500
Overall Tax Due by Z.E.C. SL (272,000 + 62,500)	334,500
Effective Tax Burden of Z.E.C. SL	**4.46%**

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He has written several articles and provided lectures on tax, international trade and customs. He extensively participated in the drafting of Republic Act (RA) No. 9135 which amended certain provisions of the 1978 Tariff and Customs Code of the Philippines (TCCP), as well as the final draft of its implementing rules. He was also involved in the drafting of RA 10863, otherwise known as the Customs Modernization Tariff Act (C.M.TA.) as well as in the various regulations implementing the provisions of the C.M.T.A.

Mark is a recipient of various international awards and recognition, including, among others, – "2016 Asia Tax Practice Leader of the Year" by the International Tax Review; and one of the foremost "Recognized Indirect Tax Leaders in the Philippines" for several consecutive years. During his watch as the head of SGV's indirect tax practice, his group was awarded – "The Indirect Tax Firm of the Year 2009 and 2011"; and "The Best Indirect Tax Advisory Team" in the Philippines for 2014 by the Offshore Excellence Awards.

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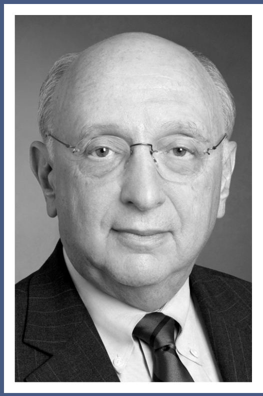

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- New York State Bar
- District of Columbia Bar
- American Bar Association, Section of Taxation
- International Fiscal Association
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LANGUAGES

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