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INSIGHTS

SWISS CORPORATE TAX REFORM: T.R.A.F. IN A NUTSHELL

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AND MORE

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EDITORS' NOTE

In uncertain times, *Insights* soldiers on, providing you the tax guidance you need to meet your long-term goals. This month's edition addresses the following topics:

- **Swiss Corporate Tax Reform: T.R.A.F. in a Nutshell.** As a result of a favorable vote last year, T.R.A.F. – the tax reform in Switzerland – came into effect on January 1, 2020. T.R.A.F. was crafted to generate additional revenue for cantons, enhance old age pensions and survivors insurance funding, and reform corporate tax rules. Peter von Berg of Blum&Grob Attorneys at Law in Zurich, Switzerland, identifies the major changes for companies and individuals and provides examples of the effects on various entities.

- **The Netherlands Introduces Compensation Regulation to Discourage "Dormant Employment."** For U.S. tax advisers not versed in Dutch labor law, the world of employee rights and employer obligations is a thing to behold. To illustrate, in 2015, the Dutch parliament enacted a law under which an employee in the Netherlands having spent 104 weeks on paid sick leave is entitled to a transition payment if the employment contract was terminated by the employer. However, many employers attempted to avoid the payment by retaining these employees under "dormant contracts," where the contract remained in force but there was no position available and no pay. New legislation effective April 1, 2020, breaks the deadlock. The transition fee remains in effect, but all or most of the payment is funded on a deferred basis by the Dutch government. Rachida el Johari and Madeleine Molster of Saguire Legal, Amsterdam, the Netherlands, explain how the Compensation Regulation works and propose a winning strategy for employers.

- **The Multilateral Instrument and Its Applicability in India.** One of the most significant outcomes of the B.E.P.S. Project is the signing of the multilateral instrument ("M.L.I.") in 2017. The O.E.C.D. initiated the B.E.P.S. Project in 2013 with a view to curtail tax avoidance. The M.L.I. addresses B.E.P.S. concerns in thousands of bilateral tax treaties through one common treaty. India has been at the forefront of implementing B.E.P.S. measures, and India's covered tax treaties will need to be read with the M.L.I. from April 1, 2020. Sakate Khaitan of Khaitan Legal Associates, Mumbai, India, and Abbas Jaorawala, a chartered accountant and consultant to that firm, explain India's positions on various provisions of the M.L.I. for those engaged in trade or investment opportunities relating to India.

- **Foreign Tokens – U.S. Tax Characterization: Questions and Discussion.** Initial coin offerings ("I.C.O.'s") provide blockchain-based companies with a new way to raise capital. Companies in the U.S. and abroad have been raising capital using blockchain technology since 2016. As this means of raising funds gained popularity, the S.E.C. ruled that some tokens are securities, making U.S. I.C.O.'s subject to Federal securities laws. Tax questions also arose, but not all questions have been addressed by the I.R.S. Specifically, no guidance exists with respect to the proper characterization of a token, and as a result, U.S. investors are not assured of the tax consequences of their investments. Galia Antebi and Andreas A. Apostolides walk through the issues, identify the problems, and suggest solutions where appropriate.

- **O.E.C.D. to Use Hybrid Model to Develop Digital Economy Nexus and Profit Attribution Rules.** The O.E.C.D. announced on January 31, 2020, that its policy development efforts under Pillar One, related to the taxation of the digital economy, will move forward using the non-consensus "Unified Approach" as a working model. The O.E.C.D.'s deadline for obtaining a consensus outcome is highly ambitious. Michael Peggs provides his views. Despite what people may think about when this effort should have begun, it is crucially important that it has begun at last and in an organized way.

- **Variety is the Spice of Life: Alternate Tax Structures for a U.S. Individual Disposing of Foreign Real Property.** When U.S. individuals acquire personal use real property or fallow land located abroad, the property often is owned by a corporation. Typically, that decision is driven by local considerations, of one kind or another. However, corporate ownership poses income tax issues in the U.S. at the time the property or the shares are sold. Neha Rastogi, Nina Krauthamer, and Stanley C. Ruchelman explore various ways by which a sale can be effected and the U.S. tax considerations that result. The answers may not be what the client expects to hear, especially if the sale transaction is cast as a sale of real property by a foreign corporation.

- **Transfer of Business Contracts – I.R.S. Disagrees with Greenteam, No Capital Gains Without a Fight.** In an Action on Decision ("A.O.D.") published in late 2019, the I.R.S. announced its nonacquiescence to the Tax Court's decision in *Greenteam Materials Recovery Facility v. Commr*. The case involved Code §1253, the provision that standardizes rules under which payments that are incident to the transfer of a franchise, trademark, or trade name may or may not be properly treated as capital gains. The case was decided in the taxpayer's favor because the taxpayer's agreement avoided all the terms that would otherwise cause the sales proceeds to be characterized as ordinary income. However, the nonacquiescence means that the I.R.S. will not follow the holding in cases appealable in Circuit Courts of Appeals other than the 9th Circuit. Lisa Marie Singh and Stanley C. Ruchelman discuss the case and the nonacquiescence, cautioning that a franchise contract that cannot appreciate over time because the payments are fixed in amount or in scope of service is not an appreciating asset in the eyes of the I.R.S.

- **J-5 Step Up Anti-Money Laundering in 2020, Sights Set on Central America.** The Joint Chiefs of Global Tax Enforcement, known as the J-5, is a coordinated team of crime-fighting tax authorities from the U.K., the U.S., Canada, Australia, and the Netherlands. Formed in 2018, the mandate of the J-5 is to stop the facilitation of offshore tax evasion and money laundering. In January, the J-5 conducted coordinated action regarding a Central American financial institution believed to be involved in money laundering and tax evasion on a global basis. Denisse Lopez reports.

This is the last edition edited under the guidance of Jennifer Lapper, the Director of Marketing and Special Events at Ruchelman P.L.L.C. After seven years, Jennifer has accepted a position with a multi-city firm as part of its marketing team. We wish her all the best in her new digs.

We hope you enjoy this issue.

- The Editors

SWISS CORPORATE TAX REFORM: T.R.A.F. IN A NUTSHELL

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INTRODUCTION

It has taken a while for the Swiss corporate tax reform to be adopted. As outlined in our previous articles, Swiss voters defeated the initial tax reform package by a majority of almost 60-40 in 2017.[1] In the aftermath of the defeat, a steering committee representing the cantons and the Swiss Federation issued Tax Proposal 17, recommending a modified version of corporate tax reform.[2] An analysis showed that important reasons for the defeat of the initial proposal were an adverse view of reform that was held by many and cantonal concerns over a loss of tax revenue.

More than one year later, on September 28, 2018, the Swiss parliament approved the amended bill, which was renamed the Federal Law on Tax Reform and Old-Age and Survivors' Insurance Financing ("Tax Reform and A.H.V. Financing" or "T.R.A.F."). As the modified name indicates, the law was newly linked to old-age and survivors' insurance ("A.H.V.").

T.R.A.F. was crafted to generate additional revenue for the cantons, enhance A.H.V. pensions, and reform corporate tax rules. As a result, the modified bill was approved by a large majority of Swiss voters, who went to the polls on May 19, 2019. The tax reform and A.H.V. financing provisions came into force on January 1, 2020.

T.R.A.F. IN A NUTSHELL

The final law follows the initial reform package. The existing tax regimes for companies, such as holding companies and mixed companies have been abolished, as they no longer are in line with international standards. No changes have been made to (i) the new cantonal and municipal patent box regimes based on the O.E.C.D. nexus approach, (ii) the additional deduction for research and development ("R&D") costs, and (iii) the step-up mechanism.

The following tables provide an overview of all measures adopted in T.R.A.F.

Measures Affecting Companies

Measure	T.R.A.F. Provision
Abolishment of Tax Regimes	At a cantonal level, tax regimes enabled certain Swiss companies, such as holding companies, to pay little or no corporate income tax. These tax privileges are abolished subject to a phase-in provision.

1 "Swiss Corporate Tax Reform Postponed," *Insights* 4, no. 2 (2017).

2 "New Proposal for Swiss Corporate Tax Reform," *Insights* 4, no. 4 (2017).

Measure	T.R.A.F. Provision
Patent Box	The profits from patents and comparable rights are separated from other profits and are taxed at a lower rate. Each canton has discretion to determine the extent of the minimum base to be taxed. As an example, the tax base in Zurich is 10%, which is the minimum permitted by Federal law.
Additional Deductions for R&D	Additional deductions of up to 50% may be claimed for R&D expenditures. Each canton has discretion to determine whether it will adopt the provision and, if so, the percentage increase for the additional deduction. As an example, the increased rate to expenditures in Zurich is 50%.
Notional Interest Deduction ("N.I.D.")	The cantons may allow an interest deduction on equity where the effective Federal, cantonal, and municipal income tax burden in the cantonal capital is at least 18.03%. At this time, the N.I.D. will be applicable only in the canton of Zurich, which is the only canton having a rate in excess of the threshold.
Limitation of the Aggregate Relief	The aggregate tax relief resulting from the patent box, the additional deductions for R&D, and the N.I.D. cannot exceed 70% of income prior to these deductions. Several cantons have introduced lower ceilings on the aggregated relief, among them Basel, where the ceiling is 40% of income prior to these deductions.
Adjustments to Capital Tax	All cantons levy capital tax on the equity of resident companies. The cantons may introduce a reduced tax rate on equity attributable to participations, patents, comparable rights, and intercompany loans.
Step-Up Mechanism	Companies that relocate their headquarters to Switzerland can benefit from a step-up in the base used to compute depreciation.
Extension of the Lump-Sum Tax Credit	The lump-sum tax credit prevents international double taxation. It allows a Swiss-resident company to claim a credit for foreign taxes under certain conditions, such as a receipt of dividends. Now, this credit may be claimed by a Swiss permanent establishment of a foreign company.

Measures Affecting Shareholders with Domicile in Switzerland

Measure	T.R.A.F. Provision
Partial Taxation of Dividends	Shareholders resident in Switzerland holding a participation of at least 10% of the capital of a company may profit from a special partial taxation of dividends received from such company. In other words, only 60% of a divided is taxed at the Federal level and at least 50% of is taxed at the cantonal and municipal levels.

Measure	T.R.A.F. Provision
Restrictions on Tax-Free Repayment of Capital Contribution	The principle that paid-in capital and capital reserves may be paid back to the local or foreign shareholder without any tax consequences was introduced to Swiss tax law in 2011. Swiss companies were free to decide whether a payment to a shareholder would be a dividend distribution or a repayment of such reserves. The reform restricts tax-free repayments of capital contributions for Swiss listed companies, as these companies will have to match every capital repayment with an equal dividend. This will ensure that some extent of dividends is taxed for income tax purposes. The new rule does not affect non-listed companies.
Capital Gains Tax	In general, no capital gains tax is levied on the sale of shares by an individual resident in Switzerland. Among other exemptions, the new law includes a stricter practice on capital gains tax when the shares are sold to a company controlled by the shareholder.

Fiscal Policy Measures

Measure	T.R.A.F. Provision
Cantonal Share of Direct Federal Tax	The cantons' share of direct Federal tax revenue will be increased from 17% to 21.2%, limiting the cantons' risk of a loss of tax revenues.
Municipality Clause	The cantons will compensate the municipalities for the financial effects of tax reductions at the cantonal level.
Adjustments in Financial Equalization Between Cantons	The fiscal equalization aims to mitigate cantonal differences regarding financial capacity. When calculating financial equalization between the cantons, the profits of companies having certain status are now to be given lesser weight than other profits.
A.H.V.	As originally proposed, the corporate tax reform favored Swiss corporations to the exclusion of individuals. This gave rise to an apprehension that individuals would face a tax increase in order to make up for a shortfall in tax revenue, which led to its defeat at the polls. To make T.R.A.F. attractive to voters, it includes additional financing for the Swiss social security system. Starting in 2020, an additional C.H.F. 2 billion per year will be paid into the A.H.V. system, of which approximately C.H.F. 800 million will be funded by the Swiss Confederation. Employers and employees will contribute another C.H.F. 1.2 billion.

EFFECT ON COMPANIES

The following two examples illustrate the ways companies are affected by T.R.A.F.

Example 1: Swiss Holding Company

A Swiss corporation has its registered seat in Zurich. As the corporation met the cantonal requirements for the holding company privilege, it was exempt from corporate income tax on a cantonal and municipal level until the end of 2019. With the implementation of the tax reform, the holding privilege has been abolished at the cantonal and municipal levels. The corporation will become subject to ordinary corporate income taxes. It is allowed to claim the benefit of the participation deduction as currently applicable for Federal taxes.

The company's assets consist mainly of 10% or greater participations and some cash and securities. At the end of 2019, various securities are accounted at acquisition cost, although the fair market value was higher as a result of unrealized capital gains.

Provisional Balance Sheet 2019			
Assets		**Liabilities and Equity**	
Cash	$100	Liabilities	$100
Securities*	$1,000	Loans	$3,000
Participations	$3,000	Equity	$1,000
Total	$4,100	*Total*	$4,100
* Market value $3,000 (unrealized capital gain = $2,000)			

According to Swiss accounting rules, a company may choose to account for securities at acquisition or fair market value. If fair market value is used, all securities must be accounted for at fair market value in one entry in the balance sheet. Reference must be made in the notes to the accounts.

As the holding privilege is still applicable in 2019, the company may choose to increase the value of the securities from acquisition to fair market value, resulting in a realized gain.

Final Balance Sheet 2019			
Assets		**Liabilities and Equity**	
Cash	$100	Liabilities	$100
Securities	$3,000	Loans	$3,000
Participations	$3,000	Equity	$1,000
		Income 2019	$2,000
Total	$6,100	*Total*	$6,100

> ***"A Swiss company may reduce its tax burden significantly if unrealized gains are included in the balance sheet for 2019."***

On the level of cantonal and municipal tax, the company may apply the holding privilege in the year 2019. Consequently, the realized gain of $2,000 is not taxed. However, beginning with the financial year 2020, the book values that were reported at the end of 2019 will be recognized for tax purposes.

The company will report taxable income including the realized gain of $2,000 for direct Federal taxes in 2019, and tax will be paid.

In summary, a Swiss company may reduce its tax burden significantly if unrealized gains are included in the balance sheet for 2019. From 2020 on, realized gains will be fully taxed on all three levels. See simplified example as follows, effective tax rate included.

	2019	2020
Direct Federal Tax	7.8%	7.8%
Cantonal/Municipal Tax*	0.0%	13.5%
Aggregated Tax Burden	7.8%	21.3%
Profit on Securities	$2,000	$2000
Profit Tax	$156	$426

* The canton of Zurich will reduce its tax rate in 2021 slightly (aggregate tax rate as of 2021 will be approximately 20%).

With regard to the participations (shareholdings of >10%), there is – in general – no need for a revaluation. Income arising from such participations will be subject to the participation relief, as currently applied for Federal taxes, also on the cantonal and municipal levels.

The participation exemption is a percentage deduction from corporate income tax that is equal to net participation income (gross participation income from qualifying dividends and capital gains, less related administration and financing costs) divided by taxable income. In most cases, the participation relief results in a full exemption from corporate income tax for all or most of the participation income. The participation relief applies to dividends and capital gains. No significant tax consequences should be applicable. If participations have been depreciated in the past, it must be determined whether a step-up is possible.

In summary, Swiss holding companies should analyze their assets for unrealized gains and may decide to realize them in the final 2019 financial accounts. If so, they should act immediately since the transition must be addressed with the competent tax authorities (*i.e.*, via ruling request) and/or should be included in the final balance sheet and profit and loss statement for 2019.

Finally, since tax rates vary from canton to canton, management may wish to relocate the headquarters location and functions to a more tax-favorable canton such as Zug, where the aggregate effective tax rate is approximately 12%.

Example 2: Swiss Industrial Company

A Swiss corporation has its registered office in Zurich. Until the end of 2019, the company paid ordinary corporate income taxes at the cantonal and municipal levels. The company invents industrial products in R&D centers that are located principally in Europe (outside Switzerland) and the U.S. Consequently, the operation in Switzerland has been limited to distribution activities.

The company explores whether it can benefit from T.R.A.F. It identifies that new product A will be fully developed in Switzerland and that new product B could be developed in Switzerland. If so, the Swiss contributions to R&D is expected to be 52.5%.

Additional Deductions for R&D

One of the measures provided by T.R.A.F. is the allowance of an additional deduction for R&D performed in Switzerland. The cantons may allow a deduction for up to 50% of the R&D expenses incurred by the taxpayer directly or indirectly through third parties in Switzerland. The additional deduction is allowed on the directly attributable personnel expenses for R&D plus a surcharge of 35% as well as 80% of expenses for R&D invoiced by third parties.

In our example, the canton of Zurich introduced the additional deduction for R&D. Therefore, the company may apply this additional deduction to reduce taxable income. If the company had its research facility in Basel-Stadt, it could not claim the deduction, as Basel-Stadt has not introduced the additional deduction. Again, consideration should be given to a move of headquarters and functions from Basel-Stadt.

Patent Box

Another measure of T.R.A.F. to be considered is the introduction of a patent box tax regime. Philosophically, R&D is a tax benefit that is realized at the time expenditures are made whereas the patent box regime provides benefits at a later point in time when revenue is realized. It is inappropriate to claim both benefits. Consequently, when adopting the patent box tax regime, the benefit of R&D expenses that have been deducted must be recaptured. Consequently, a corporation must analyze whether it is worthwhile to switch to the patent box regime. In our example, this question is irrelevant, as no R&D has been carried out in Switzerland in the past.

In making an analysis, the first step is to identify the patents that generate income qualifying for the patent box regime. Covered patents include

- patents registered under the European Patent Convention,
- patents registered under the Swiss Patent Act, and
- foreign patents corresponding to European or Swiss patents.

Intellectual property such as trademarks or know-how are not included for the patent box calculation.

When computing the benefit under the patent box regime, profits from intellectual property must be adjusted using the modified nexus approach. Under this approach, the expenditures for qualifying R&D performed in Switzerland is divided by total R&D expenditures. The resulting percentage is applied to the net income from patents to determine the portion that qualifies for the benefit.

In our above-mentioned very simplified example, the company has a 100% nexus for product A and a 52.5% nexus for product B. Therefore, future profits from such patents should benefit from the patent box mechanism. Note that the computations required to be made under the patent box regime are quite complex, including analysis of functions, relations to products, and proper use of transfer pricing concepts to identify the enhanced return attributable to the application of the patented technology in the manufacture of the product.

Step-Up in Basis

Where moving a foreign company's seat to Switzerland or transferring certain business operations or functions to Switzerland is feasible, the availability of a tax neutral step-up in the depreciable basis of transferred assets should be analyzed. Under the new rules, a tax-neutral realization of unrealized capital gains or other hidden reserves is possible as a result of the transfer. Again, tax rates vary from canton to canton. Consequently, identification of the most tax-favorable canton is important.

"Companies having no operation or location in Switzerland may consider building R&D centers in Switzerland to profit from the advantageous tax and business environment."

OUTLOOK

With the approval of T.R.A.F. by Swiss voters, a tax system based on internationally acceptable measures came into force effective January 1, 2020. Switzerland remains an interesting tax location for individuals and companies looking to expand operations to Europe.

For companies already conducting operations in Switzerland, T.R.A.F. rewards those companies that are located in cantons with favorable tax rules. Important tax benefits may be lost for those companies that are unwilling to undergo the proper study. Companies having no operation or location in Switzerland may consider building R&D centers in Switzerland to profit from the advantageous tax and business environment, including the patent box regime illustrated in Example 2 above.

Having implemented T.R.A.F. does not mean that all tax can be eliminated through operations within a tax favored jurisdiction. Additional global reforms are under consideration by the O.E.C.D. At the end of 2019, the O.E.C.D. published a proposal to ensure that large and highly profitable multinational companies, especially I.T. companies, must pay a minimum level of tax. The proposal is currently under review and is expected to be finalized by the close of 2020.[3] Adopting a market-based approach to tax jurisdiction, the O.E.C.D. proposes that part of the profits should be taxable in jurisdictions with significant consumer-facing activities and where profits are generated. The upcoming discussions of the O.E.C.D. proposal will be interesting, as European companies may face increased taxation abroad by reason of the proposals.

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3 See "Statement by the O.E.C.D./G-20 Inclusive Framework on B.E.P.S. on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy," as approved by the O.E.C.D./G-20 Inclusive Framework on B.E.P.S. on January 29-30, 2020.

THE NETHERLANDS INTRODUCES COMPENSATION REGULATION TO DISCOURAGE "DORMANT EMPLOYMENT"

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INTRODUCTION

Companies that employ staff in the Netherlands have a statutory obligation to continue salary payments when employees are absent on sick leave. Paid sick leave can extend up to 104 weeks, a full two years. During the entire period, the employer and employee are required to meet reintegration obligations designed to plan for the employee's return to work. If the employer fails to observe the statutory reintegration obligations the paid sick-leave period can be extended by an additional 52 weeks.

After 104 weeks, the employer may request permission from the Employee Insurance Agency ("U.W.V.") to terminate the employment contract. If instead the employer does not opt for termination of the employment contract and has observed its reintegration obligations, after the end of the 104th week, the employee is no longer entitled to salary payments for the remainder of the sick leave. Because the employment contract remains valid, the post-payment period is generally referred to as "dormant employment."

With the overhaul of dismissal laws in 2015, the Netherlands introduced a statutory transition fee due upon termination of an employment contract in certain circumstances. The transition fee offers financial compensation for the loss of a job and promotes employability. It enables the transition from one employment arrangement to another. The transition fee is essentially a form of legally mandated severance in a case of forced dismissal. When the employer opts for termination after 104 weeks of sick leave, it is deemed a forced dismissal and the employee is entitled to the transition fee.

The transition fee is not payable if the employee resigns or if the parties come to a mutual agreement on the termination of the employment contract. Under an exception applicable to older employees, the transition fee is also not payable if the employee has reached the state pension age. Since its implementation in 2015, many employers keep employment contracts dormant to circumvent the obligation to pay the transition fee.

This article will address recent changes to the rules that control the payment of transition fees intended to break the stalemate in the employment situation that has arisen from dormant contracts:

- The Dutch parliament has enacted legislation, known as the "Compensation Regulation," that offers employers the opportunity of being reimbursed by the Dutch government for a transition fee paid in relation to a dismissal of an employee for reason of continued sick-leave after 104 weeks. This regulation is effective as of April 1, 2020. The regulation has retroactive effect and will cover terminations due to long-term sick leave and corresponding paid transition fees from July 1, 2015, onwards. This is discussed in greater detail below, under **The Compensation Regulation**.

- In addition, the Supreme Court of the Netherlands recently ruled that the practice of dormant employments must come to an end. If the employee wants a termination of a contract after 104 weeks of sickness – viewed under prior law as a voluntary termination instead of a unilateral forced termination – the employer has the obligation to terminate the employment contract and pay the transition fee, making the termination involuntary.

The termination fee, employer compensation mechanism, and relevant court cases are discussed in detail below.

CALCULATING THE STATUTORY TRANSITION FEE

July 2015 – December 31, 2019

With the introduction of the transition fee effective July 1, 2015, the calculation was as follows. Note, the transition fee is calculated as of the formal termination date of the employment contract (*i.e.*, years of employment includes sick leave).

Years of Employment	Remuneration for Every Six Months
0-10 years	1/6 monthly gross salary
10+ years	1/4 monthly gross salary

A more generous calculation applied to employees age 50 or older with at least ten years of service:

Years of Employment if Age 50+	Remuneration for Every Six Months
0-10 years	1/6 monthly gross salary
10+ years	1/2 monthly gross salary

The transition fee was capped at (i) €75,000 gross (for 2015) or (ii) one year's salary if the employee earned more than €75,000 gross per year.

January 1, 2020 and Beyond

Effective January 1, 2020, Dutch labor legislation underwent yet another set of significant changes with the implementation of the so-called Labor Market in Balance Act (*Wet Arbeidsmarkt in Balans*). This act implements various changes, including changes to the calculation of the transition fee.

The law now stipulates that the amount of the transition fee is as follows:

> The transition fee is equal to one third of the monthly wage for each calendar year that the employment contract lasted and a proportional

part thereof for a period that the employment contract has lasted for less than a calendar year. Further rules concerning the method of calculating the transition fee may be laid down in a separate order.

The simplest way to calculate the transition fee is in two steps: by month and by day. Take the following example:

An employee worked at a company for nine years and five days. The gross monthly salary was €3,000 on the basis of a 40-hour work week and an hourly wage of €20. How much is the transition fee?		
Step 1:	Calculate the transition fee for the full nine years of service	9 x (1/3 x €3,000) = €9,000
Step 2:	Calculate the transition fee for the five days	40 x €20 = €800 (800/3000) x ((1/3 x 3000)/12) = €22.22
The transition fee is €9,022.22 gross.		

The gross monthly salary is based on the most current salary that the employee receives including holiday allowance. If the employee is on sick leave and receives a lower amount, the calculation still takes into account the higher salary that the employee received prior to the sick leave. Furthermore, the monthly salary includes the average of fixed and variable compensation that was paid out to the employee, such as bonus payments.

The transition fee is capped at €83,000 gross (for 2020) or one year's salary if the employee earns more than €83,000 gross per year. The maximum amount is adjusted annually in January to reflect inflation.

Significant Difference in Outcome

The calculation method of the new transition fee has resulted in a huge difference in outcomes for employees age 50 and older who have more than ten years of service with a company. Sometimes they are eligible for only half of the amount that they would have received prior to the new legislation. Take the following example:

An employee born on January 1, 1960, was employed with a company since January 1, 2000. His gross monthly salary was €3,000. What is the transition fee?	
Contract Terminated on December 31, 2019:	[20 x (1/6 x 3,000)] + [20 x (1/2 x 3,000)] = €40,000
Contract Terminated on January 1, 2020:	20 x (1/3 x 3,000) = €20,000

The portion of the monthly salary that forms the base of the transition fee remains flat, at one-third, irrespective of the employee's age.

SICK LEAVE IN THE NETHERLANDS

Dutch law provides that during the first 104 weeks of sickness or disability, the employer must continue to pay the employee a minimum of 70% of the salary (capped at €219.28 per day as of January 2020). It is common that in individual employment contracts or in collective bargaining agreements, employers pay a greater percentage, often up to 100% of the contractual salary for the first 52 weeks of sick leave.

During sick leave, both employer and employee should (demonstratively) make the best effort to ensure that the employee can recover and resume work. These are the re-integration obligations mentioned above. If both parties have observed their respective re-integration obligations well, the employer can stop paying salary after 104 weeks. The governmental agency U.W.V. then takes over the re-integration obligation, and the employee is entitled only to long-term sickness benefits per state rules. If the employer failed to observe its statutory re-integration obligations, U.W.V. can determine that the salary payment must continue for a maximum of 52 weeks, resulting in the continuous payment of salary for a total of three years of sickness.

For the period in which the employer has the obligation to continue salary payments, there is a strict prohibition against terminating employment during sick leave (*opzegverbod*). This means that during a period of two or potentially three years (the "Sickness Period"), the employer may not terminate the employment contract.

After the Sickness Period, the obligation to continue salary payments and the prohibition against termination cease to exist. If the employer does not opt for termination under one of the statutory forms of legally valid termination, the employment contract remains in a dormant state.

"Dutch law provides that during the first 104 weeks of sickness or disability, the employer must continue to pay the employee a minimum of 70% of the salary."

Since the introduction of the transition fee in 2015, there has been a tendency among employers to keep employees who are on long-term sick leave "on the books." Employers experience that the transition fee, when combined with salary payments during the Sickness Periods and the costs of reintegration efforts, is problematic and unjust because of the financial burden it entails. As long as the employment contract is not terminated, the transition fee is not due.

THE COMPENSATION REGULATION

In the period leading to enactment of the Compensation Regulation Transition Fee Act (*Wet Regeling Compensatie Transitievergoeding* or the Compensation Regulation), it was estimated that there were thousands of dormant employment contracts in the Netherlands. The Dutch parliament concluded that the number of dormant contracts was undesirable. All employees, including long-term sick employees, are entitled to a transition fee when their employment contract is terminated by the employer. At the same time, the Dutch parliament acknowledged that the transition fee places a burden on employers. In order to encourage employers to terminate an employment contract after the Sickness Period runs out, the Compensation Regulation was adopted with an effective date of April 1, 2020.

As of that date, an employer can submit an application to U.W.V. requesting compensation for transition fees paid to employees once the Sickness Period runs out. The Compensation Regulation will cover employment contracts that have been terminated from July 1, 2015, onward. Please refer to the two situations (old and new) described below.

The Compensation Regulation passes some or all of the transition fee from the employer to the government. In order to receive compensation, the employer must meet two conditions. First, the transition payment must be due were the contract terminated with U.W.V.'s permission or via the courts. Second, the payment of the transition fee is related to the termination of the contract due to the employee's long-term sickness.

We can differentiate two situations where employers would be eligible to apply for compensation:

Applications Based on "Old Situations"

- The employee's contract was terminated in the period between July 1, 2015 – March 31, 2020.
- The transition fee was paid to the employee before April 1, 2020.
- The application to U.W.V. can be submitted in the period April 1, 2020 – October 1, 2020.

Applications Based on "New Situations"

- The employee's contract is terminated on or after April 1, 2020.
- The transition fee has been paid in full.
- The application to U.W.V. must be submitted within six months from the date of payment of the transition fee.

There are some limitations as to the amount of compensation that the employer will receive:

- In principle, the compensation may not be greater than the actual amount of transition fee paid to the employee.
- The compensation may not be greater than the transition fee calculated at the time the employee was on sick leave for 104 weeks. If a higher fee is paid because the employment agreement is terminated at a later date, *i.e.*, because the employment was left dormant or the employer was ordered by U.W.V. to continue payment for another 52 weeks, the compensation is still capped at the transition fee payable after the initial 104-week Sickness Period.
- The compensation may not be greater than the salary amount that the employer paid to the employee during the Sickness Period. This amount is the gross salary excluding the employer's costs. If the employer paid more than the statutory minimum of 70% of the salary, these costs will generally be greater than the transition fee. The Minister of Social Affairs is investigating whether certain state benefits and subsidies impact the compensation as mentioned under this point.

A possible consequence of these limitations is that an employer may force an employee to agree on a payment that is not higher than the compensation the employer will receive from U.W.V. If the transition fee is higher than the compensation due to the limitations described above, the employer can threaten not to terminate the contract, leaving the employment dormant.

CASE LAW: LOWER COURTS

Prior to the introduction of the Compensation Regulation, case law in the lower courts showed that it was almost impossible for an employee on long-term sick leave to force termination on an employer by initiating a court proceeding. Courts generally ruled that, according to Dutch law, no legal obligation was imposed on an employer to terminate an employment contract after the Sickness Period. The courts also did not consider this to violate good employment practices.

Despite the introduction of the Compensation Regulation, many employers remain unwilling to terminate dormant employment contracts. However, case law has been divided on whether dormant employments are allowed after adoption of the Compensation Regulation. To illustrate, one district court ruled that continued employment under a dormant contract was not contrary to the practice of good employment. In comparison, another district court ruled in a comparable situation that the continuation of a dormant contract was contrary to the standard of good employment practice. This employer was instructed to terminate the contract. In the second case, the district court took into account the Compensation Regulation, and on that basis, the district found that no justification existed for the employer to keep the employment dormant.

THE SUPREME COURT AND DORMANT EMPLOYMENTS: "WAKE UP AND PAY UP!"

In light of these divisions, the Supreme Court issued a preliminary ruling on November 8, 2019, on questions of law regarding the termination of dormant employments.

The Supreme Court does not share the view of some lower courts that keeping employees in a dormant employment status is allowed. With the introduction of the Compensation Regulation, employers will be compensated for the costs they incur in terms of the payout of the transition fee. Consequently, they are no longer confronted with an unreasonable financial burden on top of their reintegration obligations and continued salary payments during the 104-week period. Moreover, it is clear that the Dutch parliament intended to reduce the number of dormant employment contracts as much as possible. The principle of good employer conduct implies that a dormant employment agreement should, in principle, be terminated if the employee desires termination and the employer does not have any reasonable or legitimate interest in continuing the employment agreement.

The employer may have a legitimate interest if, *inter alia*, realistic re-integration opportunities exist for the employee. Denying termination because the employee will soon reach pensionable age – resulting in a termination of the employment contract by operation of law without entitlement to the transition fee – is not considered to be a legitimate interest. The main principle remains that the transition fee is payable once the Sickness Period runs out and the employee has requested a termination of the employment contract.

IMPLEMENTATION OF THE SUPREME COURT RULING: PRACTICAL TIPS AND TRICKS

In principle, employers are not obliged to take the initiative to terminate dormant employments. The Supreme Court only adopted an obligation for employers to agree to a request from the employee on long-term sick leave to terminate the employment contract and pay the transition fee.

While the notion of a dormant employment may still sound attractive to employers, certain risks exist when dormant contracts are allowed to continue. As long as the employment is dormant, the employer has the duty to phase the employee into the work force once the employee is at least partially recovered, provided that realistic opportunities exist. At some point, a recovered employee can claim reinstatement and continued payment of salary. If the recovered employee is fulfilling a suitable other position for a period of four weeks or longer, the entitlement to the Sickness Period starts anew, exposing the employer to continued salary payments.

Moreover, the transition fee is calculated as of the formal termination date of the employment contract. The Compensation Regulation creates the possibility to be compensated for the transition fee, but that compensation is not greater than the transition fee calculated at the time the employee was on sick leave for 104 weeks. The difference between the actual transition fee that must be paid to the employee (*i.e.*, as of the formal termination date of the employment contract) and the compensation that the employer will receive from U.W.V. (*i.e.*, the transition fee payable after the 104 weeks of sick leave) remains for the account of the employer.

In view of the potential risks as well as the continued accrual of the transition fee, we recommend starting discussions with employees on long-term sick leave and agreeing on a mutual termination of their employment after the Sickness Period. If the employee rejects the offer, the employer cannot be viewed to have neglected the principles of good employer conduct. As in many aspects surrounding a disputed termination of employment, the employer must carefully record its negotiation position with the employee on a contemporaneous basis. The employer then has the choice of maintaining a dormant contract. Should the employee have a change of mind and request a termination offer, it is prudent for the employer to offer an amount that is equal to the anticipated compensation under the terms of the Compensation Regulation. In this way, the employer clearly will have followed the letter of the law, and it is expected that the difference between the actual transition fee at the time of termination and the compensation that will be received from the Dutch government will not have to be paid by the employer directly after 104 weeks of sick leave.

Alternatively, the employer can request permission from U.W.V. to terminate the employee's contract. The cost of the transition fee is then equal to the compensation under the Compensation Regulation.

CONCLUSION

The stalemate generated by dormant contract arrangements has come to an end as a result of the Compensation Regulation. The Compensation Regulation calls for payment of transitions fees following the end of an employee's Sickness Period that will be reimbursed entirely or mostly by the by Dutch government. In many, if not most, situations the Dutch government will bear the cost of the transition fee on a deferred basis. Aside from timing and professional fees incurred, this appears to be a win-win situation for both parties to the employment contract.

"The stalemate generated by dormant contract arrangements has come to an end as a result of the Compensation Regulation."

THE MULTILATERAL INSTRUMENT AND ITS APPLICABILITY IN INDIA

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Tags
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INTRODUCTION

The O.E.C.D. initiated the Base Erosion and Profit Shifting ("B.E.P.S.") Project in 2013 with a view to curtail tax avoidance. The B.E.P.S. Project seeks to nullify tax planning strategies that exploit gaps and mismatches in tax rules in order to artificially shift profits to low-tax or no-tax locations with inadequate economic substance or activity. It is estimated that B.E.P.S. strategies cost countries $100-240 billion in lost revenue, annually. Under the B.E.P.S. Project, over 90 countries and jurisdictions are collaborating to implement the recommended 15 B.E.P.S. measures.

One of the most significant outcomes of the B.E.P.S. Project is the signing of the multilateral instrument ("M.L.I.") in 2017. The M.L.I. seeks to address B.E.P.S. concerns in thousands of bilateral tax treaties through one common treaty. While the M.L.I. does not replace bilateral tax treaties, it acts as an extended text to be read along with the covered bilateral tax treaties for implementing specific B.E.P.S. measures. In order to be considered a "covered tax treaty" under the M.L.I., each partner jurisdiction to a tax treaty must notify the treaty and then agree on the specific provisions of the M.L.I. that will apply.

India has been at the forefront of implementing B.E.P.S. measures and submitted a ratified M.L.I. with the O.E.C.D. on June 25, 2019. The date of entry into force of the M.L.I. has been notified by India as of October 1, 2019. Accordingly, India's covered tax treaties will need to be read with the M.L.I. from April 1, 2020. India has notified tax treaties with 93 jurisdictions (including the U.S.) under the M.L.I. India has not notified the tax treaty with China under the M.L.I. since the treaty was recently amended bilaterally to incorporate B.E.P.S. measures.

As of January 10, 2020, 23 Indian bilateral tax treaties are treated as covered. These are the following:

Austria	Australia	Belgium	Finland	France
Georgia	Ireland	Israel	Japan	Lithuania
Luxembourg	Malta	Netherlands	New Zealand	Poland
Russia	Serbia	Singapore	Slovak Republic	Slovenia
Sweden	U.K.	U.A.E.		

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IMPACT OF THE M.L.I. ON INDIAN STRUCTURES OF U.S.-BASED BUSINESSES

The U.S. is not a signatory to the M.L.I. However, many U.S.-based businesses have in the past used either Mauritius, Singapore, or the Netherlands to route investments into India or for rendering managerial, technical, or consultancy services to Indian entities, due to the beneficial tax treatment in India's treaties with these countries. Benefits include the following:

- Exemption on capital gains arising on disposal of shares of Indian companies in certain situations
- Exemption from withholding tax or lower withholding tax on service payments
- Relaxed conditions for constituting a Service Permanent Establishment in India

Given that India's tax treaties with Singapore and the Netherlands will be covered by the M.L.I. from April 1, 2020, onwards, this development would be of keen interest for U.S.-based businesses that have routed their Indian interests through these countries.

"The U.S. is not a signatory to the M.L.I. However, many U.S.-based businesses have in the past used either Mauritius, Singapore, or the Netherlands to route investments."

Importantly, while Mauritius has signed the M.L.I., it has yet to notify the tax treaty with India under the M.L.I. Accordingly, the India-Mauritius Tax Treaty will not be currently impacted by the M.L.I. However, the treaty is expected to be bilaterally amended along the lines of the B.E.P.S. measures, especially the minimum standards required under the M.L.I. India's position on each of the articles of the M.L.I. and its generic impact is discussed below.

INDIA'S RELEVANT POSITIONS ON THE M.L.I.

Article	In Brief	India's Position & the Impact
Article 3: **Transparent Entities**	A fiscally transparent entity will be granted tax treaty benefits only to the extent the income is considered to be that of a resident of the jurisdiction for taxation purposes and taxed at the level of its members.	India has not adopted this article, and accordingly, this article will not impact or modify any of India's tax treaties. Interestingly, Indian tax authorities have, in the past, denied complete tax treaty benefits to fiscally transparent entities on the grounds that they themselves are not tax residents of their jurisdiction. Although courts have overruled this view in a number of instances, the tax authorities continue to deny tax treaty benefits to fiscally transparent entities. Accordingly, the position remains unsettled.

Article	In Brief	India's Position & the Impact
Article 4: **Dual Resident Entities**	This article deals with cases where a non-individual is dual tax resident. In such a case, the final tax residency will be decided by mutual agreement between competent authorities of the jurisdictions involved. To arrive at a conclusion, the authorities will consider factors such as the place of effective management ("P.O.E.M.") of the entity, its place of incorporation or constitution, and any other relevant factors. In absence of such agreement, a dual tax resident will be denied tax treaty benefits altogether, unless otherwise agreed between the authorities.	India has adopted this article. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. Under Indian tax law, companies are tax resident in India if they are incorporated in India or have their P.O.E.M. in India. If a company incorporated outside India is held to be resident in India under the P.O.E.M. rule, this article will mandate mutual agreement to be reached between Indian tax authorities and authorities of the other jurisdiction. In absence of such agreement, the tax treaty benefits are likely to be denied.
Article 5: **Application of Methods for Elimination of Double Taxation**	Three options are provided for eliminating double taxation under domestic tax law: • Option A: Exemption method (the foreign income is not taxed at all in the jurisdiction of residence) • Option B: Exemption method (for all income other than dividends that are deductible in the jurisdiction of source) • Option C: Credit method (the foreign income is taxed in the jurisdiction of residence with an appropriate tax credit for foreign taxes)	India has adopted Option C (*i.e.*, the credit method). Most of India's tax treaties already provide for the credit method. Only four of the India's tax treaties (*i.e.*, with Bulgaria, Egypt, Greece, and the Slovak Republic) provide for the exemption method. Since these tax treaties are not commonly used in India-related structures, this article is not expected to have major impact.

Article	In Brief	India's Position & the Impact
Article 6: **Purpose of a Covered Tax Agreement**	This is a minimum standard that requires clarifying the intention of the tax treaty through modification, or insertion, of the preamble of the tax treaty. The preamble will clarify that the intention of the jurisdictions is to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including cases of treaty shopping for indirect benefits for residents of third jurisdictions.	The standard preamble provided in the M.L.I. and adopted by India, being a minimum standard, will apply to all Indian tax treaties notified and covered under the M.L.I. Indian courts have, in the past, relied on the preamble text while interpreting tax treaty provisions. This is a very important update and is expected to influence the interpretation of tax treaty provisions while adjudicating tax treaty benefits in India.
Article 7: **Prevention of Treaty Abuse**	This is one of the most anticipated and important articles of the M.L.I. The article requires insertion of the following one or more tests in the tax treaty for preventing tax treaty abuse: • Principal Purpose Test ("P.P.T.") – minimum standard • Simplified Limitation of Benefits ("S.L.O.B.") clause – optional and in support of the P.P.T. • Detailed Limitation of Benefits ("D.L.O.B.") clause – to be bilaterally agreed in line with B.E.P.S. measures and can replace the P.P.T.	India has adopted both the P.P.T. and S.L.O.B. with an option to bilaterally agree to a D.L.O.B., as required. The P.P.T. being a minimum standard, it will apply to all Indian tax treaties notified and covered under the M.L.I. However, an S.L.O.B. will apply only in cases where it has also been adopted by the other jurisdiction. Most of India's key tax treaty partners have not opted for an S.L.O.B. Singapore and the Netherlands have both applied only the P.P.T. and not the S.L.O.B. clause, and hence, their tax treaties with India will be modified only to the extent of the P.P.T. The applicability of the P.P.T. is one of the most significant updates arising from the M.L.I. in the context of India's tax treaties. In fact, the P.P.T. could result in increased litigation with the tax authorities if not implemented carefully and in spirit. A detailed discussion on the possible impact of the P.P.T. is provided in the next section for better understanding.

Article	In Brief	India's Position & the Impact
Article 8: **Dividend Transfer Transactions**	Many tax treaties provide for exemptions or concessional withholding tax rates on dividends for certain shareholders, which are different than the withholding tax rates otherwise applicable under the tax treaty. Article 8 requires meeting additional criteria of shareholding of minimum 365 days to avail the exemption or concessional withholding tax rate.	India has adopted this article. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. Currently, India does not impose any withholding tax on dividend payments by Indian companies, since these companies pay a dividend distribution tax ("D.D.T.") and the dividend is exempt from tax in hands of the nonresident shareholder. However, the Finance Bill, 2020, has proposed to abolish the D.D.T. with effect from April 1, 2020. Resultantly, the dividend would be taxable in the hands of the nonresident shareholder. With the proposed abolishment of the D.D.T. regime, the impact of this article on withholding tax on dividend payments must be considered going forward, as applicable.
Article 9: **Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property**	This article expands the taxing rights of the jurisdiction of source if the capital gain is essentially derived from immovable property in that jurisdiction held through a company, partnership, trust, or others.	India has adopted this article. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. India will now have the right to tax • capital gains arising from the alienation of shares or comparable interests (such as interests in a partnership or trust), • if at any time during the 365 days preceding the alienation, • these shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property situated in India.

Article	In Brief	India's Position & the Impact
Article 10: **Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions**	This article denies tax exemptions to P.E.'s situated in a third state and not engaged in active business if the tax rate in the third state is less than 60% of the tax rate in the country of residence of the taxpayer.	India is silent on this article in the ratified M.L.I. In absence of any reservation, it will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. However, Indian tax treaties generally permit the taxation of an overseas P.E. of an Indian tax resident. A requisite foreign tax credit is provided against the Indian tax payable on profits of such P.E. Hence, this article is not expected to have much impact on Indian structures in usual circumstances.
Article 11: **Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents**	This article seeks to clarify that a jurisdiction continues to have a right to tax its own residents unless the tax treaty specifically provides for other treatment.	India is silent on this article in the ratified M.L.I. In absence of any reservation, the same will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. However, since India follows the credit method under most of its tax treaties, this article is not expected to have a material impact on Indian structures.
Article 12: **Artificial Avoidance of P.E. Status Through Commissionnaire Arrangements and Similar Strategies**	This article tackles cases that would otherwise not be covered in the definition of P.E. (especially Agency P.E.) under existing tax treaties. The article brings the following activities under the P.E. definition: A person • habitually concluding contracts or • habitually playing a principal role in the conclusion of contracts on behalf of another entity.	India has adopted this article. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. India has also amended its tax law to include such cases within its own concept of taxable presence, akin to a P.E. (*i.e.*, "Business Connection"). This amendment may result in Indian tax authorities adopting an aggressive approach to establish a foreign company's P.E. status in India.

Article	In Brief	India's Position & the Impact
Article 13: **Artificial Avoidance of P.E. Status Through the Specific Activity Exemptions**	This article provides two options for determining a P.E. in cases where a P.E. is currently not constituted due to specific exemptions provided under the tax treaty: • Option A: The exempted activities stated in the tax treaty will not result in a P.E. only if they are, singularly or in combination, of a preparatory or auxiliary character. (This is a stricter provision to satisfy.) • Option B: Exempted activities will continue to not result in a P.E., irrespective of whether they are of auxiliary or preparatory character. (This is a more lenient provision to satisfy.)	India has adopted Option A. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. Foreign entities taking a position of not having a P.E. in India on the grounds that the activities are specifically exempt or are preparatory or auxiliary in nature should re-analyze their positions in light of the impact of the M.L.I. on the relevant Indian tax treaty.
Article 14: **Splitting-up of Contracts**	This article seeks to tackle cases where contracts for building or construction sites or installation projects are artificially split amongst group entities to avoid P.E. status due to each entity's presence in the other jurisdiction not exceeding the threshold of days provided for constitution of P.E. under the tax treaty.	India is silent on this article in the ratified M.L.I. In absence of any reservation, it will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article. Foreign entities having similar structures should re-analyze the position of not having a P.E. in India, in light of the M.L.I.
Article 15: **Definition of a Person Closely Related to an Enterprise**	This article defines who is a person "closely related" to an enterprise, a term used in Articles 12, 13, and 14.	India is silent on this article in the ratified M.L.I., and hence, it will apply where Articles 12, 13, and/or 14 are applicable.
Article 16: **Mutual Agreement Procedure ("M.A.P.")**	This article describes how M.A.P. procedure or practices can be implemented.	India has opted for a bilateral notification or consultation process. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article.

Article	In Brief	India's Position & the Impact
Article 17: **Corresponding Adjustments**	This article deals with double taxation of profits due to Transfer Pricing adjustments. It recommends that competent authorities in the other jurisdiction should provide corresponding adjustments arising on account of transfer pricing.	India has accepted the application of this article but has reserved the right not to apply it to tax treaties that already contain a similar provision. It will apply to all Indian tax treaties notified and covered under the M.L.I. and where the other jurisdiction has similarly adopted this article.
Articles 18 to 26: **Mandatory Arbitration**	This article provides for mandatory binding arbitration where agreement cannot be reached under M.A.P.	India has not adopted this article, and accordingly, this article will not impact or modify any of India's tax treaties.
Article 35: **Entry into Effect**	A specific provision of the article refers to the term "calendar year" for application of M.L.I.	India has substituted "calendar year" with the term "taxable period."

IMPACT OF THE P.P.T. ON TAX TREATIES NOTIFIED AND COVERED UNDER THE M.L.I.

The main impact of the M.L.I. on all covered Indian tax treaties will be the amendment or insertion of the preamble under Article 6 of the M.L.I. and, at the minimum, insertion of the P.P.T. under Article 7 of the M.L.I. For instance, both articles will apply to India's tax treaties with Singapore and the Netherlands. The P.P.T. in particular needs careful attention as it broadly states that:

A benefit under a tax treaty shall not be granted an item of income or capital if having regard to all relevant facts and circumstances it is reasonable to conclude that obtaining tax benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit unless granting that benefit in the circumstances would be in accordance with the object and purpose of the relevant provisions of the tax treaty.

Accordingly, the P.P.T. is a discretionary and subjective test for denying tax treaty benefits where obtaining the tax benefit under the tax treaty is one of the principal purposes (if not the main purpose) of the arrangement or transaction.

INTERPLAY BETWEEN THE P.P.T. AND G.A.A.R.

As the P.P.T. is an anti-abuse provision, its interplay with the General Anti-Avoidance Rule ("G.A.A.R."), introduced in India's tax law from April 1, 2017, makes for an interesting situation. Both the P.P.T. and G.A.A.R. permit the tax authorities to deny tax treaty benefits. However, at present, the manners in which they can be invoked have stark differences, as explained below:

> ***"Going forward it is imperative that any Indian inbound or outbound cross-border structuring of investment or business operations should factor in the B.E.P.S. and M.L.I. impact."***

- G.A.A.R. can be invoked only if the main purpose of an arrangement is to obtain a tax benefit. However, the P.P.T. can be invoked even if one of the principle purposes of the arrangement is to obtain a tax benefit under the tax treaty.
- G.A.A.R. can be invoked only if the tax benefit amounts to I.N.R. 30 million or more in a financial year with respect to the parties in the arrangement. The P.P.T. does not prescribe any such threshold.
- G.A.A.R. grandfathers investment structures before April 1, 2017. The P.P.T. does not provide for any such grandfathering.
- G.A.A.R. requires the income-tax officer to obtain their senior's approval and also consult the Approving Panel ("A.P.")[1] before invoking G.A.A.R. No such mechanism is provided under the P.P.T.

Accordingly, the P.P.T. has the potential of becoming a quick way for a tax officer to unilaterally deny tax treaty benefits instead of complying with the conditions or process provided under G.A.A.R. It is hoped that the Indian government amends the tax law or issues necessary administrative directions to ensure that the P.P.T. is not casually invoked by tax officers to deny tax treaty benefits. For now, no such clarification has been proposed in the Finance Bill, 2020, although the M.L.I will become effective in India from April 1, 2020.

CONCLUSION

With the M.L.I. becoming applicable to Indian tax treaties from April 1, 2020, onwards, going forward it is imperative that any Indian inbound or outbound cross-border structuring of investment or business operations should factor in the B.E.P.S. and M.L.I. impact, especially if the structuring involves availing of tax treaty benefits (in India or overseas).

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[1] The A.P. is comprised of a judge of the High Court (retired or not) as a chairperson, one member of Indian Revenue Service, and one member who is an academic or scholar having special knowledge.

FOREIGN TOKENS – U.S. TAX CHARACTERIZATION: QUESTIONS AND DISCUSSION

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INTRODUCTION

Initial coin offerings ("I.C.O.'s") offer blockchain-based[1] companies a new way to raise capital.[2] Companies, both in the U.S. and outside the U.S., have been raising capital using blockchain technology since 2016. For example, in 2016 Overstock raised $2 million through the sale of digital preferred stock on a blockchain platform, as part of a larger capital raise.

Some issuers use I.C.O. proceeds to fund the development of a service on a blockchain (*e.g.*, a crypto-asset exchange), others to purchase a property (*e.g.*, real property or even stock in a corporation). In 2019, investors were offered the opportunity to invest in Elon Musk's SpaceX venture via a new token product — USPX. A special purpose vehicle ("S.P.V."), Unicorn Tokenization Corp., was formed for this purpose. It bought shares of SpaceX on a secondary market and offered investors to purchase tokens representing shares in the S.P.V. Token holders were granted economic rights proportionally equivalent to the underlying SpaceX shares.

As these means of raising funds gained popularity around the world, questions arose. The S.E.C. ruled that some tokens are securities, so that an offer to the public in the U.S. is subject to Federal securities laws.[3] Tax questions also arose, but not all questions have been answered. Specifically, no guidance exists with respect to the proper characterization of a token, and U.S. investors are not assured of the tax consequences of their investments. Nor are they advised on how they should be reported.

No "one answer fits all" can exist in these circumstances, as each token is different. The rights and powers embedded in each token are specific to the offered token and are described in the I.C.O. documentation. Some tokens are sold as an equivalent of a stock (*e.g.*, USPX tokens, which were therefore not offered to U.S. investors), making them an instrument that is relatively clear for most U.S. tax purposes, although some uncertainties remain. For example, is a token holder considered a "shareholder" for purposes of meeting the requirements to be treated as a

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1 "Blockchain" refers to the technology that allows decentralized ledger. See our Blockchain 101 article.

2 While many refer to coins and token interchangeably, in fact, they are different. A coin is native to its blockchain (Bitcoin, Litecoin, Ether, Neo, to name a few) and can be used as a (crypto)currency outside its native blockchain, while a token is generally created on an existing blockchain. For example, a token can be built on the Ethereum platform. This token is known as the ERC-20 token.

3 S.E.C. Release No. 81207 in relation to their investigation of The DAO token offering.

real estate investment trust ("R.E.I.T.")?[4] Others tokens are not clearly presented to buyers as an equivalent of stock, and those raise more questions when it comes to determining their U.S. tax characterization.

TOKENS ARE PROPERTY. BUT ARE THEY EQUITY?

It seems that tokens are a type of cryptocurrency. The I.R.S. ruled that Bitcoin and other virtual currencies are treated like property and that a transaction using such property is a taxable event.[5] However, the I.R.S. has not addressed when certain tokens that hold equity-like characteristics (*e.g.*, voting rights, rights to participation payments, or redemption rights) will be treated as equity for tax purposes. Not all tokens offer such equity-like characteristics. Some tokens offer merely the future right to participate in a service, or receive a product, developed by the issuer. The I.R.S. has not addressed the U.S. tax treatment of these tokens.

"I.R.S. has amended Form 1040, **U.S. Individual Tax Return***, to include a question as to whether the taxpayer received, sold, sent, exchanged, or otherwise acquired a financial interest in any virtual currency."*

If certain non-U.S. issued tokens were viewed as representing an equity interest in the issuer, their ownership may affect the status of the issuing corporation as a controlled foreign corporation ("C.F.C.") or a passive foreign investment company ("P.F.I.C."). As a result, this would affect an individual holder's U.S. reporting obligations – and potentially those of other holders as well as the holders of the common stock of the issuer. This could also affect their income calculation under Subpart F rules, G.I.L.T.I. rules, and P.F.I.C. rules. And noncompliance, especially on international matters, is harshly penalized.

Additionally, this could affect the issuing company. Will the I.C.O. proceeds be taxable to the issuer? Will payments, if any, made to token holders be a deductible expense or could it be viewed as a dividend payment? How will the Foreign Account Tax Compliance Act ("F.A.T.C.A.") apply to the issuing entity?

The classification of tokens is important, especially since the I.R.S. has amended Form 1040, *U.S. Individual Tax Return*, to include a question as to whether the taxpayer received, sold, sent, exchanged, or otherwise acquired a financial interest in any virtual currency. In the absence of guidance as to the tax characterization of a token, the specific characteristics of a particular token must be examined based on generally accepted tax principals.

Separately, FinCEN has advised that "virtual currency held in an offshore account is not a foreign account that needs to be reported on [the] FBAR [*i.e.*, Report of Foreign Bank and Financial Accounts]." Nevertheless, FinCEN and the I.R.S. are continuing to study the question of whether offshore virtual currency should be incorporated into F.B.A.R. reporting requirements.

GENERAL TAX PRINCIPALS: DEBT V. EQUITY

The well-developed standards of the debt v. equity treatment of a corporate instrument can be looked to when performing the required analysis of the character of a

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[4] It is largely believed that the answer is yes; however, a legal opinion is generally obtained by the issuer prior to electing to be treated as a R.E.I.T.

[5] I.R.S. Notice 2014-21.

particular token. Debt and equity are two major forms of capital with different rights, risks, and rewards for the holder and the issuing corporation. As one court noted, the "vital" difference between stock and debt is the status it confers on the owner: The shareholder is "an adventurer in the corporate business; he takes the risk, and profits from success," whereas the creditor, "in compensation for not sharing the profits, is to be paid independently of the risk of success, and gets a right to dip into capital when the payment date arrives."[6]

Because companies and investors are often incentivized to treat junior funding as equity or debt, the I.R.S. has often disagreed with a taxpayer's conclusion and re-characterized the instrument. As a result, prior to the 1969 enactment of Code §385,[7] courts devised a variety of tests to determine whether shareholders' or creditors' funding of a corporation in which they own interests should be treated as stock or as debt.

The most widely cited opinion in the debt v. equity area, issued by the Third Circuit, mentioned 16 different factors to be considered in discerning the substance of a shareholder's or creditor's interest as either debt or equity:

- Intent of the parties to fund via debt or equity
- Whether identity exists between the "creditor" and the entity's shareholder base
- Extent of participation in management by the holder of the instrument
- Ability of the corporation to obtain funds from outside sources
- "Thinness" of capital structure in relation to debt
- Risk involved
- Formal indicia of the arrangement
- Relative position of obliges as to other creditors regarding payment of interest and principal (*i.e.*, is there any subordination involved)
- Voting power of the instrument holder
- Provision of a fixed rate of interest
- Contingency of the obligation to repay
- Source of interest payments
- Presence or absence of a fixed maturity date
- Provision for redemption by the corporation
- Provision for redemption at the option of the holder
- Timing of the advance with reference to the organization of the corporation[8]

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6 *Commr. v. O.P.P. Holding Corp.*, 76 F.2d 11, 12 (2d Cir. 1935).

7 Enacted in 1969 as part of P.L. 91-172, Sec. 415(a).

8 *Fin Hay Realty Co. v. U.S.*, 398 F.2d 694 (3rd Cir. 1968).

In 1969, Congress called on the Treasury to codify the factors into a uniform set. Code §385 provided for the following factors and authorized the Treasury to issue regulations to determine whether an instrument is to be treated as debt or equity:

- Whether there is a written unconditional promise to pay on demand or on a specified date a certain sum of money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest
- Whether there is subordination to or preference over any indebtedness of the corporation
- The ratio of debt to equity of the corporation
- Whether there is convertibility into the stock of the corporation
- The relationship between holdings of stock in the corporation and holdings of the interest in question

Until 2016, the only regulations issued in proposed or final form were withdrawn.[9] Separately, in 1992, Congress enacted Code §385(c), requiring consistency of treatment between issuers and holders. In 2016, the I.R.S. issued new proposed regulations generally applicable to domestic C-corporations, using Code §385 as an additional weapon to attack "earnings stripping" transactions with affiliate debt, primarily in the inversion context.[10] By the time they were finalized in 2019, the rules' relevance had already receded, but they incorporated and extended the multi-factor case law test.[11]

Thus, the case law factors continue to be applicable and fall into four main groups:

- Factors involving the formal rights and remedies of creditors as distinguished from stockholders
- Factors bearing on the genuineness of the intention to create a debtor-creditor relationship
- Factors bearing on the reasonableness or economic reality of that intention (the risk element)
- Factors that are merely rhetorical expressions having no proper evidentiary weight in themselves[12]

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9 The Treasury proposed comprehensive regulations in March 1980 and final regulations in December of that year but delayed their effective date on two occasions; subsequently, the I.R.S. promulgated proposed amendments. The effective date of these, together with the final regulations, were again postponed until, finally, the regulations were withdrawn by T.D. 7920 in 1983, without ever having been in effect.

10 These new rules, finally trimmed down, focused on "covered debt instruments" held between related members of the same expanded group that do not result in new investment in the issuer's operations.

11 The regulations also made clear that caselaw factors will continue to apply in other contexts whenever not contrary to the regulations.

12 William T. Plumb, Jr., "The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and a Proposal", 26 Tax. L. Rev. 369, at 411-12 (1970-71).

Despite the multitude of factors cited, because this determination is fact-intensive the courts generally focus on a select two or three factors most relevant to the specific facts. Each factor's weight in any particular fact pattern can vary. While most decisions under the multi-factor test have concerned related persons, the factors can be and are applied between unrelated parties, as well when risk takers, assume the guise of lenders.[13]

APPLYING THE FACTORS TO TOKENS

In the context of tokens, the most relevant factors that must be analyzed are likely to include:

- Participation in profits
- The promise of an actual (albeit contingent) consideration for the investment versus the anticipation of mere value growth (*e.g.*, future product developed or access to a platform developed)
- Voting rights
- The issuer's promise to buy back the token

For example, a token that provides for a profit sharing element clearly has an equity characteristic. However, if that same token provides restrictions on eligibility for profit sharing (*e.g.*, blocking the marketability of the token in a smart contract for a period of time) and states that the token holders' right to the participation payment are equal to other claims of creditors, arguably such token should not be treated as equity for U.S. tax purposes, absent other equity-like features.

Another equity-like factor to consider is voting rights. Tokens that are intended to be treated as equity often attach voting rights. However, restrictions may be imposed on such voting power, such as allowing a vote on certain issues only, without it affecting the equity treatment of the token.

CONCLUSION

With the increased popularity of I.C.O.'s as a mean to raise capital for corporations, clarifying the tax treatment of tokens is very important. As mentioned above, it can affect the status of the corporation as well as the income inclusion of its holder. With high penalties imposed on noncompliance, getting this right is crucial.

While specific guidance is not available, general principles used to determine debt v. equity treatment should be applicable here. The I.C.O. documentation must be carefully read, with a goal of extracting the intent of the parties to create an instrument that may or may not be essentially equivalent to stock.

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[13] I.R.S. Notice 94-47, 1994-1 C.B. 357, applicable to hybrid instruments.

O.E.C.D. TO USE HYBRID MODEL TO DEVELOP DIGITAL ECONOMY NEXUS AND PROFIT ATTRIBUTION RULES

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Unified Approach

INTRODUCTION

The O.E.C.D. announced on January 31, 2020, that its policy development efforts under Pillar One, related to the taxation of the digital economy, will move forward using the non-consensus "Unified Approach" as a working model.[1] In the interest of averting the negative worldwide welfare effects of trade countermeasures to unilateral Digital Services Taxes, the O.E.C.D.'s deadline for obtaining a consensus outcome is highly ambitious. Consensus outcomes for Pillar One and its less controversial, but nonetheless complex, Pillar Two counterpart are expected by the end of 2020 – a relative blink of an eye when we recall that the groundbreaking B.E.P.S. Project began in 2012 and produced drafts in 2015.

POLICY CHALLENGES

The policy development and consensus-building effort will be led by the O.E.C.D. Center for Tax Policy and Administration. It will seek input and contend with criticism from a group of 137 tax administration representatives, known as the Inclusive Framework ("I.F.").

The January 31 release and subsequent O.E.C.D. comments confirm that the target multinational corporate taxpayer will be determined using the same global sales test that applies to the Country-by-Country Reporting rules – that is approximately $810 million at the current exchange rate. Preliminary estimates of the gain in tax revenue resulting from the proposed policies (currently 4% of global corporate income tax revenue) indicate that more than half of the reallocated profit will come from 100 multinational companies.

The I.F. members will have a difficult technical hill to climb while constantly evaluating the net benefit to their own treasuries, negotiating each step carefully.

The fundamental question is to identify those businesses that fall within the scope of the new rules. The answer poses a challenge. Initially touted as a regime for consumer-facing businesses, the anticipated list of businesses has been broadened to include automated digital services such as search engines, social media platforms, online marketplaces, and content streaming, gaming, cloud computing, and online advertising services. Consumer-facing businesses are tentatively defined to include (i) direct-sale operations, (ii) businesses that sell through resellers or intermediaries, and (iii) franchising and licensing businesses.

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1 See the O.E.C.D. statement on "International Community Renews Commitment to Multilateral Efforts to Address Tax Challenges from Digitalisation of the Economy" and "O.E.C.D. Unified Approach Garners Less Unified Comments from Europe's Tech Producers and Users" from *Insights*.

Weighting factors are yet to be negotiated. These factors will be applied to identify and value (i) the residual profit of Amount A (*i.e.*, the new taxing right) to account for "digital differentiation" or different degrees of digitalization between in scope business activities, (ii) the all-important routine return that will serve as the threshold for the calculation of the residual profit under Amount A, and (iii) specific returns to market jurisdictions or regions.

In addition to anticipating and controlling for overlap and duplication resulting from the consensus formulae, the very fundamental question of a company's ability to gather accurate sales data for the purpose of sourcing revenue to market jurisdictions and distinguishing between the jurisdiction of purchase and the jurisdiction of use or viewing is still to be resolved. It would appear at present that this problem will be handed to multinational companies to solve, much like Country-by-Country Reporting, which will result in much complaint followed by a consulting fee windfall.

Just as the peak of the hill becomes visible as the days get shorter in 2020, further challenges are anticipated in connection with the operation of the income tax treaty system, which usually relies on there being a transaction between controlled residents to effect resolution of double taxation. Under the Unified Approach, income can be allocated without satisfying the necessary condition of a controlled transaction. To achieve the intended policy outcome, significant changes to the mechanisms used by companies and tax authorities to adjust profit and resolve disputes will be required, including another series of multilateral-instrument-like treaty amendments. In principle, an essential policy feature will be the adoption of a mandatory and binding dispute resolution system to resolve disputes between tax administrations. While lip service to the adoption of a dispute resolution mechanism is popular, moving from concept to implementation has proved to be an ongoing point of disagreement between countries.

SAFE HARBOR PROPOSAL

Should the I.F. come to a consensus before the end of 2020 and agree to join hands and attempt to reach the summit of the technical hill, it will do so knowing it will meet the U.S. Secretary of the Treasury Steve Mnuchin on the way. Secretary Mnuchin has supported the type of multilateral solution the I.F. seeks and has proposed that Pillar One be implemented as an opt-in safe harbor. The O.E.C.D. has decided to address the safe harbor issue when all other matters have been resolved.

Given that the mood of large U.S. tech companies seems to be leaning in favor of abandoning the arm's length standard in a selective way in exchange for tax certainty, the safe harbor proposal appears to be a potentially viable strategy to play if the objective of the I.R.S. and Treasury is the resolution of multisided tax controversy for its very largest tech firm taxpayers while maintaining the arm's length standard and the ability to defend the corporate income tax base for the great majority.

A FINAL POSITIVE EXTERNALITY

It seems we must conclude on a positive note, as the prospect of an unavoidable hike through transfer pricing policy "Mordor" may be an unsettling idea. We are pleased to report that an unambiguously positive byproduct of the December 2020 O.E.C.D./G-20 deadline has been a renewed focus on the measurement of the various aspects of the digital economy by national statistical agencies under the direction of the O.E.C.D.'s economics and statistics staff.[2] These efforts stalled in 2013 during the initial B.E.P.S. Project and have been resuscitated in the interest of measuring expected policy outcomes (*i.e.*, the increase in corporate tax revenue) at the firm level.

Despite what people may think about when this effort should have begun, it is crucially important that it has finally begun in an organized way. Data collection to date has focused on aggregate or national income statistics instead of firm-level data. Examples of useful data now getting serious consideration include (i) user counts or impressions by country, (ii) expenditure statistics of various types, (iii) sales by country in line with a common nexus standard, and (iv) employment and income by relevant occupation type. While they may not all become public statistics, these micro-level data are essential to the uniform and accurate application of the new Unified Approach.

[2] See "Webcast: Update on Economic Analysis and Impact Assessment" from the O.E.C.D.

VARIETY IS THE SPICE OF LIFE: ALTERNATE TAX STRUCTURES FOR A U.S. INDIVIDUAL DISPOSING OF FOREIGN REAL PROPERTY

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While some activities are limited when working from home during a global lockdown, there are still a variety of tax-efficient options available to sell foreign real property. This article discusses the U.S. Federal income tax consequences of several options available to a U.S. individual disposing of foreign real property.

LAYING DOWN THE BASICS

The facts that drive this article are as follows:

- Mr. A is a U.S. tax resident (*i.e.*, an individual who is either a U.S. citizen, a lawful permanent resident of the U.S. for immigration purposes, or a U.S. resident for income tax purposes under the Substantial Presence Test).
- He resides in the U.S. and is gainfully employed in the U.S.
- He owns the stock of a Spanish corporation ("F Co."), which in turn owns a parcel of undeveloped real property in Spain.
- Mr. A is a nonresident for Spanish tax purposes.
- Mr. A invested in the property in 2010 with a goal of long-term appreciation.
- The property has substantially increased in value, and Mr. A is now proposing to sell it at a significant gain.
- F Co. is a controlled foreign corporation ("C.F.C.").

Very simply, a foreign corporation is a C.F.C. if more than 50% of its voting rights or value is owned by one or more U.S. Shareholders.[1] A U.S. Shareholder, *inter alia*, includes an individual who is a U.S. citizen who owns at least 10% of the voting rights or value of a foreign corporation.[2] Since, Mr. A owns all of the voting rights and value of F Co., he meets the definition of U.S. Shareholder, and F Co. is a C.F.C.

ALTERNATE TAX STRUCTURES[3]

Option 1: F Co. Sells the Property and Distributes Dividends to Mr. A

One of the easiest ways to dispose of the real property is a direct sale of the property by F Co.

1 Code §957(a).

2 Code §951(b).

3 The article briefly discusses the basic Spanish capital gain tax and personal income tax regime for purposes of background only.

First Level of Tax: Spanish Corporate Income Tax on F Co. on Capital Gains

Spain will treat the excess of the sale proceeds over the adjusted basis of the real property as a capital gain, which will be subject to tax in the hands of F Co. at the corporate rate of 25%.

Second Level of Tax: Spanish Personal Income Tax on Mr. A on Dividends Distributed by F Co.

Mr. A will be subject to Spanish personal income tax on the dividends distributed by F Co. F Co. will be responsible for withholding tax at the time the payment is made to Mr. A. As a result, he will be eligible to claim the benefit of a lower tax rate on Spanish-source dividends. Article 10 of the Spain-U.S. Income Tax Treaty provides for a 15% withholding tax on dividends paid by a Spanish company to an individual.

Third Level of Tax: U.S. Federal Income Tax on Subpart F Income

For U.S. Federal income tax purposes, F Co. is a C.F.C. and Mr. A is a U.S. Shareholder. The capital gain in the hands of F Co. will be treated as Subpart F[4] Income in the hands of Mr. A, who will be taxed on the Spanish company's Foreign Personal Holding Company Income even if it is not distributed by F Co. Subpart F Income is treated as ordinary income, and therefore, Mr. A will be subject to U.S. Federal income tax at a rate of up to 37%. Mr. A will not be subject to additional U.S. tax when F Co. makes an actual distribution of the dividends.[5]

Eligibility of Mr A to Claim Credit for Income Taxes Paid in Spain

When computing the U.S. tax liability of a U.S. individual for income tax purposes, the Code allows a taxpayer to claim a foreign tax credit for the foreign income taxes paid or accrued with regard to the foreign income that is taxed. In broad terms, this allows the U.S. tax to be reduced by the foreign taxes paid. However, the foreign tax credit reduces only the portion of U.S. tax imposed on foreign-source income.[6] Broadly, an individual is allowed to claim a credit of the taxes paid to a foreign country only if, *inter alia*, the following conditions are satisfied:

- The individual is the person on whom the foreign jurisdiction imposes the legal liability to pay the income tax ("Technical Taxpayer Rule").[7]
- The foreign levy is an income tax in the U.S. sense.[8]
- The income is foreign-source income.[9]

Typically, a foreign income tax paid by a foreign entity treated as a corporation under U.S. income tax rules for characterizing entities,[10] is not considered to be the legal

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4 Code §954(c)(1)(B)(iii). In particular, the gain will be treated as a Foreign Holding Personal Company Income, which is one category of Subpart F Income.

5 Code §959(a).

6 Code §904(a).

7 Treas. Reg. §1.901-2(f).

8 Treas. Reg. §§1.901-2(a)(1)(ii), 1.901-2(a)(3)(i).

9 Code §904(a).

10 Treas. Reg. §§301.7701-2 and 301.7701-3.

liability of its shareholder. Therefore, Spanish taxes paid by F Co. on its capital gain arising from the sale of the real property is not treated as being imposed on Mr. A. The legal liability test is not met. Thus, Mr. A fails the Technical Taxpayer condition and, accordingly, is not eligible to claim a credit for the Spanish foreign taxes (25%) paid by F Co. on the gain.

As for the Spanish personal income tax paid by Mr. A on the dividends distributed by F Co., the character of the Foreign Personal Holding Company Income is passive, as is the tax imposed by Spain on dividend income. Although the actual dividends paid should be treated as previously taxed income that is not subject to further U.S. tax, because the income is passive, Mr. A will be eligible to claim a credit for the foreign taxes (15%) withheld by F Co. that offsets the U.S. tax on the Foreign Personal Holding Company Income recognized and taxed in the U.S. This will allow Mr. X to offset his U.S. Federal income tax liability (37%) on the income taxed under Subpart F. In effect, the total tax liability in both countries amounts to 62% (25%+ 37%) plus Net Investment Income Tax ("N.I.I.T.") of 3.8%, which is due at the time of receipt of the actual dividend.

If the dividend is paid in a subsequent year, the tax may be creditable, but there may not be any income in the passive foreign tax credit limitation basket. If the foreign tax cannot be claimed as a credit in the year paid because of insufficient foreign tax credit limitation, the tax may be carried back one year and then carried forward ten years in an attempt to find a year in which sufficient limitation exists to absorb the previously unused credits.[11] If the actual dividend is deferred, the N.I.I.T. is deferred in the absence of an election to pay the tax currently.[12]

High-Tax Exception

Subpart F Income does not include any item of income earned by a C.F.C. if such income is subject to an effective rate of foreign income tax that is greater than 90% of the maximum U.S. corporate tax rate under Code §11.[13] Consequently, if the income is subject to foreign income tax of more than 18.9% (90% of 21%), the income is excluded from the definition of Subpart F Income. This rule is known as the high-tax exception.

A taxpayer electing the high-tax exception gets the benefit of deferring the U.S. Federal income tax liability until an actual distribution is made by the C.F.C. The actual distribution may be treated as a qualified dividend subject to a reduced rate of up to 20% if the U.S. has an income tax treaty with the country in which the C.F.C. is organized and the C.F.C. would be entitled to full benefits under the treaty were it to receive income from U.S. sources. Otherwise, the distribution is treated as an ordinary dividend that is subject to tax at rates of up to 37%. In either case, the individual is subject to the N.I.I.T. of 3.8%. The individual is eligible to claim a foreign tax credit for the taxes withheld in the foreign country at the time the C.F.C. distributes dividends. The foreign tax credit does not apply to offset the N.I.I.T.

Coming back to the facts of Mr. A, the capital gain earned by F Co. on the sale of the real property is subject to the 25% Spanish corporate income tax. Since the foreign tax on Subpart F Income exceeds 18.9%, Mr. A is eligible for the high-tax exception.

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11 Code §904(c).

12 Treas. Reg. §§1.1411-10(c)(1)(i)(A)(1) and (g).

13 Under Code §954(b)(4).

If Mr. A makes a timely election on his personal U.S. income tax return for the year in which the C.F.C. earns Subpart F Income, he will not be subject to any tax on such income. Nonetheless, Mr. A will be subject to U.S. Federal income tax at the rate of 20% (qualified dividends since U.S. has an income tax treaty with Spain) when F Co. makes actual distribution of dividends. The Spanish tax withheld by F Co. on the dividends will be allowed as a credit against Mr. A's U.S. Federal income tax liability on the dividend. As a result, the total tax liability of both countries amounts to 48.8% (25%+ 20% + 3.8%)!

Option 2: F Co. Sells the Property and Distributes Dividends and Mr. A Makes a Code §962 Election

Code §962 was introduced with the objective of placing U.S. individuals making foreign investments through a C.F.C. at tax parity with U.S. corporations for Subpart F purposes while the income remains undistributed. Under Code §962, an individual shareholder of a C.F.C. can elect to be taxed on Subpart F Income as if it formed a U.S. corporation and the U.S. corporation invested in F Co. The income of the hypothetical U.S. corporation is computed in a separate silo of the U.S. individual's tax return. The income of the hypothetical U.S. corporation is taxed at 21% as opposed to a maximum of 37%. An indirect foreign tax credit may be claimed by the hypothetical U.S. corporation for the Spanish income taxes paid by F Co. The Technical Taxpayer Rule applies at the level of F Co.

First and Second Levels of Tax: Spanish Income Taxes

The first and second levels of taxation, related to the tax in Spain, remain unchanged.

Third Level of Tax: U.S. Federal Income Tax on Subpart F Income

If Mr. A makes a timely Code §962 election on his personal U.S. income tax return for the year in which F Co. earned the capital gain, it will have the following effects:

- Mr. A's share of Subpart F Income will be taxed at the corporate rate of 21% while the funds remain in F Co.
- Mr. A will be eligible to claim a credit for the foreign taxes paid by F Co. on the gain (25%) in Spain against his U.S. Federal income tax liability (21%) on Subpart F Income.
- The excess credit cannot be used to reduce U.S. tax on other foreign source income of Mr. A.

Fourth Level of Tax: U.S. Federal Income Tax on Actual Distributions

Although a Code §962 election comes with tax benefits while the proceeds of the sale remain in F Co., it results in a second level of U.S. taxation at the time of an actual distribution to the U.S. Shareholder. When F Co. distributes the earnings derived from the sale of the property, Mr. A will be required to include in his gross income the amount of the actual distribution from F Co. to the extent that it exceeds the U.S. tax previously paid on the Subpart F inclusion, computed to take into account the benefit of the indirect foreign tax credit. The dividend is treated as a dividend from F Co., and if F Co. qualifies for full benefits under the Spain-U.S. Income Tax Treaty, the dividend is treated as a qualified dividend subject to a tax of at a rate of up to 20%. Additionally, Mr. A will be subject to the N.I.I.T. of 3.8%.

In sum, the election approximates the result if a domestic corporation had directly earned the distributed income, suffered U.S. tax (reduced by the foreign tax credit) on the income, and distributed the income net of the tax to the individual shareholder.

Option 3: Mr. A Disposes of the F Co. Stock

Option 3 entails an indirect transfer of the ownership interest in the real property by selling the stock of F Co. to the buyer.

Notably, a disposition of the stock of the foreign company that owns the real property comes with its own advantages and disadvantages. It may not be the first choice for a potential buyer of real property to acquire stock of a company because there are several unknown variables. With the acquisition of the stock, a buyer acquires the entire balance sheet. In other words, the buyer not only acquires the assets but also the liabilities of the company. It typically is not viewed by M&A lawyers as the preferable approach. Although, clients often view a stock sale as an easier transaction to consummate.

First Level of Tax: Spanish Personal Income Tax on Mr. A on the Capital Gain Arising from the Sale of the Stock of F Co.

"Spain imposes a personal income tax of 24% on the gain arising from the sale of the stock of a Spanish corporation if the seller is nonresident in Spain and resident outside the European Union."

Spain imposes a personal income tax of 24% on the gain arising from the sale of the stock of a Spanish corporation if the seller is nonresident in Spain and resident outside the European Union. Mr. A is a U.S. citizen residing in the U.S. Therefore, as a nonresident of Spain, he will be subject to Spanish tax of 24% on the capital gain.

Second Level of Tax: U.S. Federal Income Tax on the Disposition of the Stock of F Co.

Typically, a gain from the sale of stock of a corporation is treated as a capital gain. However, a sale of the stock of a C.F.C. is governed by a special rule codified under Code §1248, which recharacterizes the gain to dividend income to the extent of underlying earnings arising while the seller was a U.S. Shareholder and the target company was a C.F.C. To that extent, the gain is recharacterized as a dividend, and if the dividend is treated as a qualified dividend under the standards described above, it is subject to a reduced Federal income tax rate of 20%. Otherwise, the divided is taxed at ordinary rates, which range between 10% and 37%. The dividend is treated as foreign-source income for foreign tax credit purposes. To the extent the gain is treated as a capital gain, it is subject to a tax rate of up to 20%, and it is treated as domestic-source income for a U.S. person residing in the U.S. Rules for determining the source of the gain are discussed in greater detail, below. Both the dividend element and the gain element are subject to N.I.I.T of 3.8%.

Corporation Does Not Have Any Earnings When the Real Property Is Not Income Producing and Is Held for Investment Purposes

A foreign corporation organized as a holding company of real property with the objective of earning profits from appreciation will likely not earn any income until the sale of the property. As a result, the foreign corporation will not have any earnings. Generally, a distribution from a corporation is treated as a dividend to the extent of its earnings.[14] In the absence of any earnings, no amount of the gain can be treated as a dividend. Therefore, Code §1248 will not have any effect on the disposition of

[14] Code §316(a).

the stock of a C.F.C. in the absence of any earnings. In such a case, all of the gain from the sale of the stock will be treated as a capital gain.

Mr. A, in our example, bought the real property for investment purposes, and F Co. did not generate revenue during the time it held the property. This type of investment is often referred to as "land banking." Therefore, F Co. is not expected to have any earnings. As a result, despite the application of Code §1248, all of the gain from the sale of the stock of F Co. will be treated as capital gain. U.S. income tax will be imposed at rates of up to 20% plus 3.8% N.I.I.T.

<u>Foreign Tax Credit for Spanish Personal Tax Paid on Sale of F Co. Stock – Determining Source of the Gain</u>

If Mr. A is a U.S. citizen, he is therefore subject to U.S. Federal income tax on his worldwide income. As previously mentioned, when computing the U.S. Federal income tax liability of a U.S. taxpayer, the Code allows the taxpayer to claim a credit for the foreign income taxes paid or accrued with regard to that income.[15] However, the foreign tax credit offsets only the U.S. tax on foreign-source income. The U.S. retains the primary right to tax its citizens and residents. Consequently, if both the U.S. and a foreign country treat the same item of income as domestic-source income, there is no opportunity for a U.S. taxpayer to reduce U.S. tax on that income by a foreign tax credit.

Code §865 provides that the taxation of the gain on the sale of personal property (including stock of a company) depends on the residence of the seller. Any gain from the sale of personal property by a U.S. resident is a U.S.-source income and is therefore subject to U.S. Federal income tax.[16] On the other hand, any gain from the sale of a personal property by a U.S. nonresident is foreign-source income. An individual is a U.S. resident for foreign tax credit purposes if he is a U.S. citizen who does not have a tax home[17] in a foreign country.[18]

For the purposes of our example, Mr. A is a U.S. citizen who resides and is employed in the U.S. Therefore, he is said to have a tax home in the U.S. Accordingly, for foreign tax credit purposes, he is a U.S. resident. Thus, the capital gain arising from the sale of the stock of F Co. is U.S.-source income. As such, Mr. A is not eligible to claim a credit for Spanish personal income taxes paid by him on the capital gain arising from the sale of the stock of F Co. since the gain is not a foreign-source income for foreign tax credit purposes. Therefore, in absence of any relief under the Spain-U.S. Income Tax Treaty, Mr. A will not only be subject to a 24% tax in Spain but also a total of 23.8% tax in the U.S., thereby bringing his total tax liability of both countries to 47.8%

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[15] Note that various technical rules apply when computing the foreign tax credit limitation. In many instances, those rules limit the amount of foreign taxes that can be credited in any particular year. This memorandum does not address those rules.

[16] Code §865(a)(1).

[17] An individual has a tax home at a particular place if it is the individual's regular place of business or, if there is more than one regular place, if it is the principal place of business. If an individual does not have a principal place of business, the tax home is at the person's regular place of abode in a real and substantial sense. Code §911(d)(3) and Treas. Reg. §301.7701(b)-2(c)(1).

[18] Code §865(g).

Possible Relief Under the Spain-U.S. Income Tax Treaty

In a rather complicated and indirect way, the Spain-U.S. Income Tax Treaty revises the source rule of U.S. domestic tax law in connection with a U.S. person's sale of shares of a company owning mainly Spanish real estate. It does this in the following way:

- Paragraph 4 of Article 13 (Capital Gain) of the Spain-U.S. Income Tax Treaty grants Spain a right to tax the gains arising from the disposition of shares of a Spanish corporation that entitles its shareholder the rights to enjoy immovable property situated in Spain.
- Paragraph 3 of Article 1 (General Scope) provides a saving clause that generally allows the U.S. to impose tax on its citizens and residents, as determined under the treaty, as if the treaty had not come into effect.
- However, Paragraph 3 of Article 1 (General Scope) provides an exception to the saving clause for the purposes of Article 24 (Relief from Double Taxation).

In a nutshell, this means that if Spain can impose tax on the gain from a sale of shares of a real estate company, the U.S. will treat the gain as foreign-source income, thereby allowing a full foreign tax credit for the Spanish tax.

This result is supported by language in the Treasury Technical Explanation of the Spain-U.S. Income Tax Treaty, which was prepared by the U.S. Treasury Department at the time the treaty was submitted to the Senate for ratification in 1990:

> Thus, to the extent that gains from the alienation of shares in a Spanish corporation[[19]] derived by a U.S. person are taxed by Spain under the provisions of paragraph 4, *such gains will be sourced in Spain for purposes of allowing a foreign tax credit*. The reference that the resourcing is for purposes of avoiding double taxation is intended to bring this provision within the exception to the saving clause for Article 24 (Relief from Double Taxation), provided in paragraph 4(a) of Article 1 (General Scope) [emphasis added].

In view of the above, Mr. A may rely on the treaty provision to claim a credit for the Spanish tax paid on the capital gain arising from the sale of the stock when computing his U.S. Federal income tax liability. As a result, Mr. A will be subject to a 24% tax in Spain, which will be used to set off the 20% capital gains tax in the U.S. No credit will be available against the N.I.I.T. of 3.8%. Therefore, the total tax liability in both countries is limited to 27.8% (24% + 3.8%), plus state and local taxes in his state of residence in the U.S.

CONCLUSION

In sum, several options are available for consideration when planning a dispositions of a direct or indirect interest in Spanish real property. Each option contains several

[19] The protocol to the Spain-U.S. Income Tax Treaty, which came into effect in 2019, expands the right of Spain to impose tax on shares of real estate companies to income companies formed both within and outside Spain. See Paragraph 1 of Article VII of the protocol.

variables. Also, U.S. state and local tax consequences must be taken into account when advising a client.

Option 3, which involves the sale of the stock of F Co., appears to be the most tax-efficient way to sell the real property. Nonetheless, several other factors must be taken into account when making a realistic evaluation of its feasibility. Factors include (i) the difficulty in finding a buyer willing to buy the stock rather than real property, (ii) reduction in the sale price that may be required in order to convince a purchaser to acquire stock, and (iii) possible exposure to ad valorem taxes on the transfer of the stock, which typically is borne by the seller. Regrettably, no structure can be determined to be most efficient without running actual numbers on a spreadsheet to see the final tax liability in both countries.

TRANSFER OF BUSINESS CONTRACTS – I.R.S. DISAGREES WITH GREENTEAM, NO CAPITAL GAINS WITHOUT A FIGHT

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Code §1253
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INTRODUCTION

In an Action on Decision ("A.O.D.") published in late 2019, the I.R.S. announced its nonacquiescence to the Tax Court's decision in *Greenteam Materials Recovery Facility v. Commr*.[1] In *Greenteam*, the Tax Court analyzed Code §1253, the provision that standardizes the rules under which payments that are incident to the transfer of a franchise, trademark, or trade name may or many not be treated as capital gains. For individuals, capital gains treatment is favorable because the rate of tax is capped at 20%, rather than 37%. The court concluded that the sale of service contracts as part of the complete sale of a business is covered by Code §1253. The I.R.S.'s nonacquiescence in *Greenteam* indicates that it does not agree with the holding and will not follow the decision in examinations of other taxpayers.

CODE §1253

Code §1253 attempts to distinguish payments that are properly considered royalties from payments representing consideration received in connection with the sale of a capital asset. Code §1253(a) provides as follows:

> A transfer of a franchise, trademark, or trade name shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the transferred property.[2]

Code §1253(b)(2) defines the circumstances when a significant power, right, or continuing interest exists. It provides as follows:

> The term 'significant power, right, or continuing interest' includes, but is not limited to, the following rights with respect to the interest transferred:
>
> (A) A right to disapprove any assignment of such interest, or any part thereof.
>
> (B) A right to terminate at will.
>
> (C) A right to prescribe the standards of quality of products used or sold, or of services furnished, and of the equipment and facilities used to promote such products or services.

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1 *Greenteam Materials Recovery Facility v. Commr.*, T.C. Memo 2017-122.

2 Code §1251(a).

(D) A right to require that the transferee sell or advertise only products or services of the transferor.

(E) A right to require that the transferee purchase substantially all of his supplies and equipment from the transferor.

(F) A right to payments contingent on the productivity, use, or disposition of the subject matter of the interest transferred, if such payments constitute a substantial element under the transfer agreement.

FACTS IN GREENTEAM

Three related California partnerships were in the business of providing waste and recycling services for several municipalities in California. In all cases, the municipalities awarded exclusive contracts to handle various waste management and recycling tasks on an exclusive basis. In each instance, the award of an exclusive contract was the last step in a complex procedure that began with a detailed request for proposal, published by the municipality and responded to by potential bidders. The exclusive contracts from the municipalities each ran for several years and a provision existed in each contract for renewal at the completion of the initial term.

At some point during the periods covered by the contracts, the three partnerships sold their businesses to an unrelated party. The transactions were set up as asset purchases that, in the aggregate, covered non-compete rights, tangible assets, land, and buildings. The total price was $46.0 million, of which approximately $28.8 million was allocated to goodwill and going concern value.

The I.R.S. examined the partnership tax returns and asserted that the amounts allocated to goodwill represented ordinary income. The partnerships filed petitions with the Tax Court. Ultimately, the amount in issue was reduced to approximately $18.25 million.

LEGAL ARGUMENTS OF TAXPAYER AND I.R.S.

Code §1253(b)(1) defines the term "franchise" in a straightforward manner:

> The term 'franchise' includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.

The taxpayers in *Greenteam* argued that, under the above definition, the contracts with the municipalities were franchises granted to the taxpayers to perform services and facilities within a specific area for a specific number of years.

In comparison, the I.R.S. argued that Code §1253 simply defines payments that are not entitled to capital gains treatment; it does not, by itself, define when a contractual right is a capital asset. Consequently, case law controls, in particular *Foy v. Commr*.[3] There, the court applied a six-factor standard to determine whether a payment to acquire a contract is a capital asset or merely a substitute for ordinary income:

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[3] 84 T.C. 50 (1985).

- How were the contract rights originated?
- How were the contract rights acquired?
- Do the contract rights represent an equitable interest in property that itself constitutes a capital asset?
- Does the transfer of contract rights merely substitute the payor of what would be ordinary income?
- Were significant investment risks associated with the contract rights and, if so, were they included in the transfer?
- Did the contract rights primarily represent compensation for personal services?

In addition, the I.R.S. argued that, since Code §1253 was not applicable to the payments, industry usage in California should apply. In the municipal waste disposal industry in California, a contract must be automatically renewable at the end of the term unless specifically terminated for the contract to be a franchise. If the contract is granted for a period of years it is a "municipal contract," rather than a franchise.

HOLDING IN GREENTEAM

The court held that the carting contracts that were sold met the definition of a franchise within the meaning of Code §1253(b)(1). The contracts collectively meet the definition of franchises under Code §1253(b)(1) since the agreements provided each facility the right to offer services in a designated area as required under the relevant contract. Industry terms used in California were not relevant in the application of Code §1253.

Once the court determined that the contracts were franchises, it looked to decided cases[4] to conclude that capital gains treatment should apply so long as the payment is not knocked out under Code §1253(a) and the contract is a capital asset.

The court then looked to the treatment of payments by the transferee. Under Code §1253(d)(1), certain payments are deductible. These are payments that are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name that are paid as part of a series of payments made not less frequently than annually throughout the entire term of the agreement that are substantially equal in amount (or payable under a fixed formula). Under Code §1253(d)(2), all other payments are chargeable to capital account, meaning the cost of acquiring an asset.

The Tax Court then cited previous decisions supporting the sale of a franchise under Code §1253 and determined that the legislative history of Code §1253 supported their interpretation.[5] As the three partnerships did not retain any significant or

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4 *McIngvale v. Commr.*, 936 F.2d 833, 839 (5th Cir. 1991), *affd.*, T.C. Memo. 1990-340; *Jackson v. Commr.*, 86 T.C. 492 (1986), *affd.*, 864 F.2d 1521 (10th Cir. 1989).

5 *Tele-Commc'ns, Inc. v Commr.*, 12 F.3d 1005 (10th Cir. 1993); and *Jefferson-Pilot Corp. & Subs. v. Commr.*, 995 F.2d 530 (4th Cir. 1993) (where the court consistently upheld capital gains treatment under Code §1253 on the sale of a franchise).

continuing interests in the assigned agreements, Code §1253 applied and capital gains treatment was proper.

A.O.D. AND I.R.S. NONACQUIESCENCE

An A.O.D. is a formal memorandum prepared by the Office of Chief Counsel announcing the future litigation position the I.R.S. and whether it will follow or continue to challenge issues notwithstanding a judicial decision on point. In its A.O.D., the I.R.S. published its nonacquiescence position with regards to the *Greenteam* decision, arguing that the plain language of Code §1253 does not support the Tax Court's reasoning.[6]

The I.R.S. announced its view that the Tax Court erred in three aspects of its holding:

- Code §1253(a) was not applicable to the facts in *Greenteam* because it does not specify when a sale or exchange of a franchise is eligible for capital gains treatment. It provides only that ordinary income treatment is required when a taxpayer retains certain powers, rights, and interests. Code §1253 does not state under what circumstances gain from the transfer of a franchise is eligible for capital gains treatment.
- Justifying the decision by looking at the tax treatment of the transferee is flawed. Code §1253(d) addresses only the tax treatment of a transferee's payments. The treatment of the transferee has no bearing on the treatment of the transferor.
- The court's reliance on its earlier cases, did not support its holding in *Greenteam*.[7] Those cases state that a transfer of a contract gives right to capital gains treatment only when the sale is a capital asset in the transferor's hands. In *Greenteam*, the Tax Court did not analyze whether the contracts were capital assets in the transferor's hand.

CONCLUSION

In looking at the I.R.S.'s nonacquiescence in the *Greenteam* decision, perhaps the aspect it found was most troublesome was the fact that the contracts were limited-term contracts to provide services under fixed-term arrangements. Aside from the fixed assets, the only item of value to sell was the future stream of income.

Law school professors lecturing on tax often illustrate the difference between capital gains and ordinary income by reference to a tree and its fruit. The tree is a capital asset, and the owner of the land has property rights for as long as the tree lives. When the land is sold, the portion of the gain attributable to the tree is given capital treatment. In comparison, the fruit grows each year and can be easily sold at a profit. In the view of the I.R.S., merely because a transferor does not retain a significant interest in a service contract that has been sold does not, by itself, mean that the sales proceeds should be viewed as gain from the sale of a capital asset. Nonetheless, the decision in *Greenteam* can provide solace to a taxpayer that has the financial wherewithal to challenge the I.R.S. position in the U.S. Tax Court.

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[6] I.R.B. 2019-42.

[7] *Jackson v Commr.*, 86 T.C. 492 (1986).

J-5 STEP UP ANTI-MONEY LAUNDERING IN 2020, SIGHTS SET ON CENTRAL AMERICA

Author
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Tags
H.M.R.C.
I.R.S.
J-5
Tax Evasion

Tax authorities that are tasked with tracking down tax evaders and their enablers take their jobs seriously. When success against tax evaders is encountered, two benefits are obtained. First, the tax evader is caught, punished, and taxes and penalties are collected. Second, a message is delivered to tax cheat "wannabes" that tax crime does not pay. That message is emphasized by the issuance of coordinated news releases praising coordinated investigatory action in several countries that is carried out on the same day.

The Joint Chiefs of Global Tax Enforcement, known as the J-5, is a coordinated team of crime-fighting tax authorities from the U.K., the U.S., Canada, Australia, and the Netherlands. Formed in 2018, the mandate of the J-5 is to stop the facilitation of offshore tax evasion and money laundering. The J-5 uses the skills of experts in tax, crypto currencies, and cyber security to identify and attack financial institutions that facilitate concealment of wealth in ways that are designed to promote tax evasion.

For the J-5, January 22 was a day coordinated day of action. It focused on a Central American financial institution believed to be involved in money laundering and tax evasion on a global basis by its customers. Information originated from the Netherlands was subsequently shared with other J-5 countries. Ultimately, the day of coordinated action arrived, evidence was gathered, interviews were conducted, subpoenas were served, and at least one person was arrested. One member of the J-5 reported that significant information was obtained as a result of the coordinated efforts. The group expects criminal, civil, and regulatory action to follow in each country.

With the success of the coordinated action, press releases were issued on a global basis by J-5 officials.

- Will Day, Australian Tax Office ("A.T.O.") Deputy Commissioner commented that never before have criminals been at such risk of being detected as they are now. With increased collaboration, data analytics, and intelligence sharing, there is no place worldwide in which a person can hide money to avoid tax payment obligations.
- Mr. Day's comments were echoed by Don Fort, Chief or the I.R.S. Criminal Investigation division, who advised that tax cheats across the world should be on notice that their days of noncompliance are over. He pointed out that J-5 countries all have the same goal, which is to broaden their reach in order to speed up investigations. Coordinated effort will have an exponentially larger impact on global tax administration.
- Simon York, Chief and Director of H.M.R.C.'s Fraud Investigation Service observed that tax evasion is a global problem that needs the global response that is provided by the J-5.

- Eric Feron of C.R.A. expressed his pleasure with the role played by the C.R.A. in the J-5. According to Mr. Feron, the day of action showed that through combined efforts, J-5 is making it increasingly difficult for taxpayers to hide their money and avoid paying their fair share of tax.

It may be expected that at least one more coordinated effort will occur and be reported early in the month of April, when U.S. individuals are required to file tax returns. Compliance is enhanced when fear of coordinated activity is spread.

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