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China Issues Clearer Guidance For "Beneficial Owners"

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In bilateral tax treaties and tax arrangements, identifying the "Beneficial Owner" of a non-resident entity is an important task when the entity derives dividends, interest or royalties from China and claims tax treaty benefits. Since 2009, China's State Administration of Taxation (S.A.T.) has released several circulars, including Guo Shui Han [2009] No. 601 (Circular 601), Bulletin of the S.A.T. [2012] No. 30. Circular 601, *Circular of the S.A.T. on the Interpretation and the Determination of "Beneficial Owners" in Tax Treaties* (Guo Shui Han [2009] No. 601), that define the term Beneficial Owner and set out seven "negative factors" that could affect a nonresident's status as a Beneficial Owner. Bulletin 30, *Bulletin of the S.A.T. on the Determination of "Beneficial Owners" in Tax Treaties* (Bulletin of the S.A.T. [2012] No. 30), issued in 2012, clarified the determination of Beneficial Owner status and introduced a safe harbour, which provided for automatic qualification as a Beneficial Owner where the recipient of dividends is a qualifying listed company or is wholly owned by a qualifying listed company. Nevertheless, taxpayers and local-level tax authorities in China have encountered numerous technical and practical problems when dealing with Beneficial Owner cases under the principles of Circular 601 and Bulletin 30.

BULLETIN 9

In February 2018, the S.A.T. released *Bulletin of the S.A.T. on Matters Concerning "Beneficial Owners" in Tax Treaties* (Bulletin of the S.A.T. [2018] No. 9 (Bulletin 9)), which explains the principles that will apply for determining whether the recipient of income is the Beneficial Owner when applying China's tax treaties. Bulletin 9 repeals Circular 601 and Bulletin 30 while retaining certain provisions and amending others, including the rules for determining Beneficial Owner status, the safe harbour, and the requirement to produce a tax residence certificate. Bulletin 9 expands the ways in which a nonresident can achieve Beneficial Owner status. At the same time, it revises the list of negative factors that, if present, prevent the recipient of income from being considered a Beneficial Owner, making it more difficult for nonresidents to obtain tax treaty benefits. Finally, the official interpretation notes accompanying Bulletin 9 contain practical examples that provide detailed guidance and clarification for both taxpayers and local Chinese tax authorities on how to understand and implement the rules in the bulletin.

> **China Issues Clearer Guidance For "Beneficial Owners"**

Bulletin 9 will apply to tax payments or withholding obligations arising on or after 1 April 2018 and provides welcome clarification on various aspects of the rules regulating Beneficial Owner status. Management of multinational corporations (M.N.C.s) are advised to review how the changes brought in by Bulletin 9 will affect their status as Beneficial Owners. In some instances, Bulletin 9 may increase the possibility that a member of the M.N.C. may enjoy treaty benefits under an existing structure or business model. In other instances, internal restructuring may be necessary in order to meet the requirements of Bulletin 9. If the extended safe harbour rule or the "same country/same treaty benefit" rule cannot be applied, revisions to the global structure of the M.N.C. may be required in order be claim treaty benefits. Either way, proper and sufficient documentation must be assembled in anticipation of questions that may arise from the S.A.T.

BULLETIN 9 V. CIRCULAR 601

Table 1 below compares the negative factors in Circular 601 with the new provisions within Bulletin 9.

Table 1

Circular 601	*Bulletin 9*
1. The recipient is obligated to distribute or pay all or most of the income (e.g. more than 60%) to a resident (s) of a third jurisdiction within a prescribed period of time (e.g. within 12 months after the income is received).	1. The recipient is obligated to pay more than 50% of the income to a resident(s) of a third jurisdiction within 12 months after it receives the income. "Obligated to pay" for this purpose means that the recipient of the income has a contractual obligation to pay or, if there is no contractual obligation to pay, the recipient actually has made a payment(s).
2. Other than holding the rights or property from which the income is derived, the recipient conducts no or very few other business activities.	2. The business activities carried out by the recipient of the income do not qualify as substantive business activities; substantive business activities include substantive manufacturing, trading and management activities, etc. The determination of whether the recipient has carried out substantive business activities will be based on the functions performed and risks assumed by the recipient. Substantive investment management activities can qualify as substantive business activities. Where a recipient carries out both non-substantive investment management activities and other business activities, it will not be considered as being engaged in substantive business activities if the other business activities are insignificant.
3. Where the recipient is an entity, such as a corporation, its assets, the size of its business and the number of its personnel are comparatively small (or insufficient), and not commensurate with its income.	Deleted

Table 1 (cont'd)

Circular 601	*Bulletin 9*
4. With respect to the income or the property or rights from which the income is derived, the recipient has little or no right to control or dispose of the relevant income/	Deleted
5. The recipient is exempt from tax on the relevant income or the income is not taxable in the residence jurisdiction, and if the income is taxable, the effective	Unchanged, now factor 3
6. In addition to a loan agreement under which interest arises, and is paid, the creditor has concluded another loan agreement or deposit agreement with a third party and that agreement contains similar terms, such as the amount, interest rate and signing date, etc. to the first-	Unchanged, now factor 4
7. A license or transfer agreement exists between the non-resident and a third party relating to the right to use, or the transfer of the ownership of, the copyright, patent or technology covered by the license agreement, based on which a royalty is derived and	Unchanged, now factor 5

GUIDANCE WITHIN BULLETIN 9

As shown in the amendment to the first unfavourable factor, above, the S.A.T. not only looks into the existence of a contractual obligation to make payment within 12 months but also examines whether any payment is made within the 12-month period. The term "payment" is given a broad application. According to the explanatory notes of Bulletin 9, payments include intercompany transactions. Examples are (i) netting of intercompany payables and receivables and (ii) the extension of loans to group companies after the receipt of income from China. Each is considered to be an unfavourable factor in determining whether the recipient of income is the Beneficial Owner.

Bulletin 9 sets out detailed guidance regarding the second unfavourable factor, involving a fact pattern in which the recipient fails to conduct substantive business activities. Substantive business activities include (i) manufacturing, trading and management activities and (ii) investment and management activities. The explanatory notes to Bulletin 9 provide guidance on what is meant by investment and management activities. These activities include pre-investment research, project analysis, investment decision, investment execution, post-investment management, industry analysis, market research, regional headquarters function, treasury function, and financing function. Presumably, they must be carried on by executives or employees of the recipient of the income.

The explanatory notes to Bulletin 9 provide several case studies. Based on the S.A.T.'s analysis of the cases, it appears that the S.A.T. now applies a standard that calls for a higher threshold of activity before it will conclude that substantive business activities exist. Accordingly, where an applicant carries out both (i) non-substantive investment and management activities (bad activities) and (ii) other business activities (good activities), an example in the explanatory notes concludes that the other business activities are not significant when the income generated from good activities constitutes less than 8% of the total income of the entity.

The third and fourth unfavourable factors in Circular 601 are deleted because their assessment criteria have already been incorporated into the second unfavourable factor in amended form under Bulletin 9.

As noted above, Bulletin 30 introduced a safe harbour for listed companies that derive Chinese-source dividend income. Bulletin 9 expands the scope of the safe harbour to include dividends received by (i) a listed company resident in the other state, (ii) an individual resident in the other state, (iii) the government of the other state, and (iv) recipients that are wholly held by one or more of the foregoing entities or persons, provided the recipient is resident in the other state. In these cases, the recipient of the dividends will be deemed to be the Beneficial Owner of the dividends and it will not be necessary to consider any of the five negative factors.

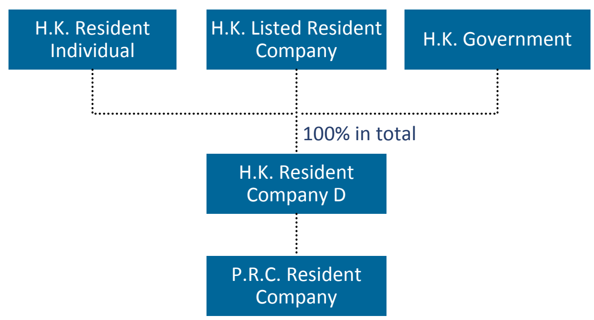
BULLETIN 9 V. BULLETIN 30

Table 2 compares the rules in Bulletin 30 with the new rules introduced by Bulletin 9.

EXAMPLES

An example within the interpretation notes shows a shareholding structure under which multiple parties that qualify for the safe harbour hold the shares of the entity receiving the Chinese-source income. This fact pattern is illustrated in Diagram 1 below.

Diagram 1



In this case, Company D is a resident of Hong Kong. It invests in a company that is resident in the P.R.C. Company D receives a dividend from the P.R.C. resident company. Company D is wholly owned by a Hong Kong resident individual, the Hong Kong government and a Hong Kong-resident company

Table 2

Bulletin 30	*Bulletin 9*
If a resident of the other contracting state applies for preferential tax treatment of Chinese-source dividends under a tax treaty it automatically will be recognised as a BO provided it is a company listed in the other contracting state or is wholly owned directly or indirectly by a company listed in the other contracting state that also is a resident of that other contracting state (except for cases where the shares of the recipient are held indirectly through a company resident in a jurisdiction other than China and the other contracting state) and the dividends are derived from the shares held by the listed company.	The following recipients of Chinese-source dividends automatically will be recognised as BOs and will not be required to undergo a comprehensive assessment of the five negative factors: 1) Government of the other contracting state; 2) Company that is a resident of and listed in the other contracting state; 3) Individual who is a resident of the other contracting state; and 4) Recipient that is wholly owned, directly or indirectly, by one or more persons described in bullets 1) to 3), and any intermediary shareholders are residents of China or the other contracting state in situations where the shares are held indirectly.

that is listed on an exchange in Hong Kong. Company D can be automatically recognized as a Beneficial Owner.

Bulletin 9 also requires that the shareholding percentage in the safe harbour rules be met at all times during the 12 consecutive months before dividends are received, reflecting a requirement for shareholder continuity. A similar requirement can be found in other S.A.T. guidance. To illustrate, see (i) Circular 81 (Guo Shui Han [2009] No. 81), where "preferential tax treatment can be granted provided the nonresident company owns, directly, at least 25% of the shares of a Chinese resident company at all times during the 12 consecutive months before receiving the dividends", and (ii) Article 10 (relating to dividends) of Circular 75 (Guo Shui Fa [2010] No. 75), where "if a Singapore resident company owns directly at least 25% of a Chinese resident company at all times during the 12 consecutive months before receiving the dividends, the Singapore resident company may be entitled to benefits under the China-Singapore tax treaty."

Bulletin 9 allows a path for a recipient of dividends to qualify for tax treaty benefits even when the recipient does not qualify for the safe harbour or as a Beneficial Owner on its own. Under this provision, which, will significantly increase the chances for a recipient to enjoy treaty benefits, the recipient will be recognized as a Beneficial Owner if:

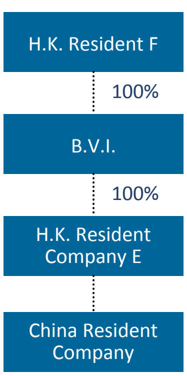
- Its shareholder wholly owns, directly or indirectly, the equity of the recipient,
- The shareholder can meet the Beneficial Owner requirements,
- None of the five negative factors apply, and
- The conditions in one of the two scenarios below are satisfied.

SCENARIO 1

The direct or indirect shareholder meets the Beneficial Owner requirements and is a tax resident of the same jurisdiction as the recipient of the dividends. Where these two facts exist, treaty benefits will apply to the recipient of the dividend whether ownership is direct or indirect. If the ownership is indirect, neither the number of intermediary tiers nor the country of residence of the intermediary entities is a relevant factor.

The interpretation notes include an example as shown in Diagram 2. Company E is a resident of Hong Kong. It invests in a Chinese Resident Company and receives dividends. Although Company E, itself, does not meet the Beneficial Owner requirement, it can be recognized as the Beneficial Owner by virtue of being wholly owned by its indirect shareholder, Company F, also a Hong Kong resident, provided that Company F can meet the Beneficial Owner requirements. The conclusion is the same whether Company F owns Company E directly or indirectly through a company resident in the British Virgin Islands, which does not have a tax treaty with China.

Diagram 2

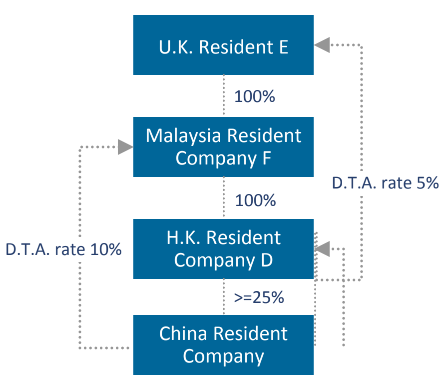


SCENARIO 2

In this scenario, the person that can meet the Beneficial Owner requirements is not a tax resident of the same jurisdiction as the recipient. However, that person, and any intermediary shareholders, are all "qualified persons". As defined in Bulletin 9, a qualified person is a person that is resident in a tax treaty jurisdiction and is entitled to treaty benefits pursuant to the relevant treaty (or arrangement) between China and the person's country of residence on Chinese-source dividends. The benefit to which the person is entitled is the same as or better than the benefit to which the recipient would be entitled.

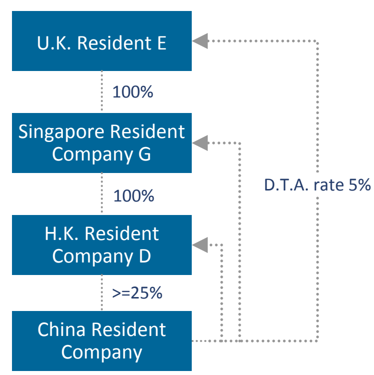
In Diagram 3-1 and 3-2, Company D is a Hong Kong resident. Company D invests in a Chinese resident company and receives dividend income. Company D cannot meet the Beneficial Owner requirements, but its 100% indirect shareholder, Company E, is resident in the U.K. Company E can meet the Beneficial Owner requirements. In Diagram 3-1, an intermediary shareholder, Company F, is resident in Malaysia. Company F is entitled to the benefit of a 10% withholding tax under the China-Malaysia tax treaty on dividends received from a Chinese company. This rate is higher than the 5% rate to which Company D would be entitled under mainland China-Hong Kong tax arrangement. Company F is not a qualified person. Therefore, Resident D cannot be recognized as a Beneficial Owner by virtue of its shareholder, Company E, which is resident in the U.K., even though Company E is entitled to a 5% withholding tax rate under the China-U.K. tax treaty.

Diagram 3-1



In Diagram 3-2, the intermediary shareholder, Company G, is resident in Singapore. Company G is entitled to a 5% withholding tax rate under the China-Singapore tax treaty. This withholding tax rate is the same rate to which Company D is entitled Resident D would be entitled under the mainland China-Hong Kong tax arrangement. Therefore, Company G is a qualified person. Similarly, U.K. Resident E is a qualified person because it is entitled to a 5% withholding tax rate on dividends under the China-U.K. treaty. As a result, Company D can be recognized as a Beneficial Owner by virtue of its indirect shareholder Company E.

Diagram 3-2

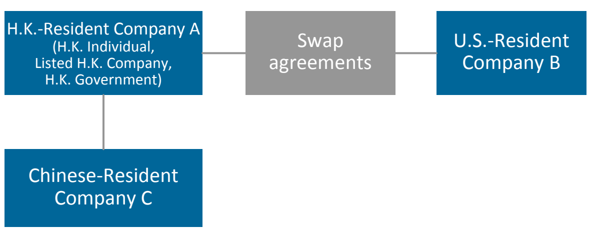


It is clear from Diagrams 2, 3-1 and 3-2 that a recipient obtaining Beneficial Owner status only by virtue of its 100% indirect shareholder that meets the Beneficial Owner requirements faces a tougher hurdle when it is not resident in the same country as the recipient of a dividend. Where the Beneficial Owner and the recipient are residents in different countries, all companies in the chain of ownership must be entitled to a withholding tax rate on China source dividends that is equal to or less than the withholding tax to which the recipient entity is entitled.

In line with the shareholding period under the safe harbour rules, in scenario 1 and scenario 2, Bulletin 9 requires the shareholding percentages be met at all times during the 12 consecutive months before dividends are received.

Of course, the above safe harbour provisions are but one of many hurdles that must be overcome. Other hurdles exist in Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) of the O.E.C.D.'s (Organization for Economic Co-operation and Development) B.E.P.S. (Base Erosion and Profit Shifting) project. There, inter alia, offsetting positions in a swap arrangement may cause the recipient of a dividend to lose its status as a Beneficial Owner. This issue is illustrated in Diagram 4:

Diagram 4



Here, Company A is a Hong Kong resident. In principle, Company A can be directly identified as the Beneficial Owner of the dividend under principles in Bulletin 9. However, its status as a Beneficial Owner may be lost if it were to enter into an economic arrangement to offload the benefit of the dividend to another party. Here, Company A and a U.S. company, Company B, enter into a beneficial interest swap agreement under which Company B pays a fixed interest on a notional principal amount to Company A in exchange for the dividends it receives from Company C, a company resident in China. Economically, Company A exchanged its anticipated dividend flow for the equivalent of a fixed yield on a debt security. Because the economic right to the dividend is enjoyed by Company B in the U.S., the tax authorities can challenge the Beneficial Owner status of Company A even though it meets the safe harbour under Bulletin 9.

The extension of the eligibility of the safe harbour rule and the adoption of the same country/same treaty benefit rule reflect the S.A.T.'s implementation of the principal purpose test (P.P.T.). This signals a big step forward for the Chinese tax authorities in aligning their interpretation of tax treaties with international standards, a development that welcomed by nonresident taxpayers.

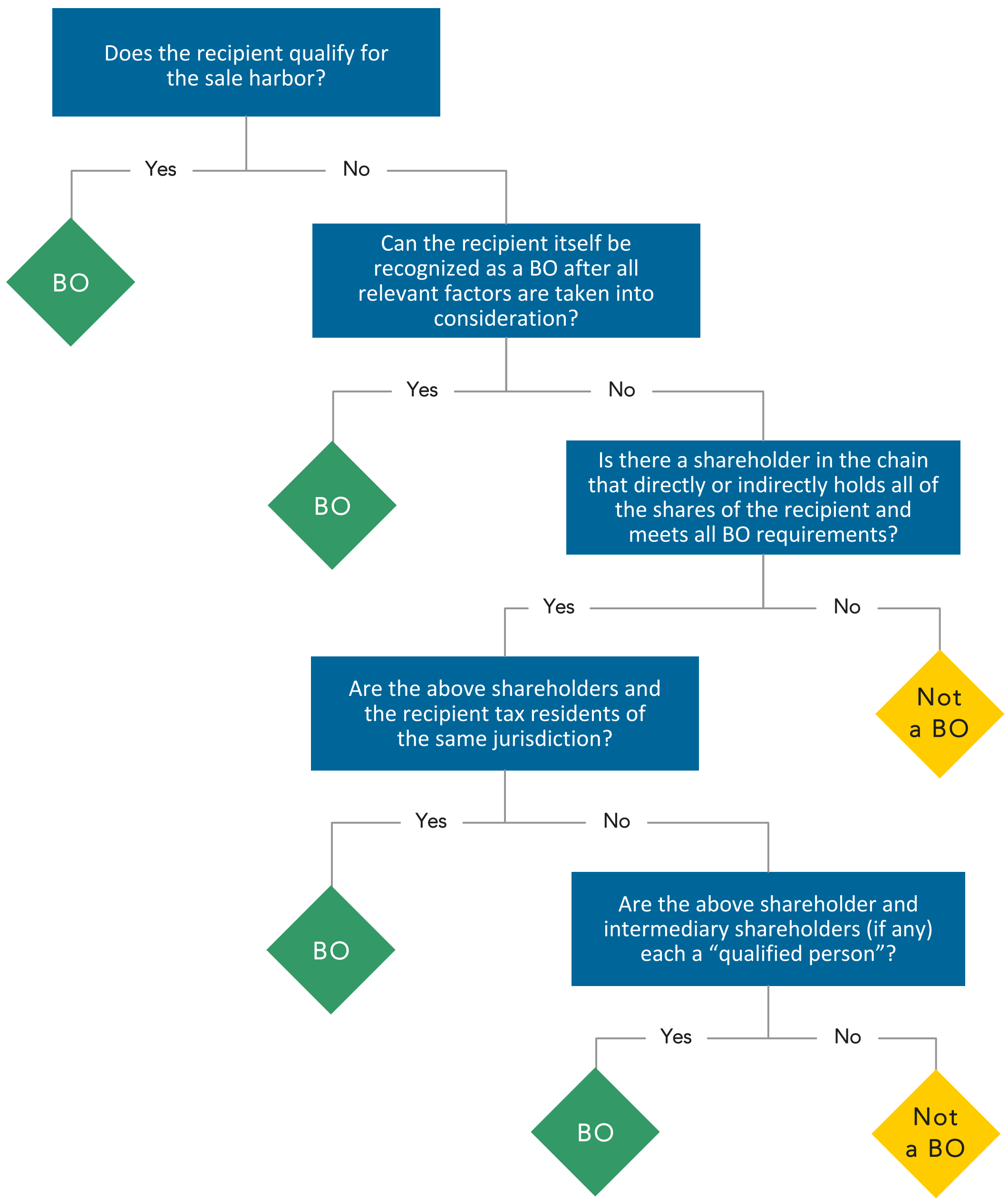
CONCLUSIONS

Generally speaking, the technical principles and administration guidance set out in Bulletin 9 will bring both hope and concerns to nonresident taxpayers. On the one hand, extending the eligibility of the safe harbour rule and adopting the same country/same treaty benefit rule for dividend income will increase the chances for nonresident taxpayers to enjoy tax treaty benefits. The clearer guidance will also reduce the difficulties faced by local level tax authorities in their post-filing administration.

These benefits come with a cost. In order to prevent tax treaty abuse, the negative factors have been strengthened in Bulletin 9. The Chinese tax authorities will look into both the form and substance of arrangements and will pay more attention to the substantive business activities of an applicant. Although the implementation of the P.P.T. mechanism reflected in Bulletin 9 is expected to benefit many taxpayers, it is anticipated that the P.P.T. will result in increased challenges to the plans of other taxpayers. A foreign investor in China that can successfully overcome the hurdles of the Beneficial Owner test and the five negative factors in Bulletin 9 may still be denied treaty benefits if the tax authorities determine that the arrangement was carried out to obtain a tax advantage.

The following decision tree (Diagram 5) sets out the requirements for obtaining Beneficial Owner status for China's tax treaty purposes:

Diagram 5


Does the recipient qualify for the sale harbor?
Yes
No
BO
Can the recipient itself be recognized as a BO after all relevant factors are taken into consideration?
Yes
No
BO
Is there a shareholder in the chain that directly or indirectly holds all of the shares of the recipient and meets all BO requirements?
Yes
No
Are the above shareholders and the recipient tax residents of the same jurisdiction?
Not a BO
Yes
No
BO
Are the above shareholder and intermediary shareholders (if any) each a "qualified person"?
Yes
No
BO
Not a BO

The Cristiano Ronaldo Transfer to Juventus: The New Italian Resident Regime Benefits Athletes from Around the World

By Andrea Tavecchio, Massimo Caldara and Riccardo Barone
Tavecchio Caldara & Associati (Italy)

INTRODUCTION

As a general rule, performance income of resident artists and sportsmen is subject to ordinary personal income tax in Italy (*Imposta sule reddito delle persone fisiche* or I.R.P.E.F.) on worldwide income. The tax rates are progressive, from 23% up to 43%, plus local surcharges. In addition, income of sportsmen often includes various forms of income from activities considered as "ancillary" to the performance. Here tax treatment is far less clear.

Within this general frame, the Italian Parliament approved the 2017 Budget Law on 7 December 2016, which introduced, *inter alia*, a new tax regime for individuals who transfer tax residence to Italy (the New Resident Regime). This regime was meant to make the transfer of tax residence to Italy more attractive to wealthy individuals and families. The regime offers preferential tax treatment, which consists of a yearly lump-sum payment of €100,000 on all foreign income and gains and exclusion from inheritance and gift tax on foreign assets. These benefits depart from ordinary treatment of residents under Italian tax law.

In its first year, almost 150 applications were filed. The regime recently made headlines as Cristiano Ronaldo[1] moved from Real Madrid to Juventus. Many reporters ascribed this choice to both football reasons and the benefits of Italy's new fiscal regime.

The wider question is how the flat tax regime can benefit athletes around the world. This article provides a general overview of the New Resident Regime and its effects on sportsmen.

THE NEW RESIDENT REGIME

The New Resident Regime is reserved for individuals who meet the following two conditions:

- They transfer tax residence to Italy.

[1] Mr. Ronaldo has recently been the subject of allegations of sexual misconduct. This article should not be seen as condoning such behaviour. If you or someone you know has been a victim, resources are available. See RCNE's Sources of help for survivors.

- They have been nonresident in Italy for tax purposes for nine out of the ten preceding taxable years.

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Within this context, it should be noted that art. 2, par. 2 of Presidential Decree 917 of 22 December 1986 (hereinafter, the Income Tax Code or I.T.C.) provides that an individual is deemed to be resident in Italy if any of the following conditions are met on 183 days or more during the tax year (184 or more days in case of leap years):

- The individual is registered in the Civil Registry of the Resident Population.
- The individual is domiciled in Italy pursuant to the Italian Civil Code.
- The individual is resident in Italy pursuant to the Italian Civil Code.

Where any of the conditions outlined above is fulfilled in a calendar year, the individual is deemed to be a resident of Italy for the entire tax period. There are no split-year rules, although exceptions apply for persons arriving from Switzerland and Germany. Where the two requirements are met, an individual may apply for New Resident Regime and take steps to become registered in the Civil Registry of the Resident Population.

Beginning with the 2017 fiscal year, the New Resident Regime provides for lump-sum taxation of €100,000 per year on non-Italian-source income and gains. This payment is in lieu of the tax that would be applied ordinarily. Remittance of the income to Italy has no effect under the New Resident Regime – no additional tax is imposed. Foreign-source income and gains are not subject to income tax whether retained abroad or remitted to Italy. However, all Italian-source income and gains remain subject to ordinary tax rules under the Italian personal income tax regime. The New Resident Regime can be extended to family members by paying an additional €25,000 per year, per relative. The taxpayer may elect to apply the New Resident Regime to income earned in all foreign countries or only selected countries ("cherry picking"). No foreign tax credit is granted for taxes paid in countries for which the new resident has elected to be covered by the €100,000 Italian tax payment.

In addition to the flat tax, the New Resident Regime grants:

- Exemption from reporting obligations in relation to foreign assets (Form R.W.)
- Exemption from payment of wealth taxes on real estate properties and financial assets held abroad (respectively, I.V.I.E. and I.V.A.F.E.)
- Exemption from inheritance and gift tax on rights and assets held abroad

The main aspect to understand is that the lump-sum tax covers only foreign income and gains. Global sportsmen are celebrities with global followings and the effect of the lump-sum tax regime on sportsmen depends on whether income is deemed to be foreign-source income rather than income from Italian sources. To address this exposure area, the New Resident Regime allows for the filing of a ruling request in order to obtain prior approval from the *Agenzia delle Entrate* on the various types of income that will be covered by the lump-sum payment of €100,000. The ruling request can be filed prior to the establishment of tax residence in Italy.

For these reasons, it is important to analyse the different kinds of income derived by professional sportsmen – and in particular by football players – in order to understand the various benefits a sportsman such as Cristiano Ronaldo might enjoy under this regime.

The balance of this article addresses three key issues for a sportsman:

- Determining the income that is deemed to arise from sports performances for purposes of Italian tax law.
- Determining the income that is deemed to arise the exploitation of image rights for purposes of Italian tax law.

- Determining the source of income for purposes of Italian tax law in order to determine if the income falls within the scope of the New Resident Regime.

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Note that concepts of law outside of Italy will affect the overall tax exposure of a sportsman who performs in various countries. The compensation paid to sportsmen for performing typically is taxed in the jurisdiction where the sporting event takes place. Tax rules outside Italy are not considered in this article, much because they are a given no matter which regime applies to a new resident. Similarly, concepts that apply under conventional provisions of Italian tax law are not considered in this article, except to the extent that they do not apply in connection with foreign-source income subject to lump-sum taxation under the New Resident Regime.

QUALIFICATION OF INCOME DERIVED BY SPORTSMAN FROM SPORTS PERFORMANCES

The classification of performance income derived by sportsmen may vary depending on whether a specific contractual obligation exists. Income of sportsmen deriving from their performances can be classified as follows:

- Employment income (art. 49 of the I.T.C.), if the activity is performed under an employment relationship;

- Income assimilated to employment income (art. 50, par. 1, let. c)-*bis* of the I.T.C.), if the sportsman does not perform his activity in the framework of an employment contract but the professional sportsman falls within the provision of art. 2 of Law n. 91 of 23 March 1981 (hereinafter, Law 91/1981), which deems the income, *inter alia*, to be that of a sportsman who performs, on a continuous basis, sports activities regulated by the *Comitato Olimpico Nazionale Italiano* (CONI);

- Self-employment income (art. 53 of the I.T.C.), if the services carried out by the sportsman are deemed to be performed in the framework of an independent service relationship and the conditions set forth by Law 91/1981 are met. In this regard, art. 3, par. 2 of Law 91/1981 provides specific conditions under which the activity of a professional sportsman should be included in the framework of an independent relationship.

    - The activity is performed during a single sports event, which lasts for a short period of time;

    - The sportsman has no contractual obligation to participate on a continuous basis in preparatory and training meetings; and

    - The sportsman's activities do not exceed eight hours per week, five days per month, or 30 days within a one-year period.

As an example, the activity performed by a football player is deemed to be considered as employment income because the player has a contractual obligation with the football club and the services are carried out under an employment relationship. In comparison, income derived by a professional golfer falls within the category of self-employment income as the activity performed is not deemed to be carried out in the framework of a dependent service relationship and such sportsman does not belong to a federation that is part of the CONI.

ANCILLARY ACTIVITIES TO PERFORMANCE

In addition to the income deriving from the activity performed, the income of sportsmen often includes casual income from activities considered as "ancillary" to the performance of services as a sportsman. Examples include income derived from the exploitation of image rights from sponsorship, advertising and endorsement. This income must be analysed and classified in order to understand the right tax treatment.

Image rights are generally divided into two broad categories. The first category is advertising/marketing

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activities. The second category is sponsoring activities. The dividing line between advertising/marketing and sponsoring activities is somewhat blurred. In general, advertising/marketing income often refers to "off-court" activities that are not directly related to the performances of services as a sportsman. An example is participation in television or print advertising campaign. In comparison, sponsorship generally refers to financial support in the form of products or services given by the sponsoring company or an institution to the person being sponsored pursuant to the terms of a contract of sponsorship. The sponsorship contract is reciprocal in that the sponsor provides funding and the sportsman wears clothing with the sponsor's logo or uses its equipment when providing services as a sportsman. The expectation of the sponsor is brand enhancement from image advertising. Sponsorship income generally requires the active participation of the sportsman, endorsing a specific product, often using the product in competition and allowing the sportsman's image to be associated with the product. Think of a professional golfer wearing a golf cap carrying the logo of a brand of golf clubs. The cap with the logo never comes off while playing, in press interviews, or at public appearances.

INCOME DERIVED FROM THE EXPLOITATION OF IMAGING RIGHTS: SPONSORSHIP AND ADVERTISING/ MARKETING

Qualifying the income from the exploitation of image rights is not straightforward under Italian law. From a civil law perspective, image rights are personal rights with patrimonial substance and are included within the class of "rights connected to the exploitation of copyright" in accordance with Law 633 of 22 of April 1941. From a tax perspective, no specific rules have been established within Italian law and views vary. Some authors hold the view that income derived from the personal exploitation of image rights directly by the sportsman should be classified as "other income" under art. 67 of the I.T.C. and, in particular, as income derived from the assumption of an obligation to act, to abstain from acting, or to permit the action of another (*obbligo di fare, non fare o permettere*) under art. 67, par. 1, let. l) of the I.T.C. Other authors hold the view that such income should be classified as self-employment income.

The position is different in the case of sale or assignment of such rights to the club or to a foreign entity such as a "star company". As a general rule, any remuneration paid by the club to the player in the framework of the employment relationship is considered employment income and taxed accordingly under art. 49 of the I.T.C. Therefore, if the image right is assigned to the employer by the football player, any income deriving from the assignment is deemed to be considered as employment income and taxed as such. It is of no consequence that the payment is not related to a sports performance or that the payment refers to the exploitation of the personal image of the player. Payments by an employer are treated as employment income. Hence, such income will be subject to I.R.P.E.F. in the hands of the football player with the application of progressive tax rates from 23% up to 43%, plus local surcharges. Moreover, income paid to Italian football players is subject to withholding tax according to art. 23 of Presidential Decree 600/1973 at applicable rates.

At times, the exploitation of image rights is carried on through a foreign entity without a permanent establishment in Italy. This company is sometimes referred to as a "star company" and the star performer is the principal shareholder. Income received by the sportsman from star company in the form of a dividend should be foreign-source income pursuant to art. 23, par. 1, let. b). However, the answer is not entirely clear.

Many anti-avoidance provisions exist in Italian tax law that can be used by tax authorities to attack foreign structures set up to circumvent Italian taxation.

- Art. 23, par. 2, let. d) of the I.T.C., which provides that when income paid to a foreign entity refers to a sports performance event carried on in Italy, the income is taxable as if it were earned directly by the resident sportsman.

- If the company is located in a low tax jurisdiction, art. 167 of the I.T.C. related to controlled foreign companies (C.F.C.s) applies. It states that if the player controls the foreign entity and certain other conditions are met, the income of the C.F.C. is imputed to the Italian resident player under a "look through" approach[2].

- If the foreign entity is considered as a fictitiously interposed entity, any income of the foreign entity is ascribed to the player. In other words, the entity is totally disregarded.

THE NEW RESIDENT REGIME AND ITS EFFECTS ON SPORTSMEN

The foregoing rules affect the scope of benefits that can be obtained under the New Resident Regime when the taxpayer is a sportsman.

Income from performances carried out by football players is classified as employment income. Through a so-called "mirror image" of art. 23, par. 1, let. c) of the I.T.C., employment income is deemed to be foreign-source income if the activity is performed abroad. If the services are performed in Italy, the income is deemed to have its source in Italy. Hence, the salary paid by Juventus to Cristiano Ronaldo for participating in Serie A football matches is Italian-source income. Therefore, the salary is not within the scope of the New Residents Regime and is subject to I.R.P.E.F. On the other hand, if Juventus pays a bonus to Cristiano Ronaldo for a victory in the Champions League final and the game is played in Belgium, arguably the income is foreign-source income considering that the performance is carried on abroad. It follows that income should be covered by the lump-sum tax of €100,000.[3] Of course, tax exposure can exist in the country where the match takes place, and that tax will not give rise to a foreign tax credit against Italian taxes unless Ronaldo elects to include the income in the regular tax regime.

Income from image rights is employment income if it is directly or indirectly paid by the employer in the framework of the employment relationship. Therefore, if Ronaldo should assign his image rights to Juventus in connection with a football match, any income paid by the club would be treated as employment income from an Italian tax perspective. Because the main activity is performed in Italy, income derived would be subject to ordinary taxation. In principle, considering that many U.E.F.A. matches take place away from Italy, it might be possible to apportion the image right income based on the location of games played in the course of the year. In practice, apportionment is not really possible in Italy.

In the case of direct exploitation of image rights by a sportsman, the income derived may be classified as "other income" or "self-employment income". The sponsorship income linked to a sports performance – such as revenue from a sponsorship contract that requires Ronaldo to wear a specific cleat while playing in football matches – should fall within the "other income" classification (*obligation to do*) and therefore should be deemed to be sourced in Italy under art. 23, par. 1, let. f) of the I.T.C. when the relevant activity is performed on the Italian territory. On the other hand, if a specific contract requires Ronaldo to wear something only in Champions League matches performed abroad, the income derived by Ronaldo for wearing the cleats in the rest of Europe should be foreign-source income and therefore covered by the New Residents Regime. Again, tax likely will be imposed in each country where a match is held.

[2] When the company is located in a low-tax jurisdiction but the C.F.C. rules do not apply, the dividend paid to the shareholder is subject to progressive tax rates from 23% up to 43% instead of a flat rate equal to 26%.

[3] In order to provide a general framework, in case of self-employment income the income from performances is deemed to be a foreign-source income if the activity is performed outside Italy. Hence, the golf player who earns a prize money for a tournament won abroad will be covered by the lump-sum regime. On the other hand, in case of income assimilated to employment income, such income is to be considered as Italian-situs income if such income is paid for the performance of services in Italy. Therefore, the professional cyclist who transfers his residence to Italy to join an Italian-resident cycling team should not benefit from the new resident regime with reference to the salary paid by his Italian team.

> ***The Cristiano Ronaldo Transfer to Juventus: The New Italian Resident Regime Benefits Athletes from Around the World***

When the exploitation of image rights is not directly linked to a sports performance, it might be difficult to determine where the activity is performed. A typical example is represented by a contract for a sportsman shown drinking a specific brand of beverage in a media campaign. In this case, the parameters are not clear in terms of identifying the source of the revenue. Is the payment received for a service, in which case, the place where the shooting takes place should control the source of income or is it paid for use of the image in the market where the advertisements are displayed? An official clarification by the Tax Authorities is desirable as the rules are not clear.

Another image right example relates to the exploitation of a personal brand licensed to unrelated companies. In the case of Ronaldo, the personal brand the CR7 brand. In such case, considering that the exploitation of his own brand is carried out on a continuous basis and represents an activity not linked to performance, the income should be classified as income derived from the exploitation of intangible assets by the "author"[4], which is a form of self-employment income. For instance, the royalties paid by a French fragrance company for the use of CR7 brand should be considered as a foreign-source income[5] and therefore covered by the lump-sum tax regime, if the advertising campaign is carried on in European countries other than Italy.

Different considerations apply to the exploitation of image rights through a foreign star company controlled by the sportsman. Under general principles, the dividend paid to the sportsman/shareholder is foreign-source income and therefore covered by the New Resident Regime. Circular Letter 17/E/2017[6] provides favourable treatment for these payments in order to attract nonresident sportsmen and others to Italy._It provides that, if the income of the star company is genuinely sourced abroad, the lump-sum taxation regime applies, even if the entity is disregarded from a fiscal perspective. In addition, if the sportsperson elects the New Resident Regime, the Italian C.F.C. rules should not apply.

CONCLUSIONS

In principle, when a sportsman such as Ronaldo establishes residence in Italy and elects the New Resident Regime, attractive benefits may be obtainable regarding various types of income. These include bonuses for participation in U.E.F.A. final matches abroad and revenue derived from the use of image rights abroad. But as the New Resident Regime has been in place for only one year and Italian tax law applicable to employees and independent contractors is relatively complex, some degree of uncertainty exists as to the source of the income and the benefits that are obtainable.

The situation may be different for athletes involved in other sports, especially for those with activities in several different countries, who receive income from activities mainly performed outside Italy. Included are golfers, tennis players, Formula 1 racing drivers and boxers, all of whom are treated as independent contractors deriving self-employment income. These persons may find the New Resident Regime helpful.

No uncertainty exists with regard to income arising from investments held abroad. Income derived from such assets are foreign-source income and therefore covered by the lump-sum tax regime. The rules favour such investments by allowing the income to be remitted on a tax-free basis to Italy and by excluding the foreign assets from inheritance tax.

[4] See art. 53, par. 2, let. b) of the I.T.C.

[5] See art. 23, par. 2, let. c) of the I.T.C.

[6] It has been clarified that where an individual benefiting from the New Resident Regime is a director in a company formed outside of Italy, the entity is not considered to be tax resident in Italy, provided that the majority of the board of directors are not Italian residents.

Cross-Border Executives – Is Ireland a Favourable Tax Location for Key Personnel?

By Lisa Cantillon
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INTRODUCTION

With the advent of Brexit, Ireland is becoming the European capital location of choice for a growing number of multinational companies. The fund industry, in particular, gravitates towards Ireland from which products can be passported into the other E.U. member states. As companies are increasingly required to demonstrate substance and presence in Europe, the current trend is for multinationals to second one or two senior members to Ireland to start up the Irish operation. Therefore, their tax position becomes an important part of the package that is offered to attract key personnel to Ireland.

The Irish tax system has two features that make it attractive for foreign executives:

- Ireland has a favourable tax regime for foreign domiciled individuals. This regime (which is known as the remittance basis) means that Ireland is an attractive location for foreign nationals as it should be possible for them to structure their tax affairs so that they pay tax only on Irish source income. Therefore, a highly paid employee who is seconded to Ireland from abroad could maintain foreign investments, rental properties, share portfolios and even foreign employment income, all of which is not taxable in Ireland until remitted.

- Although individuals resident in Ireland are taxable on Irish source income, there is a particular tax break for most employees seconded to Ireland from abroad. This tax break, known as the Special Assignee Relief Programme (S.A.R.P.), provides that 30% of an employee's income above a certain threshold is tax free.

The combination of the rules for foreign domiciled individuals and the availability of S.A.R.P. relief makes Ireland an attractive location for key employees.

This article focuses on the employer's perspective. When a foreign business is setting up operations in Ireland and seconding key employees to Ireland, they will want to maximise the tax efficiencies in Ireland in order to provide their employees with an attractive total compensation package.

The foreign employer also must be mindful that if they have directors or employees working in Ireland, even on short-term assignments, the employer may be required to operate Irish payroll withholding taxes on the portion of that employee's salary relating to his/her work days spent in Ireland.

EMPLOYER WITHHOLDING OBLIGATION

The employer's withholding obligations vary depending on whether the employee is posted to Ireland temporarily or on a permanent basis. Therefore, the first step is for the employer to consider what its business needs are in Ireland and whether a temporary or permanent assignment is appropriate.

The key payroll tax issues for foreign employers sending individuals to work in Ireland, and a discussion of the S.A.R.P. relief available for employees seconded to Ireland, are set out below.

Coming to Ireland to work – employer's obligations

When individuals come to work in Ireland, it is necessary to consider both the employer's perspective and the employee's perspective.

Understanding the employer's obligation is important when employees are sent to work in Ireland. Irrespective of the individual's tax residence position, if an individual comes to Ireland to work and carries out duties of employment in Ireland, that employment is chargeable to income tax in Ireland and is within the scope of the Irish P.A.Y.E. (Pay As You Earn) system, which obliges the employer to deduct payroll taxes. The length of time spent in Ireland by the employee will determine the requirements for the employer to operate withholding taxes under the P.A.Y.E. system.

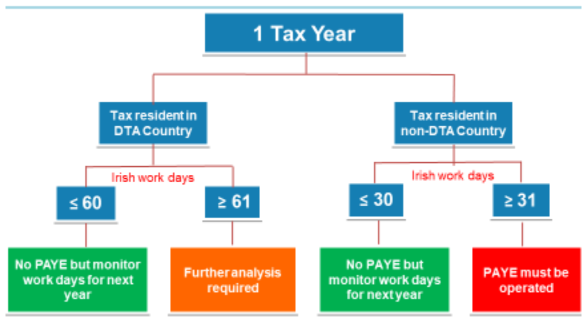
The individual's tax residence position is considered separately. If an employee becomes Irish resident, he or she may face Irish tax exposure even though the Irish Revenue may have released the employer from the obligation to operate Irish payroll taxes. Similarly, where P.A.Y.E. has been applied, this does not necessarily mean that relief under a double tax treaty will not be available for the employee.

Temporary assignment/short-term business visitors to Ireland

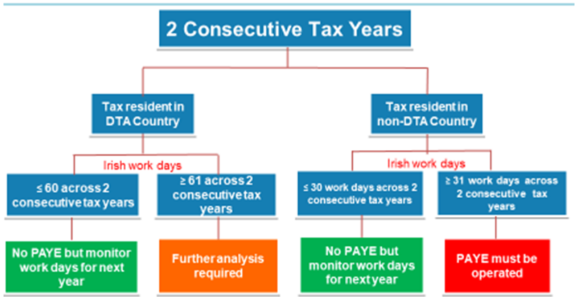
The Irish Revenue have recently provided clarification on Revenue practice regarding the obligation to operate P.A.Y.E. for temporary assignees and short-term business visitors to Ireland. This was updated on 17 April 2018 and some of the content has not yet "tried and tested". Ongoing feedback is expected from the Irish Revenue in response to practical issues that will inevitably arise from applying the new Revenue practice.

The rules for temporary assignees and short-term business visitors have been modified depending on the length of time the individual has a presence in Ireland. The charts below provide an overview of the tax position depending on whether the employee has been present in Ireland for one tax year, two consecutive tax years, or more than two consecutive tax years. As will be seen, one set of time limits applies to employees resident in a jurisdiction with which Ireland has a double tax agreement (D.T.A.) in place and another set applies to employees resident in a jurisdiction with which Ireland does not have a D.T.A. in place.

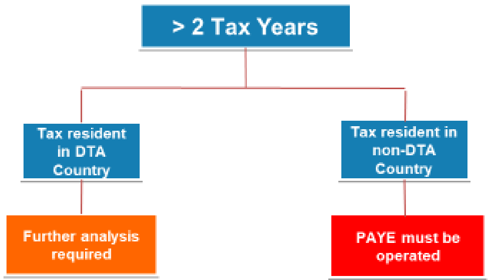
YEAR 1: Short-term business visitors:
Does Irish P.A.Y.E. have to be operated?



YEAR 2: Short-term business visitors:
Does Irish P.A.Y.E. have to be operated?



YEAR 3: Short-term business visitors:
Does Irish P.A.Y.E. have to be operated?



An in-depth analysis is set out below with respect to the three different categories mentioned in the tables: (i) P.A.Y.E. must be operated in Ireland, (ii) P.A.Y.E. does not have to be operated in Ireland, and (iii) Further analysis is required.

P.A.Y.E. must be operated

In the following circumstances, Irish P.A.Y.E. must be operated by the employer:

- The employee is not tax resident in a D.T.A. country and spends 31 or more working days in Ireland in the tax year.
- The employee is not tax resident in a D.T.A. country and has spent more than two tax years in Ireland. Even if the employee spends only one day in Ireland in the third year, P.A.Y.E. must be operated.

Circumstances where P.A.Y.E. need not be operated

- The employee is resident in a D.T.A. country and spends up to 60 work days in Ireland in the tax year.
- The employee is resident in a D.T.A. country and spends two consecutive tax years in Ireland and has up to 60 Irish work days across two consecutive tax years.
- The employee is not resident in a D.T.A. country and spends up to 30 work days in Ireland in the tax year.
- The employee is not resident in a D.T.A. country and spends up to 30 work days across two consecutive tax years.

The Irish Revenue have clarified that the counting of days begins from 1 January 2018 and the new Revenue practice has retroactive effect beginning in 2018. This is an important statement for employers as previously the counting of days did not have a cumulative effect year on year.

Further analysis required and revenue submission

Where a temporary assignee exercises the duties of employment in Ireland for more than 60 work days, either in one tax year or cumulatively over two tax years, no automatic relief exists regarding the obligation to withhold Irish P.A.Y.E. Further analysis is required.

Where certain conditions are satisfied, an employer can apply to the Irish Revenue for relief from the obligation to operate Irish P.A.Y.E. The conditions are as follows:

- The assignee is resident in a country with which Ireland has a D.T.A. and is not resident in Ireland for tax purposes; and
- The assignee suffers withholding taxes at source in their "home" country on the income attributable to the performance of the duties of the foreign employment in Ireland; and
- There is a genuine foreign office or employment; and

- Subject to the discussion below, the remuneration is paid by or on behalf of an employer who is not a resident of Ireland; and

- Subject to the discussion below, the remuneration is not borne by a permanent establishment which the foreign employer has in Ireland.

Additional analysis where the employer is not Irish resident

The Irish Revenue will not accept that condition relating to a foreign employer is met where the individual is working for an Irish employer in any of the following situations:

- The assignee is replacing a member of the staff of an Irish employer;

- The assignee is supplied and paid by an agency outside Ireland to work for an Irish employer; or

- The duties performed by the assignee are an *integral* part of the business activities of the Irish employer.

The Irish Revenue guidance comments that in determining whether the duties of the assignee will be considered an integral part of the business activities of an Irish employer, all relevant factors must be considered, including:

- Who bears the responsibility or risk for the results produced by the assignee,

- Who authorises, instructs or controls where, how and or when the work is performed,

- Who does the assignee report to or who is responsible for assessing performance, and

- Whether the role or duties performed by the assignee are more typical of the functions of the overseas employer or of the Irish entity.

If the answers to these questions demonstrate that the work carried out by the assignee is integral to the Irish office, relief will not apply. The employer must operate Irish P.A.Y.E. for the compensation related to days worked in Ireland.

If the individual has an ongoing requirement to return to Ireland over a number of years, he or she will not qualify for an automatic exemption from Irish P.A.Y.E. regardless of the number of days spent in Ireland in a particular year. Furthermore, where a role is undertaken by a series of different individuals on a rotational basis, Irish P.A.Y.E. should be considered with respect to that role. As P.A.Y.E. must be operated for each individual employee fulfilling that role.

Additional analysis where the employer maintains Irish permanent establishment

The release from the obligation to operate Irish P.A.Y.E. will not be granted where the remuneration is paid by a foreign employer and the cost is recharged to an Irish employer. When determining if remuneration is recharged by a foreign employer to an Irish entity, consideration should be given to the relationship between the fees charged and the remuneration, employment benefits and employment costs of the assignee. If the fee equals these costs or is a charge with a profit element computed as a percentage of that remuneration, this would be indicative that remuneration is directly recharged.

Note that even if the remuneration is paid by a foreign employer and charged in the accounts of a foreign employer, this factor alone does not release the employer from the obligation to operate Irish P.A.Y.E..

Practical application

If there is a recharge cost operated so that the Irish entity ultimately bears the cost of the remuneration, the relief does not apply. Consequently, whether the employer will have a requirement to operate Irish

P.A.Y.E. even if the duties performed by the assignee are not an integral part of the business activities.

In circumstances where it is clear that the remuneration is not borne by a permanent establishment which the foreign employer has in Ireland, it will be necessary to analyse the nature of the work carried out by the assignee in Ireland in order to determine whether it is integral to the business of the Irish employer.

As a submission is required in these cases before relief from the obligation to operate Irish P.A.Y.E. is allowed, detail will be required within the submission as to the specific employee duties performed by the non-resident individual. Typically, the Irish Revenue request a statement from the company that no cost is borne directly or indirectly by the Irish entity.

In conclusion, the updated guidance provides an element of clarity around the Irish Revenue's position in relation to short-term business visitors to Ireland. Nonetheless, because the guidance is detailed, ongoing tweaks are anticipated as submissions are received by affected employers. Until then, the guidance is broadly untested for employers in a practical sense.

Minimising Irish P.A.Y.E. exposure

Non-Irish domiciled individuals who are tax resident in Ireland are not subject to Irish income tax on foreign employment income attributable to non-Irish work day duties. It, therefore, may be appropriate to have two contracts of employment; one Irish contract for Irish duties and a foreign contract for foreign duties which are carried on abroad. Provided all of the foreign duties under the foreign contract are carried on outside of Ireland and the payment with respect to this contract is paid outside of Ireland, the earnings from foreign duties would not be subject to tax while the individual is seconded to Ireland. Those earnings are taxed only when remitted to Ireland.

Cross-Border Executives Is Ireland a Favourable Tax Location for Key Personnel?

RELOCATING TO IRELAND – S.A.R.P.

In 2012, S.A.R.P. was introduced as a mechanism to make Ireland attractive for people with key skills. Initially due to expire in 2014, the relief programme has been extended to the year 2020. It provides generous relief for individuals that qualify for the programme.

The relief is also available to Irish citizens returning home once all conditions have been satisfied.

S.A.R.P. Overview

Section 825C Taxes Consolidation Act (T.C.A.) 1997 provides for income tax relief on a portion of income earned by certain employees assigned from abroad to work in Ireland by a "relevant employer" or for an "associated company" in Ireland during any of the tax years 2012 to 2020.

For the years 2012, 2013 and 2014, S.A.R.P. provided relief from income tax for 30% of the employee's income between €75,000 (lower threshold) and €500,000 (upper threshold). The upper income threshold of €500,000 was removed in 2015 so that the relief is unlimited. However, the income is not exempt from the charge to Universal Social Charge (U.S.C.) or Ireland's social insurance charge (P.R.S.I.).

The relief can be claimed for a maximum period of 5 consecutive years commencing with the year of first entitlement. Employees who qualify for relief under section 825C T.C.A. 1997 may also receive, free of tax, certain expenses of travel and certain costs associated with the education of their children in Ireland.

Where conditions for the relief are satisfied, an employer must file a Form SARP 1A for each employee applying for S.A.R.P. relief. The form must be submitted to the Irish Revenue within 30 days of the employee's arrival in Ireland to perform the duties of his or her employment in Ireland.

Definitions and conditions

Cross-Border Executives Is Ireland a Favourable Tax Location for Key Personnel?

A number of conditions must be met by the employer and employee in order to claim the relief. To understand the conditions, it is necessary to clarify two principal definitions associated with the relief.

The first is "Relevant Employer". This term means a company that is incorporated and tax resident in a country with which Ireland has a D.T.A. or a Tax Information Exchange Agreement (T.I.E.A.). The second is "Associated Company". This term means a company that is associated with the Relevant Employer. Under section 432 T.C.A. 1997, a company is treated as an Associated Company at a particular time if, at that time or at any time within the previous year, either company has control over the other, or both companies are under the control of the same person or persons.

The relief can be claimed by an individual who is a Relevant Employee, i.e., who meets all of the following conditions:

- Immediately before being assigned to work in Ireland, the individual worked outside Ireland for a minimum period of 6 months (12 months for employees who were assigned in 2012, 2013 or 2014).

- Arrives in Ireland in any of the tax years 2012 to 2020, at the request of his or her Relevant Employer, to perform, in Ireland, duties of his or her employment for that employer or to take up employment in Ireland with an associated company of that relevant employer and to perform duties in Ireland for that company.

- Performs duties referred to above for a minimum period of 12 consecutive months from the date he or she first performs those duties in Ireland. An employer should only certify that the employee will meet this condition where the contractual arrangements are that the individual will perform duties for the 12-month minimum period.

- Was not tax resident in Ireland for the five tax years immediately preceding the year of his or her arrival in Ireland to take up employment in Ireland.

- Is tax resident in Ireland for all tax years for which the relief is claimed.

- Earns a minimum basic salary of €75,000 per annum excluding all bonuses, commissions or other similar payments, benefits, or share-based remuneration.

Where an individual is not tax resident in Ireland in the year of arrival, he or she may elect to be resident in Ireland in that year provided he or she satisfies the conditions set out in section 819(3) T.C.A. 1997. However, that individual should bear in mind the consequences of such an election. For example, an election to be resident in Ireland may bring some or all of the individual's foreign income for that year within the charge to tax in Ireland.

The S.A.R.P. threshold

As previously noted, before an individual is eligible to claim the relief, he or she must earn "relevant income" of not less than €75,000 per annum. This means that his or her basic salary before *benefits, bonuses, commissions, share-based remuneration and other income from the Relevant Employer or Associated Company* must not be less than €75,000.

Calculation of the relief

The amount of the relief is 30% of the individual's relevant income in excess of €75,000. Where, for a tax year, a relevant employee satisfies the conditions and makes a claim for the relief, he or she will be entitled to have the tax relief granted by way of calculating what is known as the "specified amount" and relieving that specified amount from the charge to income tax. The specified amount is determined under the following formula:

Amount A – Amount B × 30%

For this purpose, Amount A is the amount of the relevant employee's income, profits or gains from his or her employment in Ireland with a Relevant Employer or Associated Company. Excluded from Amount A are expenses and amounts not assessed to tax in Ireland. It is reduced by any superannuation contributions made by the relevant employee. In addition, where the relevant employee is entitled to double taxation relief in relation to part of the income, profits or gains from the employment, that part of the income is also excluded from Amount A. For the years 2012, 2013 and 2014, where this amount exceeds €500,000, Amount A is capped at €500,000 (the "upper threshold"). No cap applies for the year 2015 and subsequent years. Also, for the purpose of the computation Amount B is €75,000.

Cross-Border Executives Is Ireland a Favourable Tax Location for Key Personnel?

In sum, with effect from the tax year 2015, the specified amount is 30% of the individual's income over €75,000. For the years 2012, 2013 and 2014, the specified amount is 30% of the individual's income between €75,000 and an upper threshold of €500,000.

Once the individual meets the €75,000 threshold as previously defined, all remuneration in excess of €75,000, including benefits, bonuses, commissions, share-based remuneration and other income from the Relevant Employer or Associated Company qualify for S.A.R.P. However, any amount on which relief for pension contributions has been obtained continues to be excluded as are amounts paid with respect to expenses.

The specified amount is exempt from income tax but is not exempt from the U.S.C. In addition, the specified amount is not exempt from P.R.S.I. unless the employee is relieved from paying Irish P.R.S.I. under either an E.U. Regulation or under a bilateral agreement with another jurisdiction.

Example

Rose is a relevant employee who earns €650,000 in 2018.

Under S.A.R.P., €172,500 of Rose's income is disregarded for income tax purposes and she is entitled to income tax relief of €69,000. This is calculated as follows:

1.	Amount A	€650,000 (No Cap)
2.	Less: Amount B	75,000 (Specified amount)
3.	Amount Available	€575,000
4.	Exclusion Percentage	x 30%
5.	S.A.R.P. Exclusion	€172,500

Relief due for 2018 is €69,000 (€172,500 @ 40%).

While €172,500 of Rose's income is relieved from tax, it remains liable to the U.S.C. and, depending on Rose's circumstances, may also be liable to P.R.S.I.

Travel costs and tuition fees

In any tax year in which an employee is entitled to S.A.R.P. relief, the following payments or reimbursements by the Relevant Employer or Associated Company of the Relevant Employer will not be chargeable to tax:

- The reasonable costs associated with one return trip from Ireland for the employee, his or her spouse or civil partner, and a child or children of the employee or of the employee's spouse or civil partner to:
    - The country of residence of the employee prior to his or her arrival in Ireland;
    - The country of residence of the employee at the time of first employment by the Relevant Employer; or
    - The country of which the employee or his or her spouse or civil partner is a national.
- The cost of school fees, not exceeding €5,000 per annum for each child of the employee or of his or her spouse or civil partner, paid to a recognised primary or secondary school in Ireland.

These costs and fee are not subject to U.S.C. or P.R.S.I..

Cross-Border Executives Is Ireland a Favourable Tax Location for Key Personnel?

EMPLOYER CERTIFICATION AND REPORTING

Form SARP 1A

In order for an individual to be regarded as a Relevant Employee, the individual's Relevant Employer or the Associated Company must certify that the individual complies with the several conditions. For employees arriving in Ireland in any of the tax years 2015 to 2020, certification is required to be made by the employer on Form SARP 1A, for each employee availing of S.A.R.P. relief, within 30 days of the employee's arrival in Ireland to perform the duties of employment in Ireland. Failure to submit a Form SARP 1A within the 30-day time limit can result in the refusal of S.A.R.P. relief, as this is a specific legislative requirement.

Some employers have experienced delays in obtaining a P.P.S. number (an Irish tax identification number) for employees, which in turn has caused a delay in the submission of the SARP 1A Form to the Irish Revenue. If there are such extenuating circumstances wholly outside the control of the employer, the relevant employer or associated company should complete the form with all other required information included and submit this form to the Irish Revenue within the required 30-day filing deadline. A brief note should be attached that explains that the P.P.S. number will follow. In these limited circumstances and provided a timely submission of the outstanding P.P.S. number is provided to the Irish Revenue, the relief should not be denied.

Annual reporting by the employer

The employer must complete and file a S.A.R.P. Annual Return. The Annual Return must be made on or before 23 February after the end of each tax year. The Relevant Employer or Associated Company of that Relevant Employer is required to set out with respect to each Relevant Employee:

- Name and P.P.S. number,
- Nationality,
- Country in which the Relevant Employee worked for the relevant employer prior to his or her first arrival in Ireland to perform duties of the relevant employment, and
- The amount of income, profits or gains in respect on which tax was not deducted.

The Relevant Employer or Associated Company must provide details of the increase in the number of employees, and details of the number of employees retained by the company as a result of the operation of the S.A.R.P..

EMPLOYEE REPORTING REQUIREMENT

A Relevant Employee who receives S.A.R.P. relief is deemed to be a "chargeable person" for the purposes of self-assessment and is therefore required to file an Irish income tax return (Form 11) with the Irish Revenue with respect to each year for which relief is claimed.

PRACTICAL POINTS REGARDING THE OPERATION OF S.A.R.P.

- An employer can make an application to the Irish Revenue to grant S.A.R.P. relief at source in real time through payroll withholding adjustments. The employer application is filed only once. Provided the employee continues to satisfy all S.A.R.P. conditions throughout the period of assignment, relief can continue through payroll for the duration of that period capped at five consecutive tax years.

- In relation to the 30-day requirement to file the SARP 1A, the timing is key. In all circumstances, the form should be submitted to the Irish Revenue despite the fact it may not be complete. The Irish Revenue reserves the right to deny relief when a late application occurs.

- To qualify for S.A.R.P., the employee must be seconded to Ireland at the request of the Relevant Employer, which is the foreign company. Where the foreign company is the only company involved, there should be no issue. However, where there is a foreign company with an Irish subsidiary, it must be clear that the secondment to Ireland is initiated by the foreign employer. For example, if the individual were to approach the Irish company directly and request a role with the new Irish subsidiary, this would not qualify for S.A.R.P. as the request did not emanate from the foreign employer.

- Difficulties can arise if an individual works for two employers in Ireland in terms of meeting the associated employer requirement and income threshold applicable to that income.

- The Irish Revenue will issue a confirmation to the employer that S.A.R.P. is available. The practical and real-time application of this involves a manual calculation at a payroll level – the software, at present, is not automated.

- In practice, many employees availing of S.A.R.P. elect to be resident during the tax year of arrival so that S.A.R.P. relief can be granted on a real-time basis. Alternatively, the employee can elect to be tax resident when filing their Income Tax Return Form 11. However, in that scenario, there will be an inevitable timing difference in the employee obtaining the S.A.R.P. relief.

- Income for S.A.R.P. is deemed not to include any amount paid with respect to expenses incurred in the performance of the duties of the relevant employment. Expense amounts are not included for the purposes of eligibility for S.A.R.P. or for calculating the S.A.R.P. tax relief.

Cross-Border Executives Is Ireland a Favourable Tax Location for Key Personnel?

CONCLUSION

Non-Irish employers should now review all temporary assignments and business visitors to Ireland to ensure the correct payroll treatment is being applied as the new guidance is already in operation. Irish Revenue submissions will be required for some employers.

This tightening of the Irish tax rules emphasises the need for international employers to have robust tracking systems and processes in place in order to identify cases that might fall within the Irish P.A.Y.E. net and those cases that might benefit from S.A.R.P. From the date the employee arrives in Ireland, the employer has a limited 30-day window to lodge a S.A.R.P. application or risk having the relief denied.

Ireland is also entering a time of P.A.Y.E. modernisation which is due to commence on 1 January 2019. P.A.Y.E. modernisation seeks to keep Ireland's P.A.Y.E. system in "real time", which will require employers to submit real-time payroll reporting to the Irish Revenue from 1 January 2019. This new system will be challenged by the operation of employment taxes for business visitors and S.A.R.P. as there are no special features to facilitate the smooth operation of P.A.Y.E. in these more complex cases.

Although Ireland is perceived as having high payroll taxes internationally, it can be a relatively favourable location for businesses and key employees, if the assignment is structured correctly from the outset.

Dutch Tax Treatment of Discretionary Trusts

By Patrick van Rooij and John Graham

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INTRODUCTION

In Anglo-Saxon jurisdictions, the trust is often used to enable an ultimate transfer of assets to a spouse or children or for asset protection purposes. However, the tax treatment of the trust has long been a problem in countries that have neither a set of common law rules nor a specific trust law. In many countries, trusts are generally seen as abusive. This is particularly the case when a trust is a discretionary trust.

Fixed interest trusts are easier to deal with for income tax purposes and gift and estate tax purposes because a share of the trust assets can be allocated to each beneficiary. This is not the case for a discretionary trust – hence the problem.

Since the 1950's, the practice of the Dutch tax authorities (the D.T.A.) was to tax the trust itself, as a separate entity, or any Dutch tax residents involved in the trust arrangement, whether settlors, beneficiaries or trustees. Results have varied.

Prior to 2010, Dutch tax literature and case law show that a grey area existed, resulting in the opportunity to exempt assets and income from taxation. In principle, this allowed an opportunity for tax planning, although it was difficult to obtain certainty. Some advisers took the view that, if a Dutch resident was the settlor of a discretionary trust in another jurisdiction, the amount settled could not be treated as a gift because no beneficiary was entitled to the transferred assets at the time of the gift. Then, at the time of a distribution to one of the discretionary beneficiaries, it was argued that the distribution could not be treated as a gift subject to Dutch gift tax because the party making the distribution was not a Dutch resident. Additionally, the income of the trust arguably was not taxed as earned because no beneficiary was entitled to receive the proceeds of the income.

This view regarding gift tax was overruled by case law dealing with transfers to a discretionary trust. The trust was considered to be an entity and the transfer was subject to Dutch gift or estate tax at the highest rate since the trust was not a relative, even if the settlor and the beneficiary were parent and child. However, no income tax would be imposed on the trust or its beneficiaries when and as earned when the trust was not managed from the Netherlands.

Dutch Tax Treatment of Discretionary Trusts

In 2010, legislation was introduced to address this problem. This resulted in the introduction of a new term, the "separate private fund" (in Dutch, the *afgezonderd particulier vermogen* or A.P.V.). An A.P.V. is a fund with a particular private objective, as opposed to a fund with a social or cultural objective, which broadly covers discretionary trusts, foundations or similar entities.

The new legislation treats assets that have been transferred to an A.P.V. as belonging to the individual who has transferred those assets, usually the settlor. Consequently, the settlor is taxed on those assets as if owned directly for both personal income tax purposes and gift and estate tax purposes. The Dutch system for unearned income, other than from a significant shareholding in a company, is based on a notional return. Consequently, the actual rate of tax depends on the income profile of the person to whom allocated.

In this paper, where we refer to income being allocated to a person, the actual position is normally that the assets are allocated to that person and the notional return is taxable in that person's hands.

This means that a distribution from a trust to a beneficiary will be treated for Dutch tax purposes as a gift from the settlor to the beneficiary. If the settlor is an actual or deemed Dutch resident[1], Dutch gift or estate tax exposure exists. Although Dutch gift and estate tax is levied on the recipient, tax exposure is dependent on the decedent or donor being resident or deemed resident in the Netherlands.

On the death of the settlor, the assets in the trust are generally attributed to the settlor's heirs in accordance with their entitlement to the total estate under Dutch inheritance law. No consideration is given to the likelihood that an heir will receive anything from the trust or the fact that little or nothing is actually received from the trust.

In certain specific cases, if the trust operates a business which is taxed at a rate of 10%, the transparency rule does not apply for income tax purposes. In practice, there are relatively few trusts which will fall under this rule. As originally enacted, all assets with income taxed at 10% were not attributed to the settlor.

While this attribution can offer some planning opportunities, many pitfalls exist. Notwithstanding the intent or residence of the settlor at the time of transfer of assets, settlors and beneficiaries to a trust can unknowingly be subject to Dutch tax. This is especially the case with structures set up before the 2010 legislation came into effect. In all fact patterns, care is needed where a trust has a Dutch link, no matter how distant.

Some of the definitions used in the 2010 legislation are ambiguous and therefore leave room for interpretation, a discretion happily used by the D.T.A.

The balance of this article will look initially at several planning opportunities and then will address some of the issues that can arise.

PLANNING POSSIBILITIES

Frequently, the parents of a family will set up a trust for the benefit of the children and remoter descendants. In the past, this would not have led to difficulties in tax treatment because people tended to remain in the country where born. Now, with freedom of movement within the European Union, it is not unusual for children to become resident in another country for short or long periods.

[1] Under Dutch inheritance and gift tax concepts, receipts from actual or deemed Dutch tax residents are subject to inheritance or gift tax. Receipts from nonresidents are not subject to either Dutch tax.

It is relatively uncommon for a Dutch resident to set up a trust. Often it is the beneficiary who relocates to the Netherlands while the settlor lives in a common law country, often the United States, the United Kingdom or Australia. As long as the parents are alive and not resident in the Netherlands the children are not subject to Dutch tax on the income of the trust or on distributions received from the trust. This can enable wealth to be transferred without the transfer actually being taxable in the hands of the recipients, although tax exposure could arise once the assets have been transferred to the beneficiary.

Dutch Tax Treatment of Discretionary Trusts

In some instances, the residence country of the settlor may no longer treat the settlor as the owner of the assets. As a result, the income may not be taxed in either jurisdiction. On the other hand, the settlor can be taxed on the income upon a move to the Netherlands even though the settlor has no entitlement to the proceeds of trust income. Moreover, Dutch gift tax may be due on distributions from the trust to a beneficiary. Double tax may ensue.

If there is a desire to provide a benefit to a person who is not an heir and that person is a resident of the Netherlands, that beneficiary will not normally be subject to Dutch tax on income from the assets even after the death of the settlor.

Provided it remains an investment type of entity, the legislation also allows the use of a family foundation by Dutch residents. Prior to the 2010 legislation, contributions to and distributions from a foundation were potentially subject to Dutch gift tax. Because, foundations did not qualify for close relative tax rates, the transfer was taxed at the maximum rate. Today, that tax rate is 40%. The current rules allow the assets to be transferred to the foundation without any gift tax and a transfer from the foundation is deemed to be a transfer from the settlor to the beneficiary, which may qualify for the lower rates, which may be zero when the settlor is a nonresident settlor.

The use of a trust or foundation in this way may also offer some benefits for those planning to emigrate from the Netherlands. Dutch citizens are deemed to be resident in the Netherlands for gift and estate tax purposes for 10 years after the departure. In comparison, persons who are not Dutch citizens are deemed resident in the Netherlands for gift tax purposes for only one year after departure. A transfer of assets to a trust will not have any immediate tax effect in the Netherlands. At the same time, the country of arrival may take the view that no gift tax or income tax is due because the transfer to the trust occurred prior to arrival.

PRACTICAL PROBLEMS

While the mismatch between the actual beneficiaries and the parties considered beneficiaries can offer planning opportunities there are frequently situations where major problems arise. These are illustrated in the following fact patterns based on actual cases.

Who is the heir?

The legislation does not define the term "heir". A US resident provided in her will that her estate should be divided among her children, Child A, Child B, and Child C. However, in the same will, she stated that the assets to be left to Child A should be placed in trust. The beneficiaries of that trust were Child A and Child A's descendants and if no descendants existed, the other two children and their descendants. The trustee was granted full discretion over the distribution of the assets to the beneficiaries. Child A was a resident of the Netherlands.

As discussed above, upon the death of the settlor the assets in the trust are allocated to the heirs in accordance with their entitlement to the estate. The questions here were whether Child A was an heir and, if so, the extent of her entitlement.

For one year, a compromise agreement was made with the D.T.A. that one-third of the assets in the trust were allocated to Child A. In the subsequent year, the tax authorities renounced that arrangement and asserted that all the assets in the trust were allocated to Child A. Moreover, the D.T.A. took the view that Child A was the settlor of the trust even though the trust was set up under the will of the mother. In the view of the D.T.A., the assets deemed to be inherited by Child A and, after a legal instant, Child A transferred the assets to the trust. On this basis, all the assets in the trust were attributed to Child A.

At some point, the D.T.A. realized that this approach would not stand up in court. Consequently, it adopted the position that all trust assets should be allocated to Child A since her siblings received their "fair share" of the estate and were not likely to receive anything from the trust given their third position as a claimant to assets. The D.T.A. did not consider the ages of the children of Child A. Moreover, no provision in Dutch law supported the approach of the D.T.A. Indeed, the parliamentary papers and the actual legislation clearly provide that a person can be considered a beneficiary unless there is absolutely no chance of the person receiving any asset under the terms of the legal document and the facts involved.

Two further challenges existed with regard to the position of the D.T.A. The first challenge was that Child A was not an heir at all since her "share" in the estate was placed in trust and she was not entitled to any distribution from the estate. The second challenge was that even if she were to be considered an heir, her share of the estate was zero. Consequently, nothing should be allocated to her.

In the case, the court of first instance decided to allocate one third of the assets in the trust to Child A. While this is a compromise which may have the benefit of "feeling right" to the judge, from a technical point of view we consider this an incorrect decision, since Child A received no assets from the estate. Therefore, even if Child A was an heir, her share in the estate was zero so that the proportion of the trust income which should be allocated to her is also zero.

This case is currently subject to appeal by both parties. Annotators on the case take the view that the inspector will not win.

Problems with Dutch-resident relatives

A Dutch citizen emigrated to South Africa and lived there for many years. He died without children. During his life, he set up a trust for the benefit of his relatives and such other individuals as the trustees might determine. Shortly before his death, he left a letter of wishes providing that after his death the trust should make some distributions to certain friends and to certain relatives. The friends were mostly resident outside the Netherlands. However, the relatives were Dutch residents.

At his death, the individual was a resident of South Africa. The question arose as to the Dutch tax consequences of the trust. The trustees agreed to follow the letter of wishes in exercising discretion provided in the trust deed. Thus, it was argued that the trust was no longer a discretionary trust because the letter of wishes amounted to written directions as if part of the trust instrument.

The D.T.A. was not prepared to accept this view. According to the D.T.A., the assets in the trust should be treated as if they were first deemed to be allocated to the relatives who were heirs of the decedent and then the heirs were deemed to make gifts to the actual beneficiaries. For Dutch tax purposes, the gifts were made proportionally by each relative. Because the relatives were all Dutch residents, the deemed gifts were subject to Dutch gift tax, even though, if the deceased had left the assets directly to his friends under his will there would have been no Dutch tax. This resulted in a tax liability of several hundred thousand euros, simply because a trust was interposed.

In comparison to the first case, where the D.T.A. took the view that the tax treatment under the law provided for an unreasonable notional allocation that should not be followed, in this case, the D.T.A. refused to deviate from their interpretation of the law, even though it appeared to be unreasonable. The letter of wishes was ignored as a meaningful document.

A difficult relationship with stepmother

An individual and his sister were residents of the Netherlands. The father was not a resident of the Netherlands and had remarried. Prior to his death, a discretionary trust was set up for the benefit of his wife and children in which his wife was co-trustee with a third party. On the father's death in 2004, he left all of his assets other than certain bequests to the trust. The trust deed provided that on father's death certain relatively small fixed amounts would be paid to the children, a certain fixed amount would be retained in the trust for the benefit of the stepmother and the children, and the balance would be paid out to the stepmother. The trust deed directed the trustee to ensure that the stepmother was to be provided for in the manner to which she was accustomed at the time of the settlor's death.

Before the introduction of the A.P.V. legislation, it was agreed with the tax authorities that the Dutch resident children did not need to report anything in respect of the trust since it was considered unlikely that they would receive income, and if they were to receive anything from the trust, it would most likely be non-taxable capital rather than income.

After the introduction of the A.P.V. legislation, the D.T.A. adopted the view that the stepmother and children should be considered as heirs and one-third of the assets of the trust should be allocated to each. This approach appears to be inappropriate. Under general case law applicable to foundations, the foundation should be ignored because the stepmother was both one of the trustees and the primary beneficiary and she, therefore, had full control over the assets. All the assets should be considered to be owned by her. Alternatively, if the trust cannot be considered the heir, it should be considered to be "transparent" in identifying the heirs and the proportion of the estate each received. Since most of the assets went to the stepmother, most if not all of the assets in the trust should be attributed to her for Dutch tax purposes.

One of the issues here is that no individual person is shown as heir in the will. If the trust is to be treated as an heir, the D.T.A. position is contrary to the object of the legislation. Moreover, if the stepmother and children should be treated as heirs, how does one allocate the proportions? The children had no knowledge as to the amount the stepmother actually received, and the stepmother is uncooperative.

This case is still in its early stages but illustrates some of the challenges which can arise from what may be considered a normal provision in another country.

CONCLUSION

At first sight, Dutch legislation covering the tax treatment of discretionary trusts looks quite straightforward. However, many practical problems exist. This is partly due to the fact that income can be allocated to people other than the actual beneficiaries so that taxes can be payable in unexpected circumstances and partly because the legislation does not take account of situations which may be normal in other countries.

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