

## **Pride or Prejudice**

*Brexit and emerging trends in EU markets*

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# Overview of session

Relevance of EU market

Brexit

BEPS and ATAD

Taxation of digitalized businesses

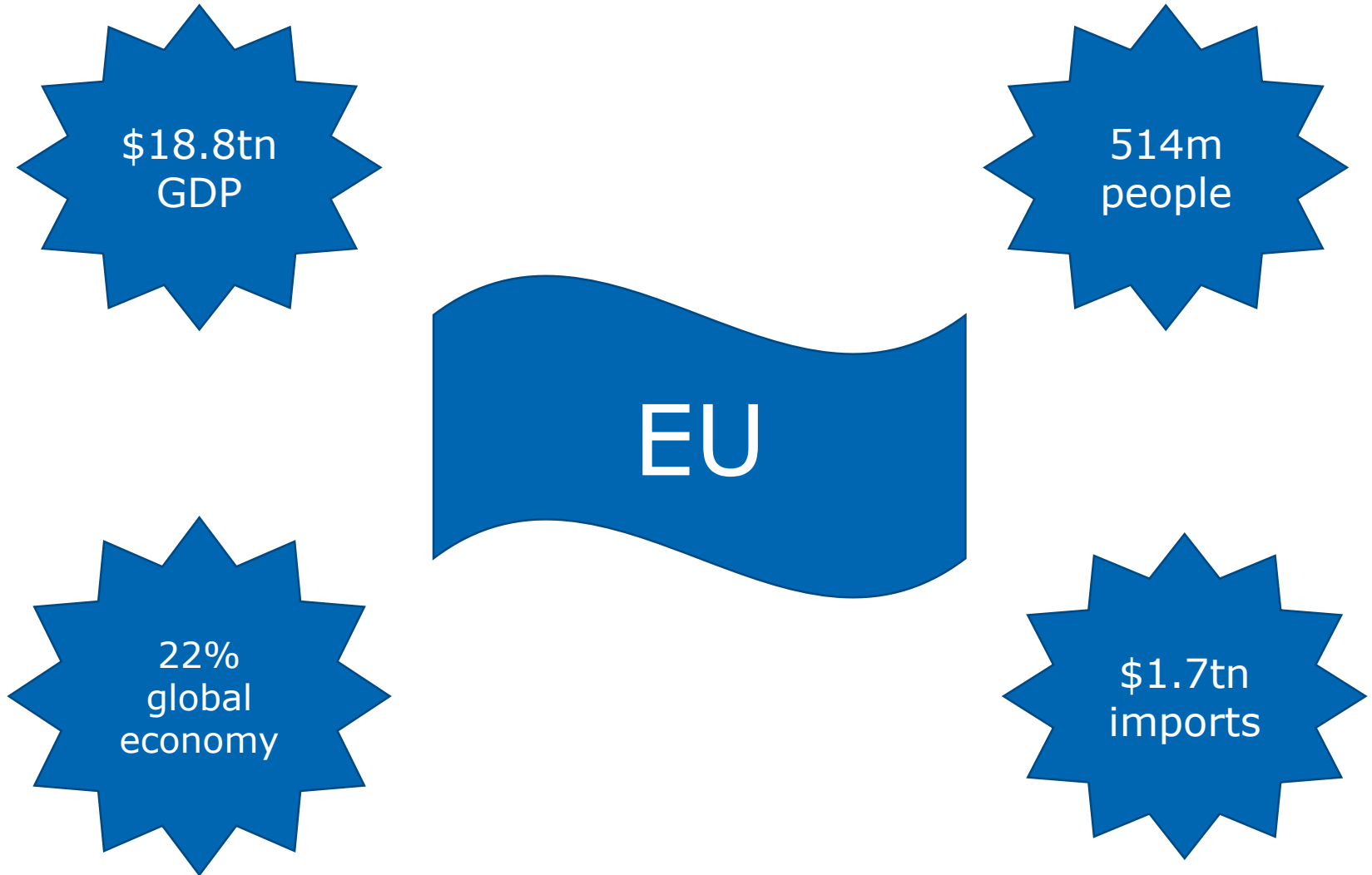
Reportable transactions / information exchange

Tax certainty in the EU

State Aid challenges

Takeaways

# Relevance of EU market



## Relevance of EU market

# The EU and tax

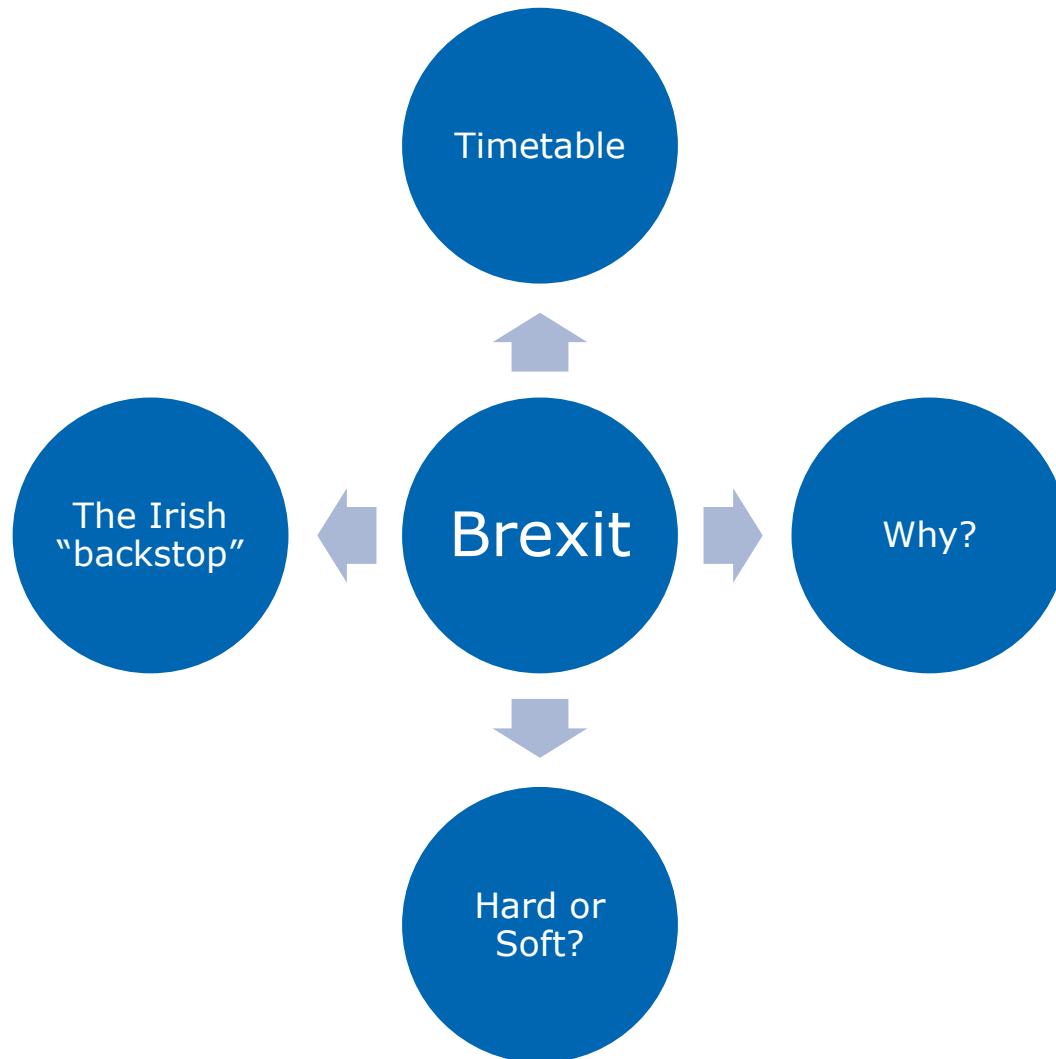
Leading voice in BEPS initiative

Unique ability to impose multijurisdictional tax rules

Framework for tax authority cooperation

Harmonization vs tax sovereignty

# Brexit – a brief overview



# Brexit – tax implications

## VAT / Customs Duties

- Customs Union – leave or stay?
- VAT – deviations from EU VAT?

## Withholding taxes

- Loss of Parent/Subsidiary Directive
- Loss of Interest/Royalties Directive

## Treaty impacts

- Reliance on treaties in absence of Directives
- Treaty provisions reliant on EU membership

# BEPS and ATAD

## What is ATAD I / II

- EU's implementation of certain BEPS actions#
- Anti Tax Avoidance Directive
- Mandatory minimum standards across EU member states

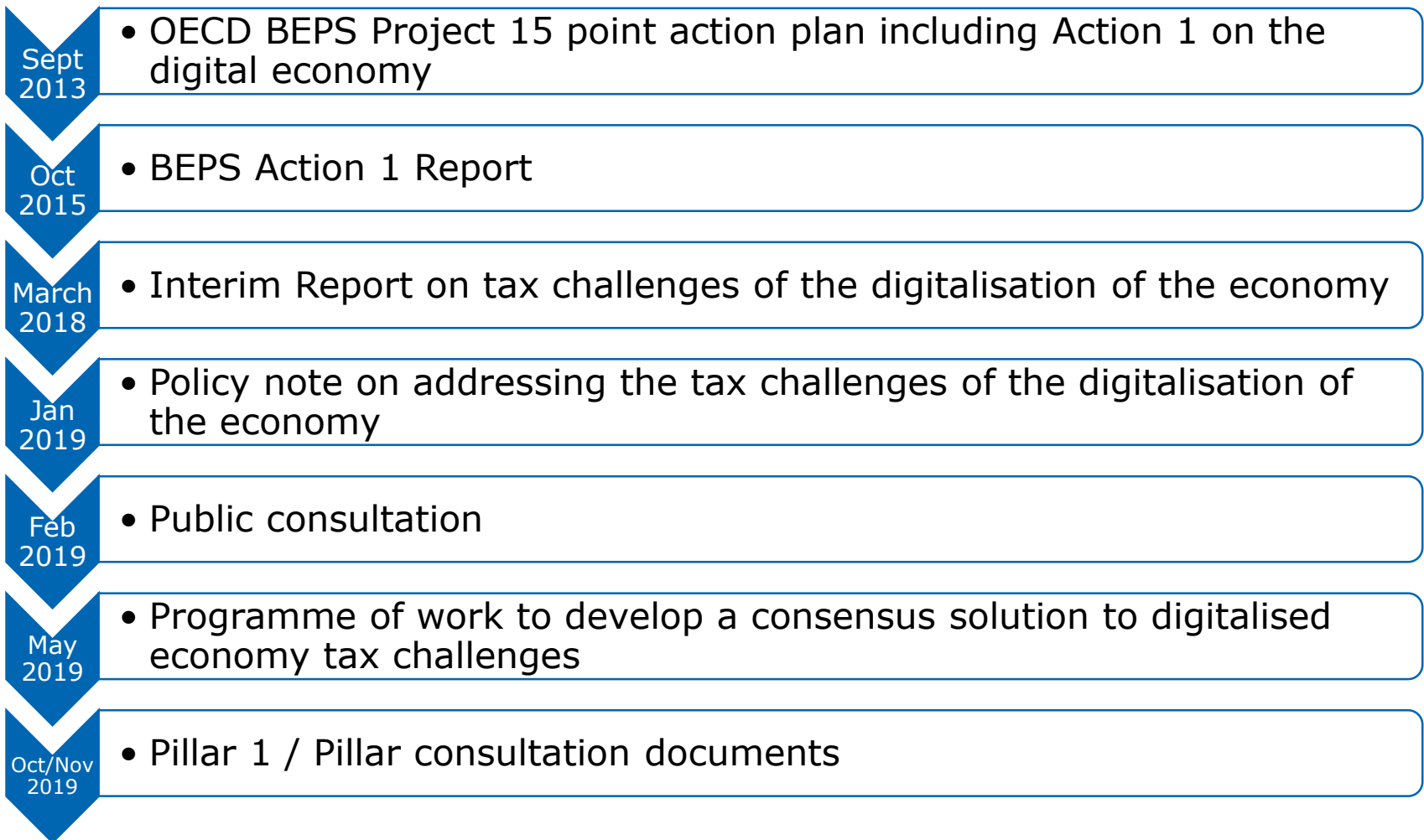
## What is included?

- Interest limitation / capping rules
- Mandatory exit taxes
- General Anti-Avoidance Rules (GAAR)
- CFC Rules
- Hybrid Mismatch rules

## When?

- 1 January 2019 – Interest limitation / CFCs / GAARs
- 1 January 2020 – Hybrid mismatch / Exit taxes
- 1 January 2022 – Hybrid mismatch – reverse hybrids

# Taxation of digitalized business





# The OECD digital tax Programme of Work

## Pillar 1

- **Profit allocation to market jurisdictions**
- **New nexus rule – remote taxable presence**

## Pillar 2

- **Income inclusion – a global minimum tax**
- **Tax on base eroding payments**

# The OECD Public Consultation

- **Pillar One**: Focuses on the allocation of taxing rights between jurisdictions and seeks to review the profit allocation and nexus rules in the context of the digital economy
  - **Not Just Digital Business**: Notwithstanding this stated objective, under public consultation paper applies to all “consumer-facing businesses,” not just highly digital businesses
  - **Economic Nexus**: The new nexus rule proposed in the consultation paper seeks to address the issue of nexus by creating a taxing right in all cases where a business “*has a sustained and significant involvement in the economy of a market jurisdiction, such as through consumer interaction and engagement, irrespective of its physical presence in that jurisdiction,*”

# The OECD Public Consultation

- **Pillar One**: (cont.)
  - **Profit Allocation**: Assuming the nexus threshold is satisfied -
    - **A** - a profit allocation is conducted by determining the deemed residual profit and allocating it to market jurisdictions;
    - **B** – a separate allocation is made to jurisdictions where the entity has a physical taxable presence under traditional standards, and a fixed return is established for such activities; and
    - **C** – an amount of additional profit to be allocated to marketing and distribution jurisdictions based on agreement of taxing authorities

# The OECD Public Consultation

- **Pillar Two**: Global anti-Base Erosion proposal or (“GloBE”) addresses, on a “without prejudice” basis, taxing rights that would “strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits.
- The Consultation paper leaves many questions unanswered, but proposes exploring:
  - **Income Inclusion Rule**—i.e., taxing the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
  - **Undertaxed Payments Rule**—i.e., denying deductions of or imposing source-based taxation (including withholding tax) on payments to related parties if such payments were not subject to tax at or above a minimum rate;

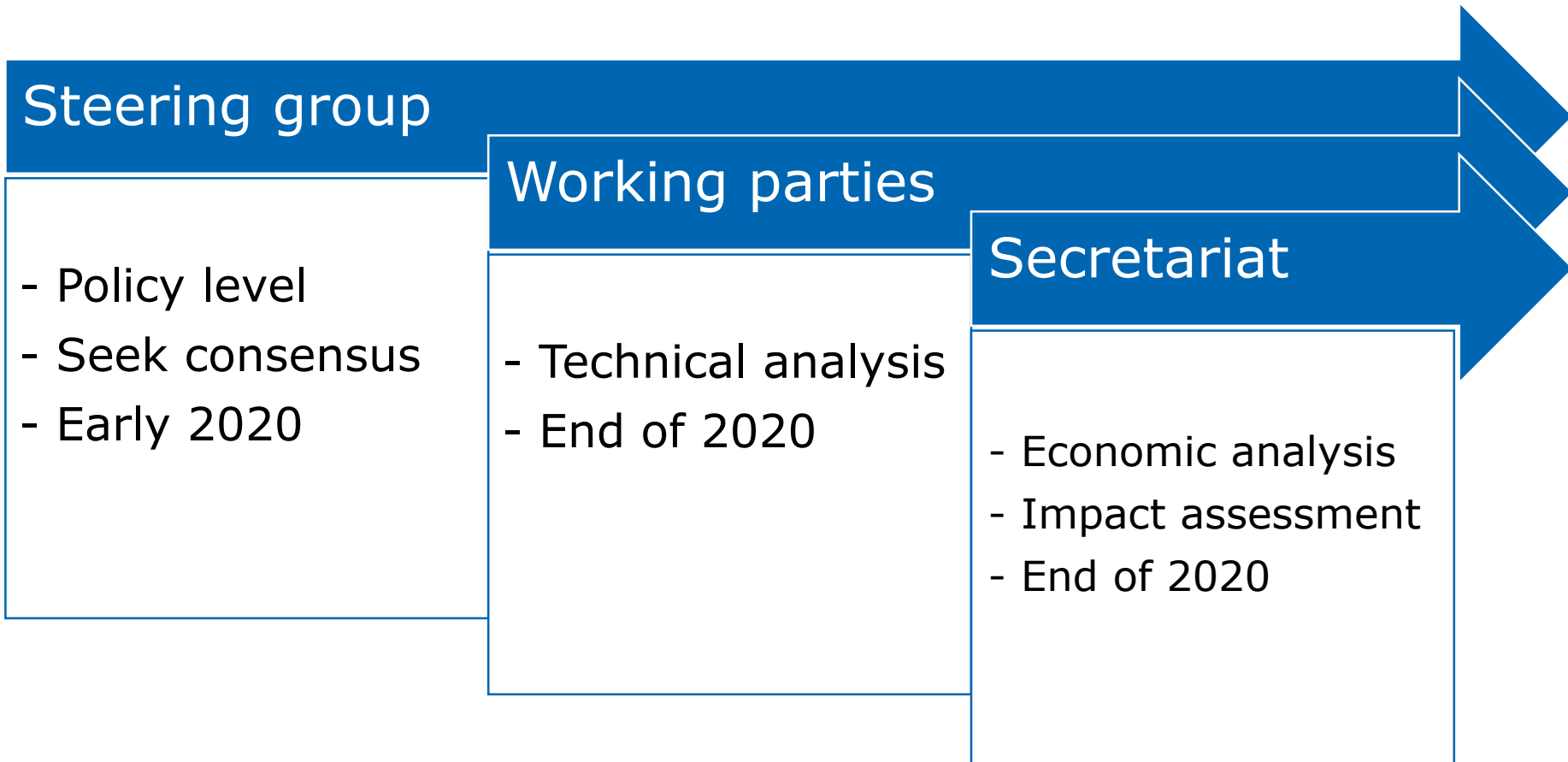
# The OECD Public Consultation

- **Pillar Two**: (cont.)
  - The Consultation paper leaves many questions unanswered, but proposes exploring:
    - **Switch-Over Rule**—i.e., permitting residence jurisdictions (by revising applicable tax treaties) to switch from an exemption to a credit method where the profits attributable to a permanent establishment (“PE”) or derived from immovable property (which is not part of a PE) were subject to an effective rate below the minimum rate; and
    - **Subject to Tax Rule**—i.e., complementing the Undertaxed Payments Rule by subjecting payments to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where such payments were not subject to tax at a minimum rate.

# The OECD Public Consultation

- **Pillar Two**: (cont.)
  - Proposes using financial accounting rules as a base for determining effective rates of tax and applying minimum tax thresholds
  - Decisions must be made as to blending of taxes (e.g., same basic question that IRS is wrestling with on GILTI high-tax)
  - Recognition that for administrability purposes there may need to be certain carve-outs

# Programme of Work - timetable



# European Commission digital tax proposals

## EC proposals

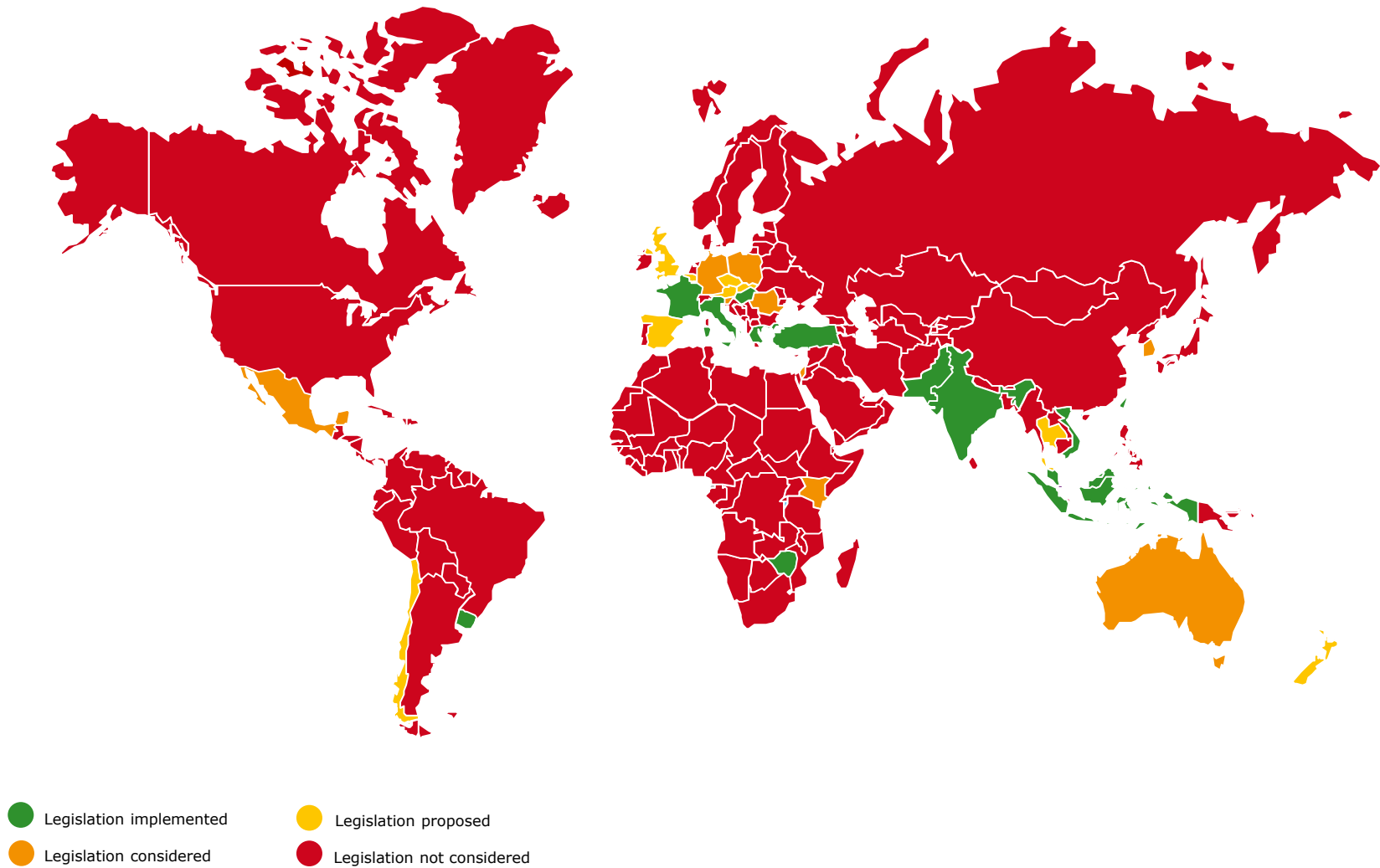
Taxable digital presence

Digital services tax

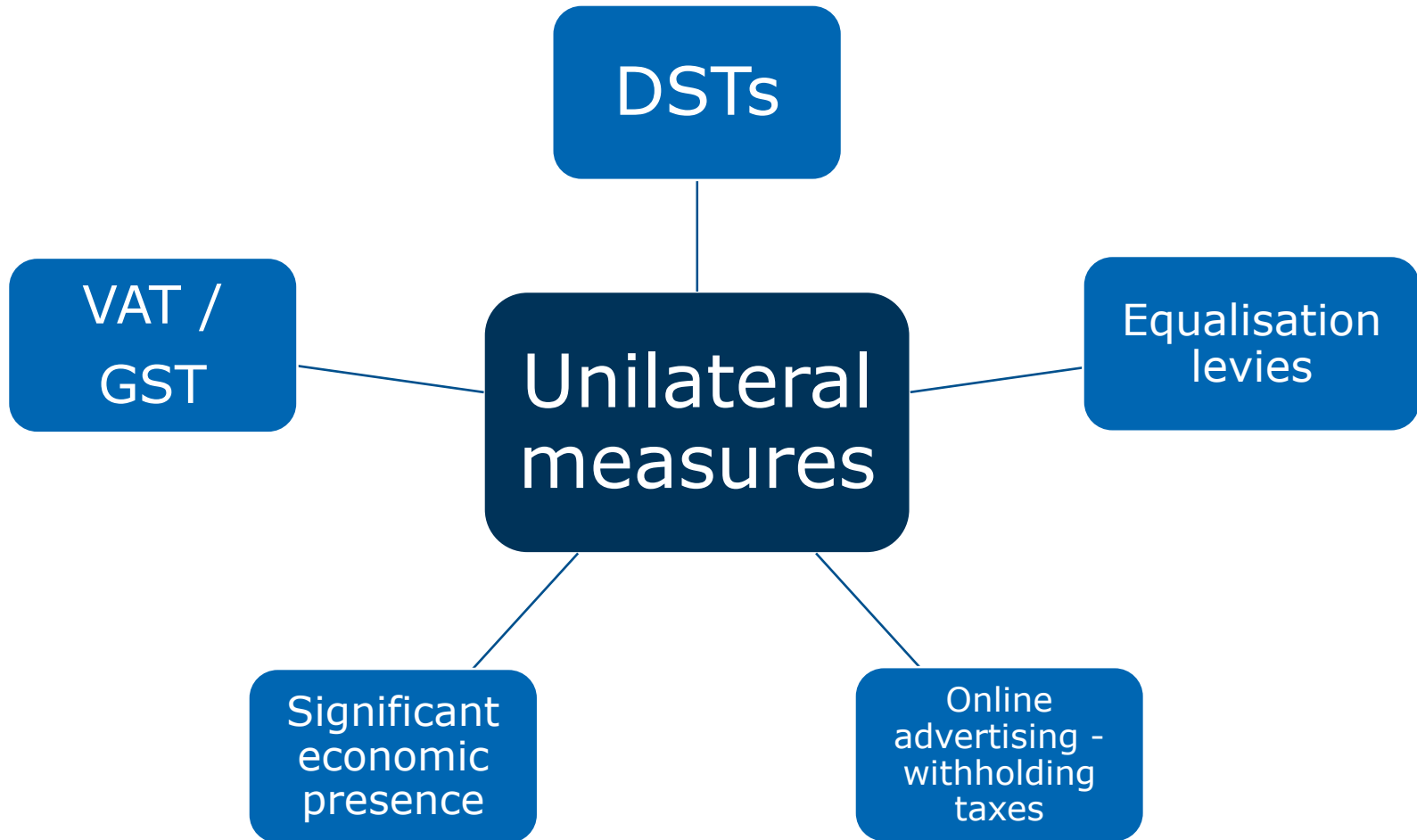
*April 2019 - EC plans blocked and put on hold*



# Unilateral, domestic digital tax proposals



# Range of unilateral digital tax measures



## The US perspective

### OECD

- Engage to ensure broad focus to reform
- Ensure certain digital businesses not unfairly targeted

### EC

- Strongly objects to DSTs
- Treasury and Senate criticism

### Unilateral

- Strong objections
- OECD represents the best route
- Trade challenges – e.g. French DST

# Reportable transactions (DAC6)

## What you need to know

- **Mandatory reporting** requirements for EU cross-border arrangements
- Imposes mandatory **obligation on intermediaries (including legal advisers) and taxpayers** to disclose information to their relevant tax authorities
- Applies to reportable cross-border arrangements entered into **from 25 June 2018**

# What is DAC6?

## Council Directive (EU) 2018/822 (“DAC6”) relating to mandatory automatic exchange of information for reportable cross-border arrangements

- DAC6 requires **intermediaries** or **taxpayers** to disclose certain **cross-border tax arrangements** which fall within one or more specified characteristics (known as **hallmarks**) that present an indication of a **potential risk of tax avoidance**
- DAC6 is aimed at **increasing tax transparency** through mandatory reporting to enable the EU Commission to detect instances of **potentially aggressive tax-planning**



Future reporting obligations date back to **25 June 2018** therefore this is a live issue

# Who is required to disclose?

- The reporting obligation primarily applies to **intermediaries** but there is also a secondary reporting obligation applicable to the EU taxpayer

## An intermediary is:

- someone with an EU connection who designs, markets, organises or makes available for implementation or manages the implementation of a reportable cross-border arrangement; or
- any person who undertakes to provide aid, assistance or advice in respect of a reportable cross-border arrangement, or any person who could reasonably be expected to know that such aid, assistance or advice relates to a reportable cross-border arrangement

- Intermediaries are likely to include professional advisers such as **legal advisers** (including in-house counsel), accountants and tax advisers, as well as banks and financial advisers
- The **information to be disclosed** includes full details of the applicable hallmarks, a summary of the arrangements (including the value) and details of any member states concerned

## When will reporting commence?

- DAC6 will have full effect from **1 July 2020**
- After 1 July 2020, intermediaries and/or taxpayers will be required to file information with their national tax authority **within 30 days** of the first of:
  - the day after the reportable cross-border arrangement is made available for implementation;
  - the day after the reportable cross-border arrangement is ready for implementation; or
  - when the first step in the implementation of the reportable cross-border arrangement has been implemented
- Intermediaries providing aid, assistance or advice must file information within **30 days beginning on the day after they provided aid, assistance or advice**
- For any reportable cross-border arrangements implemented **between 25 June 2018 and 30 June 2020**, transitional provisions are to allow for “one-off reporting” between 1 July 2020 and 31 August 2020

# Exemptions from reporting

- An intermediary can be **exempt from reporting** to the extent that it has proof that a report of the arrangement has been filed by another intermediary
- An exemption from reporting exists where there is **legal professional privilege**
- However:
  - An intermediary will **still be required to notify** another intermediary or the relevant taxpayer of reporting obligation where information is legally privileged
  - Certain information is **unlikely to be privileged** (e.g. such as names of relevant taxpayers and other intermediaries)



DAC6 does **not** have any *de minimis* value in respect of the reportable arrangements



# Cross-border arrangements

- An arrangement concerning either more than one member state, or a member state and a third country, and meets one of the broadly-drafted conditions which mostly involve a cross-border element
- HMRC is of the view that to “concern” a jurisdiction, it must be of “**some material relevance**” to the arrangement, for example:

- not all of the participants in the arrangement being resident in the same jurisdiction;
- one or more participants is resident for tax purposes in more than one jurisdiction;
- one or more of the participants carries on a business in another jurisdiction through a permanent establishment situated in that jurisdiction and the arrangement forms part or all of the business of that permanent establishment;
- one or more of the participants carries on an activity in another jurisdiction without being resident for tax purposes or creating a permanent establishment in that jurisdiction; and
- such arrangement has a possible impact on the automatic exchange of information or the identification of beneficial ownership

# Relevant hallmarks

- For a cross-border arrangement to be reportable, it must include one of the relevant **hallmarks**, which are characteristics or features that indicate a risk of tax avoidance
- Hallmarks are widely drafted but can be divided between:
  - those that require the **main benefit** (or one of the main benefits) of the arrangement to be the **obtaining of a tax advantage**; and
  - those that **do not require the main benefit** to be the obtaining of a tax advantage
- There are **five main categories** of hallmarks for DAC6:

A.	B.	C.	D.	E.
Generic hallmarks <u>linked to the main benefit test</u>	Specific hallmarks <u>linked to the main benefit test</u>	Specific hallmarks related to cross border arrangements and transfers	Specific hallmarks related to arrangements which circumvent tax reporting and transparency obligations	Specific hallmarks concerning arrangements which relate to transfer pricing

Category of arrangement	Description	Main benefit test applicable?
<p><b>A:</b> Generic hallmarks linked to the main benefit test</p> <ul style="list-style-type: none"> <li>• <b>Marketed tax avoidance schemes</b></li> </ul>	<p><b>1. Confidentiality:</b> Condition requiring a participant not to disclose tax advantages to the tax authority or to other promoters.</p> <p><b>2. Contingent Fee:</b> By reference to whether a tax advantage is obtained (or its size).</p> <p><b>3. Standardised documentation:</b> Involves the use of standardised documentation, including standard forms.</p>	<p>Yes</p> <p>Yes</p> <p>Yes</p>
<p><b>B:</b> Specific hallmarks linked to the main benefit test</p> <ul style="list-style-type: none"> <li>• <b>Structured arrangements in tax avoidance planning</b></li> </ul>	<p><b>1. Losses:</b> Participant in the scheme takes contrived steps to acquire a loss-making company (loss-buying).</p> <p><b>2. Conversion:</b> Arrangement that converts income into lower taxed/exempt categories of income.</p> <p><b>3. Circularity:</b> Arrangement that includes circular transactions with no commercial function that results in 'round tripping' of funds.</p>	<p>Yes</p> <p>Yes</p> <p>Yes</p>
<p><b>C:</b> Specific hallmarks related to cross border arrangements and transfers</p> <ul style="list-style-type: none"> <li>• <b>Capture of innovative planning</b></li> </ul>	<p><b>1. Deductible cross-border payments:</b> Made between associated enterprises where:</p> <p>(a) recipient is not resident in any jurisdiction for tax purposes;  (b)(i) recipient is in a 0% or near 0% tax jurisdiction;  (b)(ii) recipient is in a tax jurisdiction considered to be blacklisted by the OECD;  (c) payment is tax exempt where the recipient is resident; or  (d) preferential tax treatment will be given to the recipient in that jurisdiction.</p> <p><b>2. Double depreciation:</b> Arrangement where deductions for the same depreciation on the asset are claimed in more than one jurisdiction.</p> <p><b>3. Double relief:</b> Arrangement where double tax relief may be sought in respect of the same item of income or capital in more than one jurisdiction.</p> <p><b>4. Difference in consideration:</b> Arrangement where there is a material difference in the amount treated as payable for an asset in different jurisdictions.</p>	<p>No</p> <p>Yes</p> <p>No</p> <p>Yes</p> <p>Yes</p> <p>No</p> <p>No</p> <p>No</p>

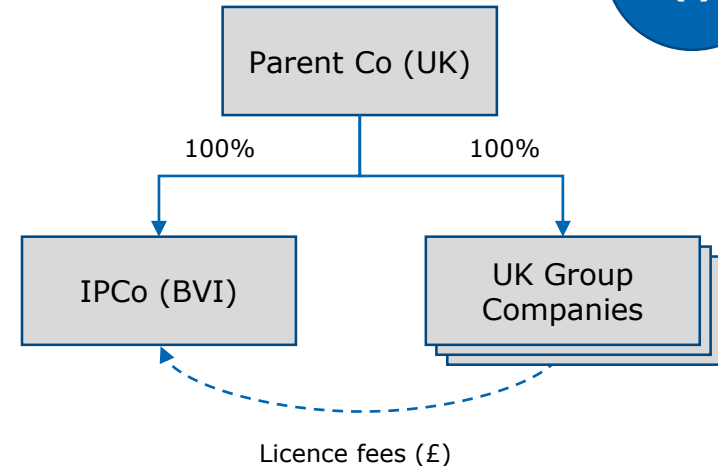
Category of arrangement	Description	Main benefit test applicable?
<p><b>D:</b> Specific hallmarks related to arrangements which circumvent tax reporting and transparency obligations</p>	<p><b>1. Reporting:</b> Arrangements which have the effect of undermining reporting obligations under agreements for the automatic exchange of information.</p>	No
	<p><b>2. Transparency:</b> Arrangements involving a non-transparent legal or beneficial chain with the use of structures that do not carry on a substantive economic activity.</p>	No
<p><b>E:</b> Specific hallmarks concerning arrangements which relate to transfer pricing</p>	<p><b>1. Safe harbour:</b> Arrangement that uses unilateral safe harbour rules.</p>	No
	<p><b>2. Intangibles:</b> Arrangement that involves the transfer of hard-to-value intangibles where the financial assumptions or projections used in valuation are highly uncertain.</p>	No
	<p><b>3. Cross-border transfers:</b> Arrangement that involves intragroup cross-border transfers of functions, risks or assets and the projected annual earnings during the three-year period after the transfer are less than 50% of the projected annual earnings had the transfer not been made.</p>	No

# Example of a potentially reportable arrangement

C.1(b)  
(i)

## Deductible cross-border payments

- Various UK group companies of Parent Co pay licence fees to IPCo which is located in BVI



## Points for consideration:

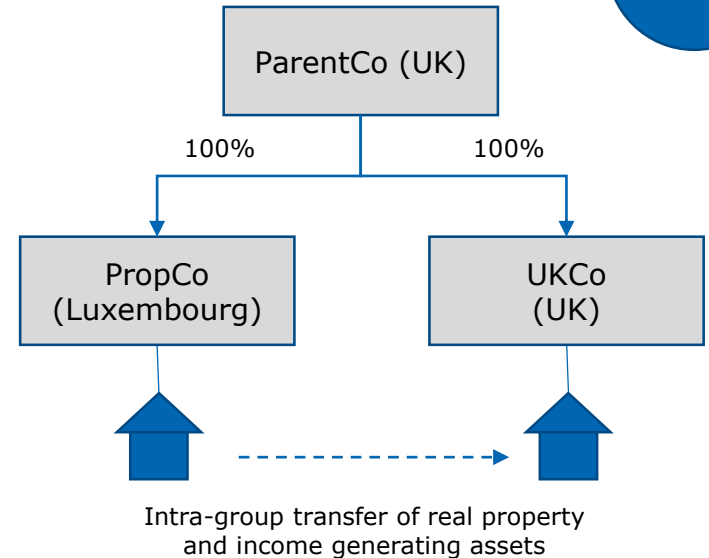
- **Hallmark C.1(b)(i)** – *recipient is in a 0% or near 0% tax jurisdiction*
- Consider whether **main benefit** test is met (i.e. is the main benefit or one of the main benefits of the arrangement the **obtaining of a tax advantage**)
- Query whether existing arrangements are caught or whether only “new” arrangements post-June 2018
- **Potentially reportable arrangement**

# Example of a potentially reportable arrangement

E.3

## Intra-group cross-border transfers

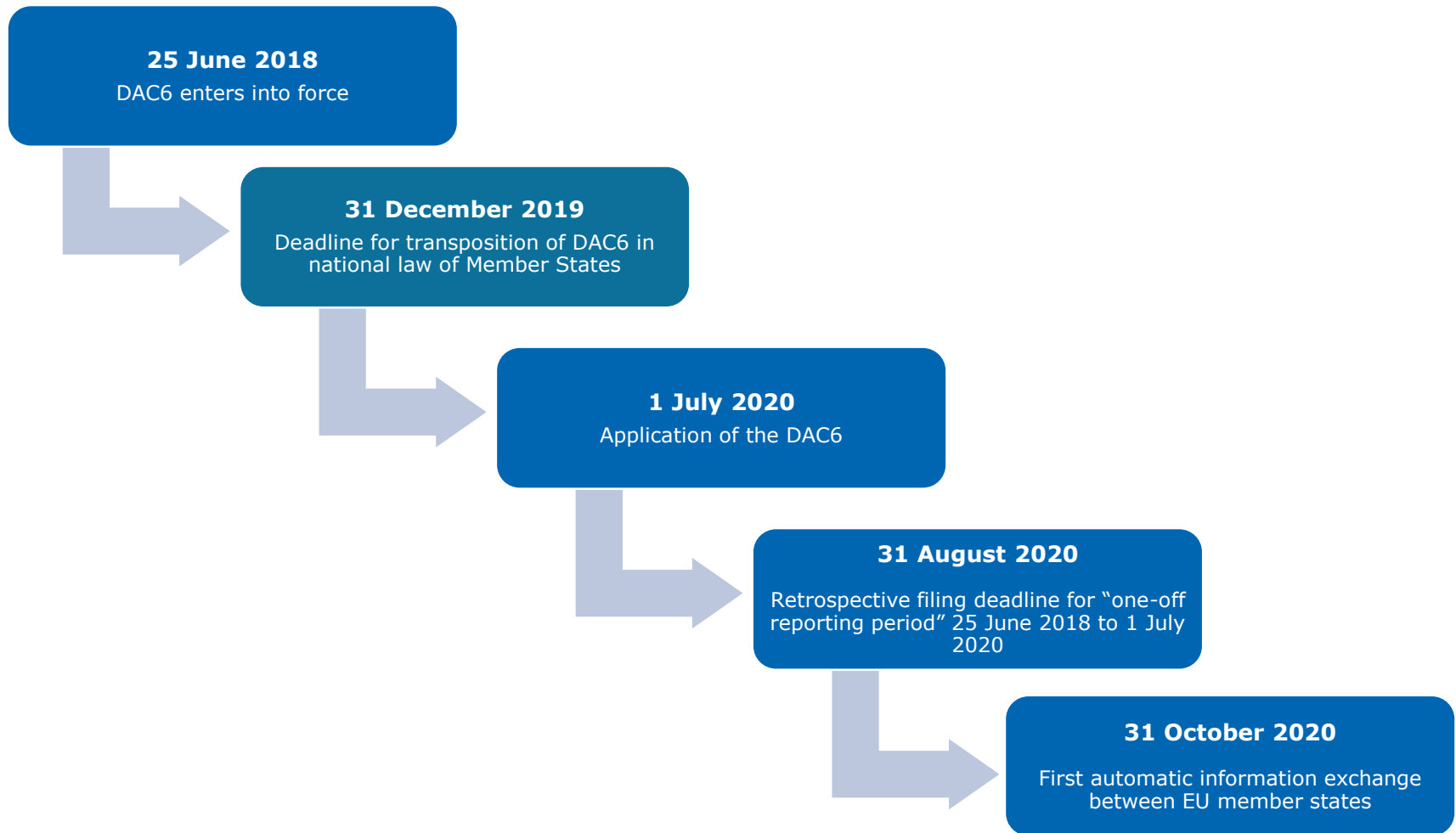
- UK parent company wants to transfer real property and income-generating assets between PropCo located in Luxembourg to UKCo located in the UK
- PropCo will be dissolved following the transfer
- Main benefit test not applicable to hallmark E.3



## Points for consideration:

- **Hallmark E.3** – intragroup cross-border transfer of assets where the projected annual EBIT of the transferor or transferors are less than 50% of the projected annual EBIT had the transfer not been made
- **Likely to be reportable even if more tax is payable following the transfer**
- Similar result could arise in relation to cross-border transfers effected due to **Brexit** and / or **NRCGT** onshoring

# Timeline



# Reportable transactions / Information exchange

## Automatic Exchange of Information

- Directive on Administrative Cooperation
- Tax information exchange
- Ruling and APA exchange
- Beneficial ownership registers

## Public CbyC Reporting

- Obligations on multinationals to public disclose tax paid in EU

## Tax strategy publication



# Tax certainty in the EU

## What do we mean by tax certainty?

- Consistent tax treatment of cross-border transactions
- Effective and efficient dispute resolution

## How is tax certainty achieved within EU?

- Advanced pricing agreements
- Mutual Agreement Procedures (MAP)
- Arbitration

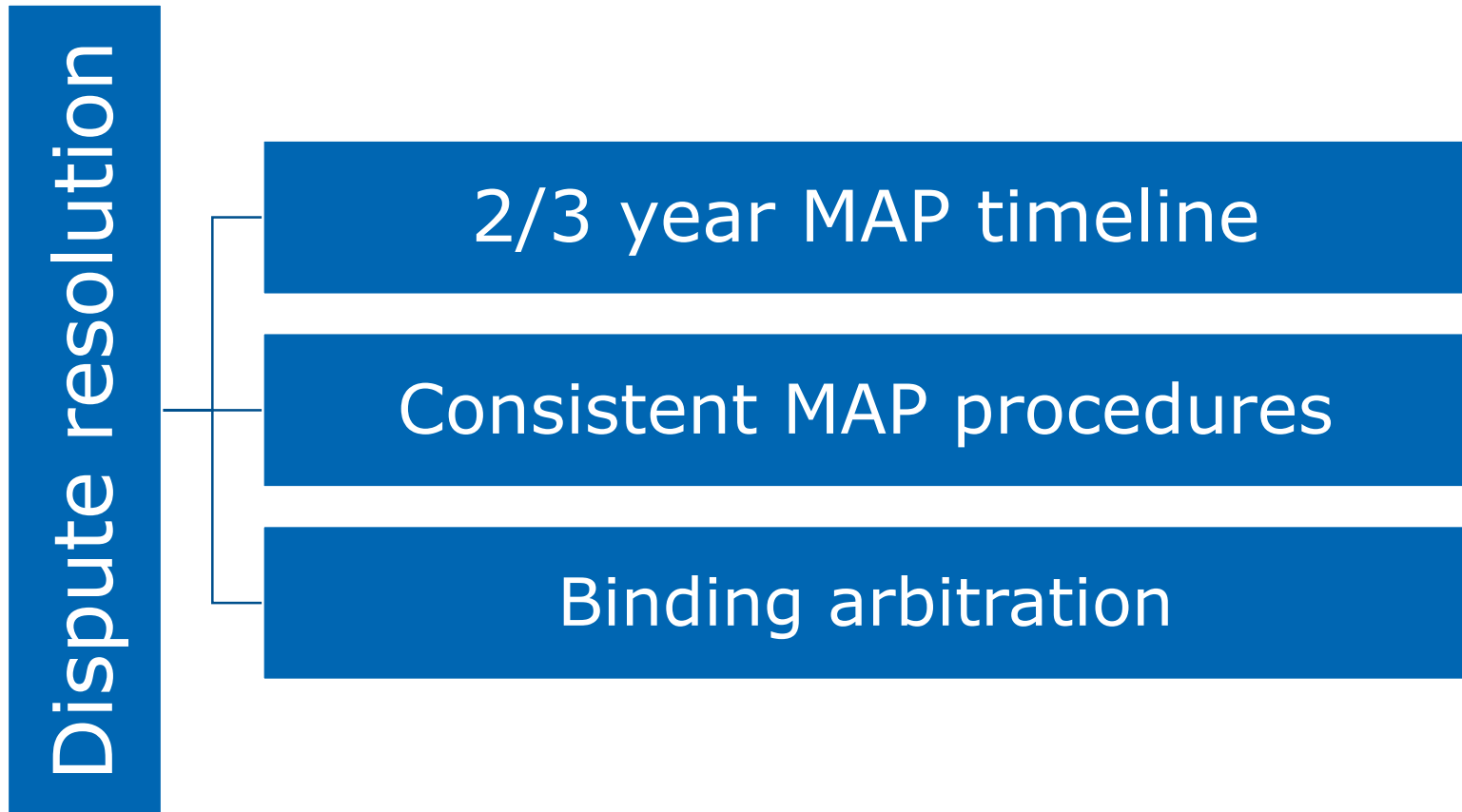
## What are the challenges with tax certainty?

- Inconsistent APA/MAP approaches
- Limited definitive dispute resolution procedures
- Increasingly complex international tax landscape
- Increased information sharing between tax authorities / joint audits

## Recent developments with tax certainty in the EU

- BEPS Action 14
- EC directive on dispute resolution

## EC Directive on dispute resolution – key features



## State aid – A brief introduction

- What are the EU State aid rules all about?
- Who decides whether State aid is legal?
- What are the key procedural requirements?
- What if State aid has been granted in breach of EU law requirements?

## State aid – A brief introduction

EU State aid rules generally prohibit State aid:

- Granted through **State resources** in any form
- Confers a **selective advantage** on **undertaking(s)**
- Can **distort competition**
- **Affects trade** between EU Member States

## Tax investigations - the wider context

*"In the current context of tight public budgets, it is particularly important that **large multinationals pay their fair share of taxes**. Under the EU's state aid rules, national authorities cannot take measures allowing certain companies to pay less tax than they should if the tax rules of the Member State were applied in a fair and non-discriminatory way."*

(Joaquín Almunia, Commission Vice President in charge of competition policy at the time, June 2014)

*"Fair tax competition is essential for the integrity of the Single Market, for the fiscal sustainability of our Member States, and for a level-playing field between our businesses. Our social and economic model relies on it, **so we must do all we can to defend it**."*

(Algirdas Šemeta, Commissioner for Taxation at the time, June 2014)

## Tax investigations - the wider context

*"The Commission is looking at the **compliance with EU state aid rules of certain tax practices in some Member States in the context of aggressive tax planning by multinationals**, with a view to ensure a level playing field. A number of multinational companies are using tax planning strategies to reduce their global tax burden, by **taking advantage of the technicalities of tax systems**, and substantially reducing their tax liabilities. This aggressive tax planning practice erodes the tax bases of Member States, which are already financially constrained"*

Commission press release, June 2014

## Tax investigations - the wider context

- On what basis can tax arrangements constitute State aid?
- Where it involves the State **foregoing income** which it otherwise would have had, as a result of applying (or dis-applying) a tax measure to certain type of companies only (i.e. **selectively**)
- For example, through **selective tax rulings**.

# Tax rulings

- What are tax rulings?
- Why are tax rulings being targeted?
- “perfectly legal” and acceptable **UNLESS** results in lower taxation than for other similar entities in similar circumstances
- Selective treatment



# Why tax rulings?

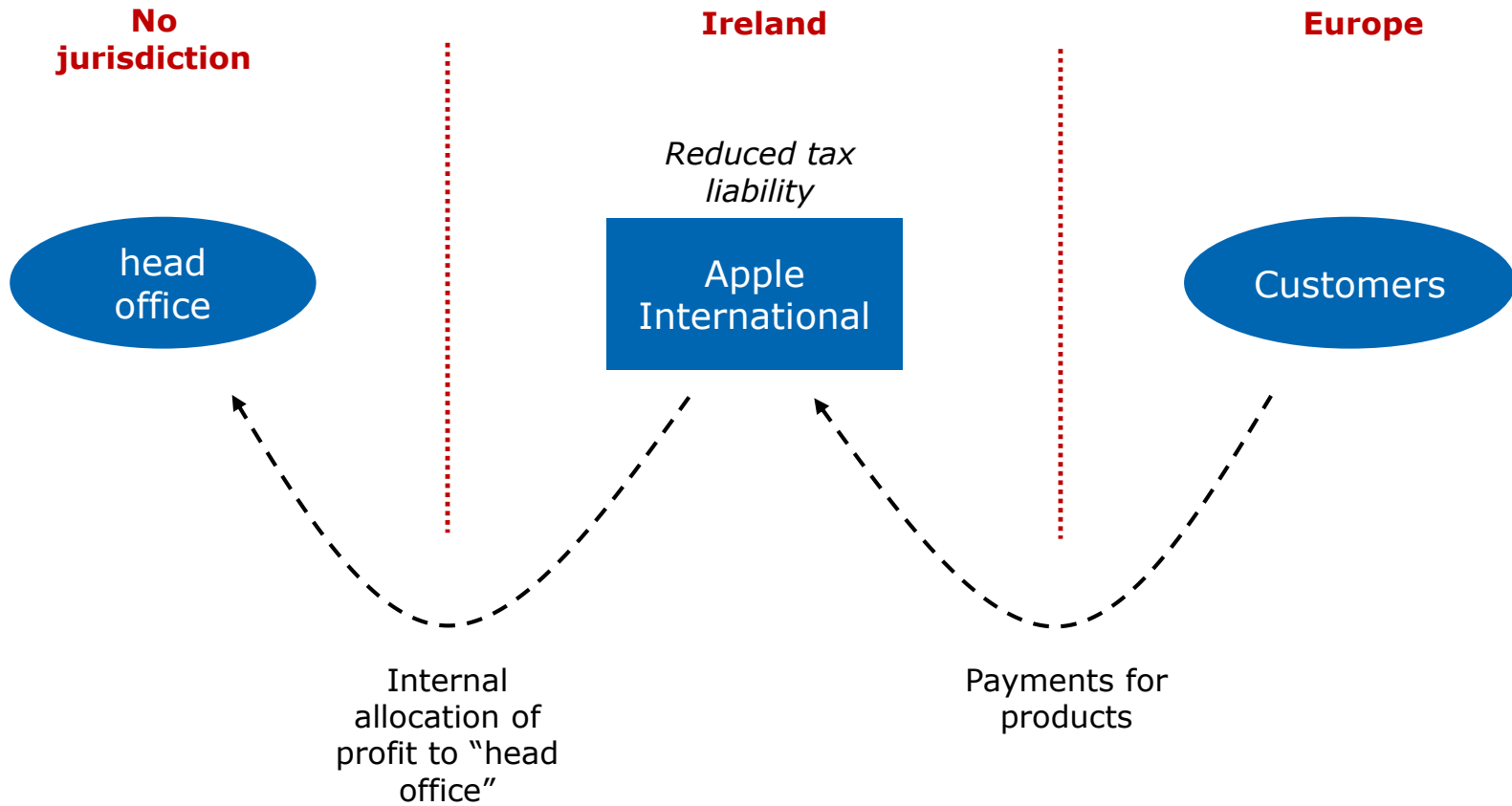
## — Examples:

- significant **discretion** exercised by tax authority
- ruling **not available** to similar entities
- “**favourable**” discretionary tax treatment
- **contradicts** applicable tax treatment

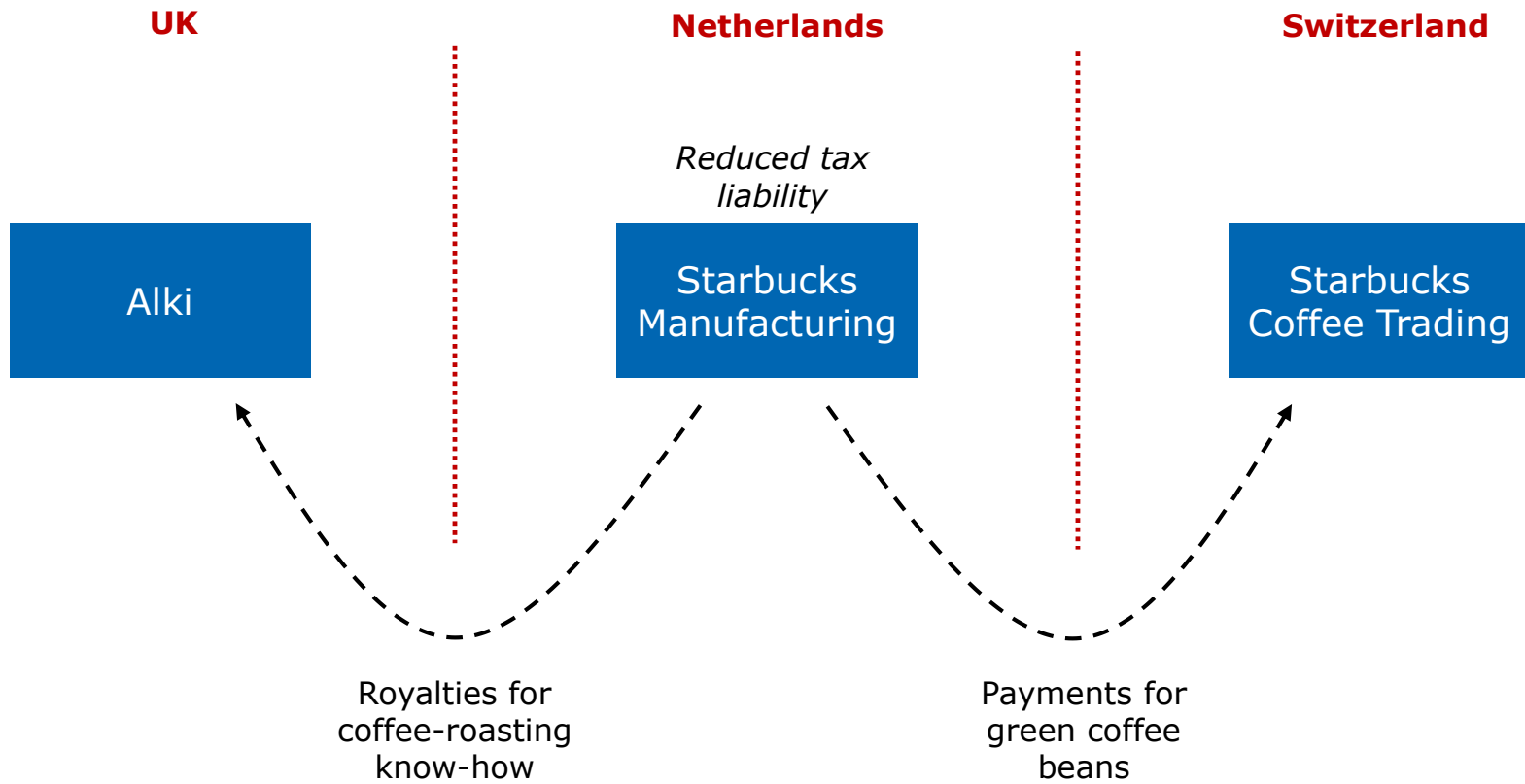
# Targeting transfer pricing rulings

- Investigations have **initially** targeted transfer pricing rulings
  - Starbucks
  - Fiat
  - Amazon
  - Apple
- “arm’s length principle **under EU state aid rules**”

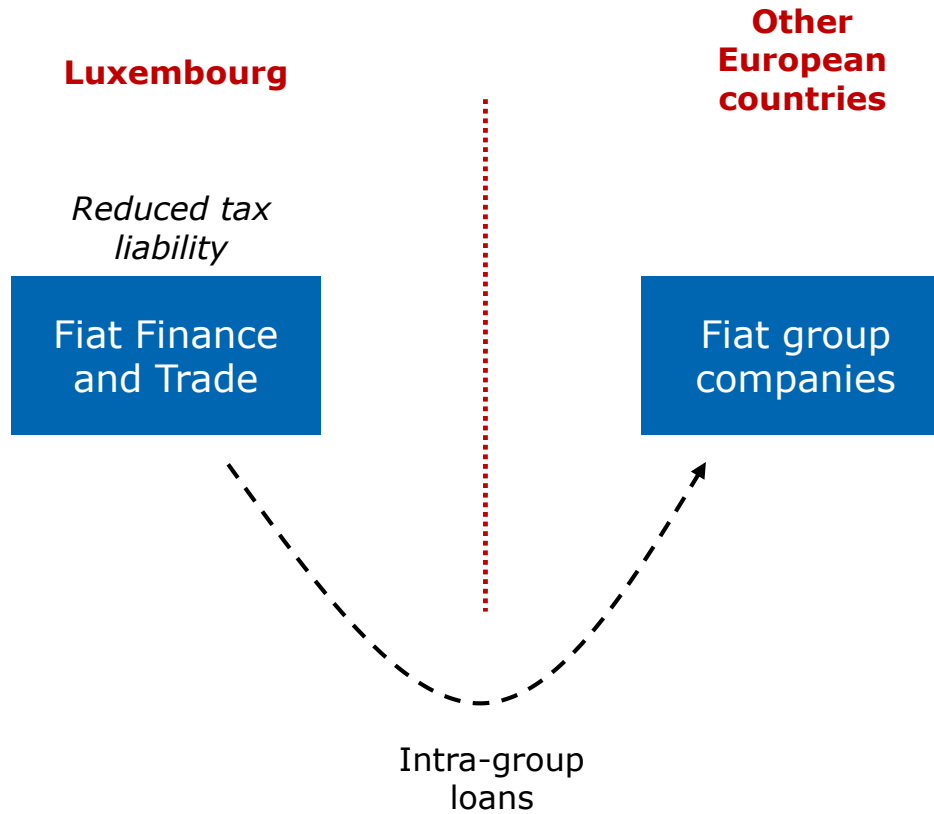
# Apple



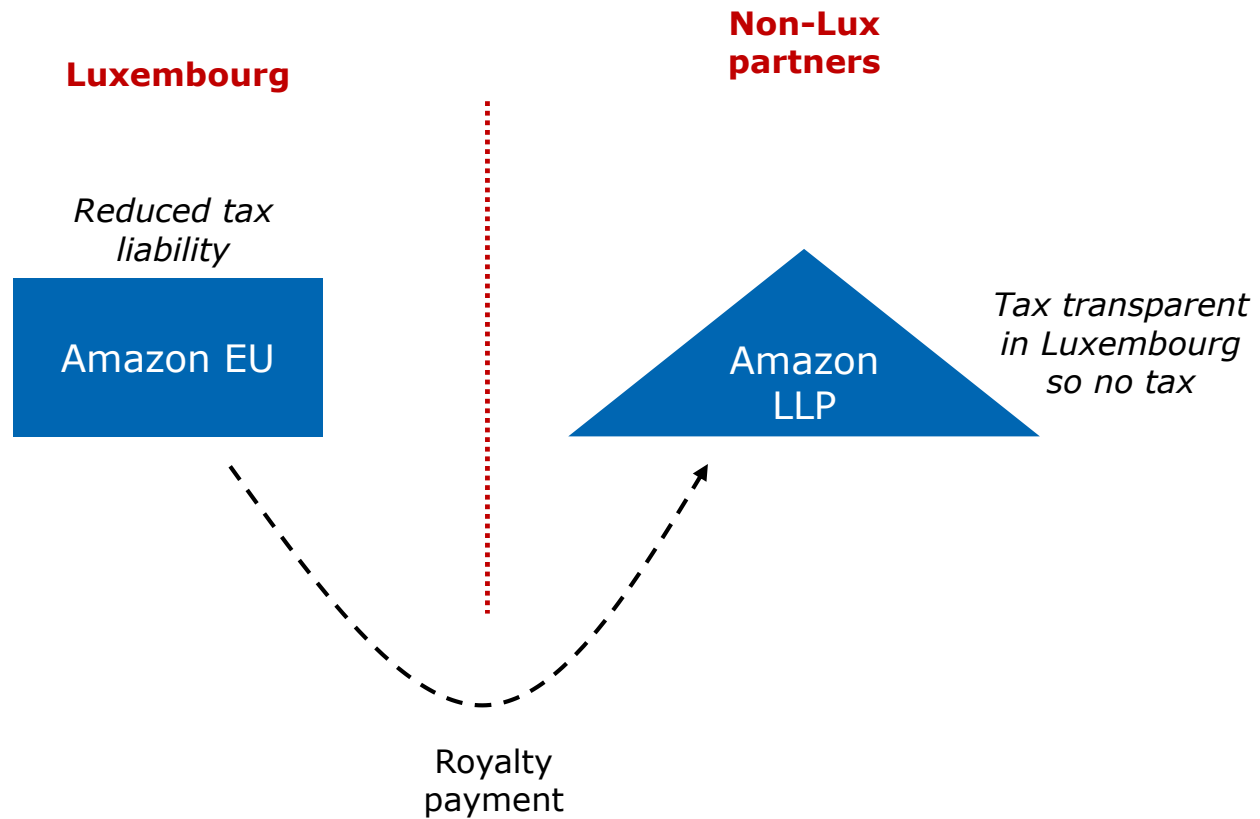
# Starbucks



# Fiat



# Amazon



# Widening investigations

- Scope of investigations now **widening**:
  - Belgian excess profit regime
  - Engie (GDF Suez)
  - UK CFC rules
  - MacDonald's
- Targeting:
  - **entire domestic regime** administered through rulings
  - rulings on **application of double tax treaties**

# Defences

- Are these investigations **justifiable** and what are the **defences**?
  - Selectivity not proven – no comparable circumstances
  - No EU arm's length principle
  - No proof of advantage
  - Legal certainty



# Takeaways



# Questions?



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