JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Multinational

OECD BEPS: OECD Releases Public Discussion Drafts and Receives Comments in respect of Action 2 (Hybrid Mismatch Arrangements) and Action 6 (Prevent Treaty Abuse)
The recommendations set forth in these reports are solely intended for public consultation but will have a significant impact on both multinational taxpayers and governments if widely adopted in their current form.
Read More below

EU Code of Conduct Group Reviews EU Patent Boxes
Following investigations by the EU with respect to the newly introduced UK patent box (see below), the EU Code of Conduct Group has agreed to review nine existing patent box and similar regimes across the EU.
Read More below

Belgium

Belgium Modifies its Notional Interest Deduction Regime to Comply with EU Law
Belgium has changed its notional interest deduction regime with respect to foreign branches following a taxpayer victory in front of the EU Court of Justice.
Read More below

China

IN THIS ISSUE

CONTRIBUTORS TO THIS ISSUE

Belgium
Howard M. Liebman
Brussels
Werner E. Heyvaert
Brussels

China
Fuli Cao
Shanghai/Beijing

France

Three Special Areas Designated for Preferential Corporate Income Tax Rates
China clarifies tax benefits for three special areas to promote economic cooperation between the Chinese Mainland and Hong Kong, Macau, and Taiwan.
- Read More below

SAT Clarifies Certain Filings for Special Reorganization Tax Treatment by Nonresident Enterprises
China clarifies certain filing and pre-transfer dividend issues concerning special reorganization tax treatment to equity transfers by nonresident enterprises.
- Read More below

France

Focus on the Anti-Avoidance Provision Targeting Hybrid Debt Instruments
France introduces further limitations of the deductibility of related party interest expenses focusing on hybrid debt.
- Read More below

Recent Case Law Affecting French CFC Rules
Recent decisions of French courts may have a significant impact on the application of the French CFC rules.
- Read More below

Germany

German Tax Authorities Allow Tax Deductibility of Additional Tier 1 Capital
Germany announces a circular to confirm deductibility of Additional Tier 1 Capital.
- Read More below

German Domestic Anti-Abuse Rules Regarding the Taxation of Partnerships Possibly Unconstitutional
The German Tax Court has referred a case to the Constitutional Court, requesting that the Constitutional Court declare German domestic anti-abuse rules regarding the taxation of partnerships unconstitutional. The case may possibly have wider implications.
- Read More below

German Constitutional Court Issues Ruling on Retroactivity of Tax Laws

Siamak Mostafavi
Paris

Emmanuel de la Rochethulon
Paris

Germany

Martin Bünning
Frankfurt

Andreas Köster-Böckenförde
Frankfurt

Italy

Marco Lombardi
Milan

Japan

Koichi Inoue
Tokyo

Luxembourg

Lodewijk Berger
Amsterdam

Werner Heyvaert
Brussels

Mexico

Rodrigo Gómez
Mexico City

Spain

Pablo Baschwitz
Madrid

The Netherlands

Lodewijk Berger
Amsterdam

Lyda Stone
Amsterdam

United Kingdom

Blaise L. Marin-Curtoud
London

Charlotte L. Sallabank
London

United States

Raymond J. Wiacek
Washington

Joseph A. Goldman
Washington

Andrew M. Eisenberg
Washington

Colleen E. Laduzinki
New York

Edward T. Kennedy
New York

Unclear wording of existing law does not justify the retroactive implementation of new law, according to the German Constitutional Court.

- Read More below

Todd Wallace
Dallas

German Tax Court Rules on Termination of Fiscal Unity under International Reorganization

The German Federal Tax Court has ruled that an intra-group reorganization involving the transfer of shares in a German subsidiary does not constitute a good cause to terminate the fiscal unity.

- Read More below

Italy

New Decree Expands the Scope of the International Ruling Procedure

A new decree expands the scope of the ruling procedures, particularly with respect to transfer pricing, but also with respect to the attribution of profits to a permanent establishment and the application of tax treaties.

- Read More below

Clarifications with Respect to Deductibility of Losses on Receivables

Italy's Finance Act 2014 clarifies the conditions that must be met to deduct losses on receivables.

- Read More below

Amendments of the Tax Regime for Financial Leases

The Finance Act 2014 improves the corporate income tax regime for financial leases.

- Read More below

Japan

Changes to Permanent Establishment Allocations

Japan changes permanent establishment income allocation rules, effective as of the fiscal year commencing on or after April 1, 2016.

- Read More below

Revision of the Japan–UK Income Tax Treaty

Japan and the UK sign a new Protocol to their income tax treaty.

- Read More below

Increase of Consumption Tax Rate

Effective as of April 1, Japan's combined rate of national and local consumption taxes has increased from 5 percent to 8 percent (6.3 percent national tax and 1.7 percent local tax). The consumption tax rate is planned to further increase from 8 percent to 10 percent (7.8 percent national tax and 2.2 percent local tax) on October 1, 2015.

- Read More below

New Reporting System for Offshore Assets

A new reporting system for offshore assets took effect as of January 1, 2014.

- Read More below

Mexico

New Withholding Tax on Dividends in Mexico
Mexico has introduced a new 10% withholding tax on dividends.
- Read More below

Claiming Tax Treaty Benefits in Mexico as of January 1
Mexico has introduced new procedures for claiming treaty benefits.
- Read More below

Spain

Government Launches Tax Reform
Spain is planning a major tax reform.
- Read More below

Changes to Exit Tax
Spain has changed its exit tax rules.
- Read More below

The Netherlands

Supreme Court Takes Formal Approach and Sides with Taxpayer in Landmark Hybrid Instrument Case
The Dutch Supreme Court has ended a long debate by confirming that income from redeemable preference shares qualifies for the participation exemption, regardless of whether a deduction will be available in the source country.
- Read More below

Introduction of New Reporting Requirements for Certain Intra-Group Lending, Licensing and Leasing Activities
Beginning on January 1, Dutch companies that are predominantly involved in intra-group back-to-back lending, licensing, or leasing transactions must declare in their Dutch tax return that they meet certain minimum substance requirements. If not all requirements are met, the Netherlands will exchange information with source countries.
- Read More below

United Kingdom

EU Investigates the Legality of the UK Patent Box Regime
The recently introduced UK patent box regime is under renewed investigation by the EU.
- Read More below

Court Case Arguably Clarifies UK Source Rules with Respect to Interest
A recent case heard by the First Tier Tribunal arguably clarifies how the question of whether interest has a UK source will be decided.
- Read More below

Increased Use of UK Tax Resident Holding Companies
The UK experiences a significantly increased interest for UK holding companies.
- Read More below

United States

Senate Hearing on Profit Shifting

On April 1, the Senate Permanent Subcommittee on Investigations held another hearing on multinational corporations that are perceived to actively reduce their worldwide tax burdens by shifting profits out of the U.S.

- Read More below

New FATCA Guidance

On April 2, the U.S. Treasury released Announcement 2014-17 under the Foreign Account Tax Compliance Act, sections 1471 through 1474 of the Internal Revenue Code, broadening the scope of when an intergovernmental agreement is considered to be in effect and extending the registration timeframe for foreign financial institutions.

- Read More below

Who's Who

Getting to Know Blaise Marin-Curtoud, UK Tax Partner

Jones Day partner Blaise Marin-Curtoud helps his clients plan and conduct their businesses to manage tax liabilities, which in today's global business environment requires vast knowledge of multiple and changing tax codes as well as strategic problem-solving skills. Based in London, Blaise focuses on tax aspects of mergers and acquisitions and real estate transactions, both of which are thriving areas of law in the United Kingdom.

- Read More below

Follow us on:

Jones Day is a legal institution with 2,400 lawyers on five continents. We are One Firm Worldwide[SM].

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Multinational

OECD BEPS: OECD Releases Public Discussion Drafts and Receives Comments in respect of Action 2 (Hybrid Mismatch Arrangements) and Action 6 (Prevent Treaty Abuse)
In March, the OECD released its discussion drafts in respect of Action 2: "Neutralise the Effects of Hybrid Mismatch Arrangements—Recommendations for Domestic Laws" and "Neutralise the Effects of Hybrid Mismatch Arrangements—Treaty Issues" and Action 6: "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances."

Key recommendations with respect to Action 2 (Hybrid Mismatch Arrangements) are (i) to eliminate hybrid mismatches by including targeted anti-hybrid rules in domestic law with respect to hybrid instruments, tax ownership mismatches, and (reverse) hybrid entities, which link the domestic tax treatment to the tax treatment in other relevant foreign countries, and (ii) to add a specific anti-abuse provision to the OECD Model Convention.

Key recommendations with respect to Action 6 (Prevent Treaty Abuse) are to modify the OECD Model Convention to include (i) a reference in the title and the preamble to prevention of tax avoidance and the creation of opportunities for non-taxation or reduced taxation, (ii) a limitation on benefits provision ("LOB"), and (iii) a main purpose test or general anti-abuse rule.

The recommendations set forth in these reports are solely intended to provide stakeholders with

IN THIS ISSUE

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Belgium

Belgium Modifies its Notional Interest Deduction Regime to Comply with EU Law
In 2008, Argenta Spaarbank NV—a Belgian savings bank operating a branch in The Netherlands—challenged the validity of the exclusion of the net book value of its Dutch branch from the computation basis for the notional interest deduction ("NID"). The principal argument of *Argenta* was that this exclusion falls afoul of the principle of freedom of establishment as established in Article 49 of the Treaty on the Functioning of the European Union ("TFEU"). Argenta argued that if the bank had operated its branch in Belgium, the net assets would have been allowed for purposes of computing its 2008 NID amount, whereas those very same net assets were being disallowed in this case because they were connected with a branch located in another EU Member State (The Netherlands). The Antwerp tax court submitted the issue to the EU Court of Justice ("ECJ") in Luxembourg for a preliminary ruling on the subject. The ECJ held on July 4, 2013 in favor of Argenta and found that Belgium's NID regime was a hindrance to the freedom of establishment insofar as it disallowed assets invested by a Belgian company through a Dutch branch from the basis for computing the NID.

With the law of December 21, 2013 (the "Law"), the Belgian government has purported to remedy the lack of compliance of the NID regime with EU law. The Law repeals the provision of the NID regime that disallows assets allocated to a branch situated in a treaty country, and it reduces the NID for Belgian

IN THIS ISSUE

companies that operate through a branch in a treaty country that is a member of the European Economic Area ("EEA"). Henceforth, the total amount of NID will be reduced as follows:

- If the Belgian company has invested any assets in or through a branch located in a treaty country that *is not a member of the EEA*, the total amount of NID will be reduced by the proportionate part thereof that corresponds to the net assets invested in such branch.
- If the Belgian company has invested any assets in or through a branch located in a treaty country that *is a member of the EEA* (an "EEA Branch"), the total amount of NID will be reduced by the proportion thereof that corresponds to the net assets invested in the EEA Branch, but only insofar as the total amount of NID exceeds the business profits derived from the EEA Branch. In other words, if an EEA Branch would end the fiscal year with a net loss, the proportion of NID corresponding to the assets of that EEA Branch would not be forfeited but can, instead, be deducted from the company's other profits (i.e., Belgian-source profits).

These new rules entered into effect for tax assessment year 2014 (i.e., for book years ending on or after December 31, 2013).

The first Belgian commentaries on the K case (ECJ, C-322/11, 7 Nov. 2013), another recent ruling by the ECJ, rightfully point out that the ECJ's findings in the K case would seem to support the way in which the Belgian legislature has remedied the NID rules following the *Argenta* case. Indeed, tax advantages or adjustments can be limited to property located in the Member State granting the tax advantage or adjustment, provided that such limitation is necessary "to safeguard the balanced allocation of the power to impose taxes between the Member States and to ensure the cohesion of the [Finnish] tax system and that it is appropriate for attaining those objectives." Because the new Belgian NID rules in fact do now achieve a similar symmetry, it may be expected that they should stand the test of EU law going forward.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

China

Three Special Areas Designated for Preferential Corporate Income Tax Rates

In recent years, the China State Council approved three special areas to promote economic cooperation between the Chinese Mainland and Hong Kong, Macau, and Taiwan. These areas are Hengqin New Area, Qianhai Shenzhen-Hong Kong Services Industry Cooperation Zone, and Pingtan Comprehensive Experimental Zone. Qualified enterprises established in the three areas may enjoy a 15 percent corporate income tax ("CIT") rate, compared to the normal 25 percent CIT rate. The Ministry of Finance and State Administration of Taxation jointly issued Cai Shui [2014] No. 26 on March 27, which clarified the policies for the CIT incentive. Three CIT incentive catalogues were issued, each for one of the three special areas. The catalogues list industry sectors that are eligible for the tax incentives. To be eligible for the 15 percent CIT rate, the main business of the enterprise must falls within the industry sectors listed in the relevant catalogue, which means that more than 70 percent of the total revenue of the enterprise must be derived from one or more listed sectors. Furthermore, if an enterprise has establishments located both inside and outside the special areas, only income derived by the establishments from within the special areas is eligible for the reduced CIT rate. The tax notice is effective for the period from January 1, 2014 to December 31, 2020.

IN THIS ISSUE

SAT Clarifies Certain Filings for Special Reorganization Tax Treatment by Nonresident Enterprises

The State Administration of Taxation ("SAT") issued the *Public Announcement on Certain Issues Concerning Special Tax Treatment on Equity Transfers by Nonresident Enterprises* ("Announcement 72") on December 12, 2013 to clarify certain filing and pre-transfer dividend issues concerning special reorganization tax treatment to equity transfers by nonresident enterprises.

Certain reorganizations qualify for special reorganization tax treatment where no gain or loss will be recognized at the time of reorganization. One of these qualifying transactions is the transfer by a nonresident enterprise of its equity interest in a PRC entity to its wholly owned subsidiary (another nonresident enterprise), provided that there is reasonable business purpose, the equity interest transfer is at least 75 percent of total equity in the PRC entity, the consideration in equity is at least 85 percent of total consideration, the withholding tax rate applicable to the gain on the future disposal of such equity interest is not reduced, and the nonresident transferor makes a written promise to the tax authorities that it will not dispose of its interest in the nonresident transferee within three years of the re-organization. Announcement 72 contains the following clarifications:

- An equity transfer of a PRC entity resulting from an offshore merger or de-merger of its nonresident enterprise shareholders should fall within the scope of this type of transfer.
- The transferor should make a filing within 30 days of the effectiveness of the equity transfer agreement and the completion of business registration with respect to the equity transfer. Previously, the filing was due only upon the filing of the PRC company's annual corporate income tax return, the deadline of which typically is on May 31 following the fiscal year.
- Where the special reorganization tax treatment has been elected, if the applicable withholding tax rate on dividends under the tax treaty between China and the transferee's country (region) is lower than that between China and the transferor's country, the retained earnings of the PRC entity accumulated prior to the transfer will not be entitled to any reduction in the dividend withholding tax rate.

The filing deadline provided in Announcement 71 also applies to a transfer by a nonresident enterprise of its shareholdings in a PRC entity to its 100 percent owned PRC subsidiary (PRC tax resident). If the special reorganization tax treatment is elected, the

transferee should file with the tax authority within 30 days of the effectiveness of the equity transfer agreement and the completion of business registration with respect to the equity transfer.

Follow us on:

Jones Day is a legal institution with 2,400 lawyers on five continents. We are One Firm Worldwide[SM].

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

France

Focus on the Anti-Avoidance Provision Targeting Hybrid Debt Instruments
The 2014 Finance Law has implemented yet another limitation of the deductibility for tax purposes of interest payments made by a French borrower to an affiliated entity (i.e., an entity controlled by the borrower, controlling the borrower, or controlled by the same third party as the borrower), this time targeting more specifically cross-border hybrid debt instruments ("Anti-Hybrid Provision" or "AHP").

The AHP is applicable to fiscal years closed as from September 25, 2013, and may thus have an immediate impact on the corporation tax returns to be filed (and the corresponding corporation tax liability to be paid) during the upcoming months.

In essence, interest payments made by a French borrower to an affiliated entity will be deductible for tax purposes only if such borrower is able to demonstrate that the lender (be it French or foreign, even though the provision was clearly designed to target cross-border hybrid debt instruments) is subject to an income tax on the corresponding interest income that is at least equal to 25 percent of the French corporation tax that would have been due had it been computed in accordance with standard French rules ("25 Percent Test"). Specific rules are also provided where the lender is a flow-through entity such as an investment fund or a partnership ("Look-Through Rule").

IN THIS ISSUE

Given its broad language and the lack of precise guidance within the parliamentary reports and debates that have preceded its enactment, many issues are likely to arise with respect to the scope of the AHP, the operation of the 25 Percent Test, and the reach of the Look-Through Rule. The guidelines to be published by the French tax authorities are thus eagerly awaited.

25 Percent Test. The main uncertainties pertaining to the AHP revolve around the 25 Percent Test and the way the comparison of the tax liabilities (i.e., the actual tax liability of the lender on the one hand and its theoretical liability under French standard rules on the other hand) will operate. While the 25 Percent Test is at the heart of the AHP, there is no unequivocal indication as to whether the comparison basis should be:

- The gross amount of the relevant interest payment;
- The net amount of the relevant interest payment and its repayment, if any, by the lender (e.g., in case of a back-to-back financing arrangement);
- The net amount of the overall interest payments received and made, if any, by the lender; or
- The overall taxable result of the lender (i.e., in order to apply every single French tax rule as if the foreign lender was a French tax resident).

While the language of the AHP itself offers little guidance, certain parliamentary debates seem to indicate that the first option (i.e., based on the gross amount) should be followed. Its main upside would be its simplicity, but it would substantially hurt the efficiency of the anti-avoidance motivation behind the AHP. Another upside would be the correspondingly reduced declarative burden, since the taxpayer is the one bearing the 25 Percent Test burden. There is, however, no guarantee that such option will be followed by the French tax authorities or by courts.

A more conservative approach would lead to the fourth option (i.e., full analysis of the overall tax situation of the lender), which could turn out to be particularly burdensome with respect to both (i) the computation to be made by the taxpayer in order to determine whether the AHP is applicable, and (ii) the demonstration to be provided by the taxpayer.

Other issues, furthermore, stem from the uncertainty among those four possibilities. For instance, what should be the relevant comparison in the situation where the borrower and the lender have different fiscal year starting/closing dates? Likewise, how should financing arrangements—whereby interest payments are either deferred (e.g., deep discount instruments) or subject to a specific accounting or tax treatment—be treated in terms of timing, at the level of the lender (i.e., the overall interest income pertaining to the financing arrangement would satisfy the 25 Percent Test but, by virtue of specific accounting or tax timing rules, the 25 Percent Test would not be satisfied for a given fiscal year)? Although some general French tax principles could provide some guidance, the guidelines to be published by the French tax authorities will have to be closely reviewed in this respect.

In the end, any of the three latter possibilities would most likely allow for the AHP to catch—in addition to cross-border hybrid debt instruments whereby payments would be deductible in France but exempt in the lender's jurisdiction—the following:

- Back-to-back financing arrangements whereby payments would (i) be deductible in France, (ii) comply, on a gross basis, with the 25 Percent Test in the lender's jurisdiction, but (iii) effectively leave a marginal tax base in such jurisdiction by being eventually up-streamed to a third low-tax jurisdiction (thereby failing the 25 Percent Test on a net basis), and

- Financing arrangements placed under a specific accounting or tax regime as described above.

Look-Through Rule. In essence, the Look-Through Rule provides that, where the lender is a flow-through entity such as an investment fund or a partnership, (i) the AHP limitation applies only to the extent that the borrower and the relevant members of the flow-through entity are affiliated entities, and (ii) the 25 Percent Test is applied at the level of such members.

This being said, the AHP does not cover double-tier structures where the lender would be a flow-through entity wholly held by another flow-through entity. Should the Look-Through Rule then be applied at each level? Should it rather be read strictly so that the first flow-through entity in the chain would be regarded as shielding the ultimate lender from the AHP?

Beyond the uncertainties surrounding the 25 Percent Test itself (see above), the guidelines to be published will also have to address the operation of the AHP in cases where several relevant members of the lending flow-through entity are (i) affiliated to the borrower but (ii) in different situations for AHP purposes (i.e., one satisfying the 25 Percent Test but not the other, because of a different location or a different tax regime despite the same location). Should the deduction of the relevant interest payments then be denied for corporation tax purposes on a combined basis? Should it rather be prorated on the basis of the participation of the sole affiliated entity failing the 25 Percent Test?

Overlap with CFC Legislation. The French CFC rules basically provide that the relevant portion of the profits of an enterprise, company, or entity are taxable in France in the following situations:

- If an entity subject to French corporate income tax operates an enterprise outside France or holds, directly or indirectly, 50 percent or more of a company or entity established outside France, and
- If such enterprise, company, or entity benefits from a so-called privileged tax regime.

Consequently, there is a possible risk that the AHP overlaps with such CFC rules in the case where a non-French lender would not satisfy the 25 Percent Test, but whose profits would ultimately be taxable in France under the aforementioned CFC legislation.

Although it has been confirmed by the Budget Minister during the parliamentary debates that the purpose of the AHP was not to catch amounts already caught by the CFC rules, precise details will be expected from the guidelines to be published by the French tax authorities.

Hybrid Entities. Even though it was not the official motivation of the initial proposal, nor the apparent intention of the Parliament, the language of the AHP could effectively result in encompassing hybrid entities (i.e., a same entity being a corporation for tax purposes in a jurisdiction, and a partnership or a disregarded entity for tax purposes in another).

Indeed, in the case where the French borrower (be it a net borrower or an on-lender of the amounts borrowed) would be disregarded for tax purposes under the tax rules applicable in the jurisdiction of the lender, the AHP could technically kick in as the 25 Percent Test would be regarded as not being satisfied (i.e., if the borrower is disregarded, then the relevant borrowing itself should be disregarded, and it would just not be possible to satisfy the 25 Percent Test).

As the AHP does not provide for any safe harbor or tiebreaker, taking into account the tax regime applicable in the other jurisdictions involved in the 25 Percent Test comparison, one may wonder to what extent the guidelines to be published by the French tax authorities will at all address the situation of hybrid entities.

Coordination with Foreign Anti-Hybrid Provisions. While the vote of the AHP was clearly intended to support the recent OECD and European Commission propositions related to the so-called mismatches of hybrid finance instruments, the French unilateral approach based on a denial of the interest deduction now appears to create serious risks of double taxation.

Indeed, aforementioned multilateral propositions instead aim at denying the benefit of a participation-exemption regime for dividends at the level of the lender (or, rather, financing provider) ("PE-Based Approach") where the dividends so received have given rise to a deduction at the level of the borrower, since the relevant payments could be regarded as interest payments.

As a result, the confrontation of the AHP with a legislation following the PE-Based Approach (e.g., the German anti-avoidance rule targeting hybrid debt instruments) could give rise, for the same payment, to (i) a denial of the deduction at the level of the French borrower, and (ii) a denial of the participation-exemption regime at the level of the lender.

As the AHP does not provide for any safe harbor or tiebreaker in the case where the other jurisdiction involved in the 25 Percent Test comparison has adopted a PE-Based Approach, one may wonder to what extent the guidelines to be published by the French tax authorities will at all address the double taxation risk.

Recent Case Law Affecting French CFC Rules

During the last 15 months or so, French tax courts have issued various decisions that may have a significant impact on the application of the French CFC rules (article 209 B of the French tax code (*Code général des impôts*, or "FTC")).

Basic Operation of the French CFC rules. The French corporate tax rules are on a strict territoriality basis, i.e., only profits generated in France are liable to tax.

Article 209 B introduces an exception to the above territoriality principle, and it may be summarized as follows:

- If a French corporate taxpayer owns, directly or indirectly, more than a certain threshold (currently 50 percent) of the share capital or voting rights or financial rights of a non-French entity; and
- Such non-French entity benefits from a so-called "privileged tax regime" in the jurisdiction where it is located (i.e., its effective tax rate in such jurisdiction is more than 50 percent lower than the effective French tax rate that would have been applicable in similar circumstances); then
- The French corporate taxpayer would be deemed to receive fully taxable dividends, from such non-French entity, in proportion to its participation in the latter.

When the non-French entity is located within the European Union, a specific safe harbor rule applies whereby article 209 B is applicable only if the participation of the French corporate taxpayer, in the above entity, is an artificial scheme targeting the avoidance of French tax legislation.

When the non-French entity is located outside of the EU, article 209 B is disapplied if the French taxpayer can prove that the principal purpose and effect of the operations, effected by the above entity, do not consist of a transfer of profits to a tax-privileged jurisdiction ("General Safe Harbor"). Article 209 B provides that, inter alia, such evidence is deemed to be provided when the non-French entity has, principally, an effective industrial or commercial activity in the jurisdiction where it is located ("Deemed Safe Harbor").

Case Law Interpretation of the Safe Harbor Rules. The case law referred to, at the beginning of this section, concerns the interpretation of the above safe harbor rules, and although they relate to a period where the wording of article 209 B of the FTC was a bit different, the resulting principles are valid under the current version.

The case law refers to two different situations, both involving a French bank:

- In one case, the potential CFC subsidiary, based in Guernsey, had a private banking activity; the local effective rate of taxation was about 4 percent, and, accordingly, article 209 B would have been applicable unless the safe harbor rule could protect the French bank.
- In the other case, the potential CFC subsidiary, based in Hong Kong, was active in the currency markets of the surrounding region; the effective taxation rate in Hong Kong was de minimis, i.e., as with the Guernsey entity, article 209 B would have been applicable if the safe harbor rule was not an effective defense.

Without going into the procedural details, the cases were first decided by the lower courts, and afterward, the Supreme Court (*Conseil d'Etat*) voided these decisions and referred them back to the lower courts. They were finally decided in summer 2013.

In both cases, the initial query was whether, for the purposes of the safe harbor rule, one should refer to the "purpose" or to the "effect" of incorporating the non-French entity in a tax privileged jurisdiction.

The position of the French tax authorities was that only the "effect" should be taken into consideration, i.e., if the presence in the non-French jurisdiction enabled a reduction in tax liability (as defined by article 209 B), then any question about the motivation or "purpose" of such presence would be irrelevant. Actually, the position of the French tax authorities seemed correct on the basis of the then-current version of article 209 B, which was indeed referring only to the effect (*Note*: the current version refers to the object *and* the effect). However, the *Conseil d'Etat* decided that, despite the wording of article 209 B, one should refer to the motivation of the taxpayer for the purpose of the safe harbor rule.

Indeed, the *Conseil d'Etat* took the view that, from a constitutional perspective, the taxpayer should be in a position, when challenged on the basis of an anti-abuse legislation (such as article 209 B), to provide the evidence that its operations were not principally tax motivated despite the local low effective rate of taxation. In other words, if only the effect were taken into account (i.e., the low tax rate), it would have been extremely difficult for the taxpayer to be protected under the safe harbor rule. Once this principle was established by the *Conseil d'Etat*, the lower court decided as follows:

- In the case of the Guernsey subsidiary of the French bank, the lower court took the view that the subsidiary was targeting international individual clients who were attracted by the banking and tax legislations applicable in Guernsey; in other words, these international clients, given their specific needs, would not have been attracted by the French bank acting from France. Interestingly, the lower court added that even if some of these clients were French, and they used French-sourced funds, the above reasoning should not be modified given that article 209 B targets the motivation of the French bank and not the motivation of its clients.
- In the case of the Hong Kong subsidiary of the French bank, the lower court took the view that the subsidiary was managing the Asian currency position of the banks' affiliates in the region (specifically by investing in the Korean market), and that such an activity could not have been effected from France given the time difference and the required expertise that may only be found locally. As with the Guernsey situation, the French tax authorities were arguing that some of the clients and funds available to the subsidiary were potentially of a French origin, and the court decided that even if these allegations were true, they would be irrelevant for the purposes of the application of the safe harbor rule.

While it is too early to decide whether there has been a definitive change in terms of application of article 209 B (from a safe harbor rule perspective), one can expect certain tendencies:

- Contrary to the position of the French tax authorities, the courts would take into account the motivation of the French taxpayer (and not only the effect of being located in a low tax jurisdiction); and
- The Deemed Safe Harbor would be less used in the future as it would imply that the relevant activity is performed in the jurisdiction where the entity is located; typically, in the Guernsey situation discussed above, the General Safe Harbor was more efficient given the bank's international clients (who are obviously not located in Guernsey).

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Germany

German Tax Authorities Allow Tax Deductibility of Additional Tier 1 Capital
Until very recently, the German tax characterization (debt or equity) of so-called Additional Tier 1 Capital instruments issued under the new regular capital framework for banking institutions (the so-called Basel III framework) was uncertain. On March 13, the German tax authorities announced that they plan to address this issue in a circular that will confirm the debt treatment. This clarification is in line with the practice in a number of other important tax jurisdictions and has been well received by the German financial institutions.

German Domestic Anti-Abuse Rules Regarding the Taxation of Partnerships Possibly Unconstitutional
In recent years, the German legislature introduced a number of special anti-abuse provisions that seek to deny certain tax benefits of a tax treaty or an EU tax directive in cases of perceived and actual abuse. The German domestic anti-treaty shopping provisions that deny such benefits dependent on whether the taxpayer meets certain specific substance requirements are a prominent example.

The German Federal Tax Court (*Bundesfinanzhof*), the highest tax court, took the view that these provisions constitute unconstitutional treaty override and has referred a specific case to Germany's Constitutional Court (*Bundesverfassungsgericht*) and has requested that a specific anti-abuse provision applicable to the taxation of international partnerships be declared void.

IN THIS ISSUE

It is widely expected that the *Bundesverfassungsgericht* will follow the arguments of the *Bundesfinanzhof* and will decide that the specific provision is void and can no longer be applied. Such decision would potentially also affect other anti-abuse provisions included in German domestic law.

German Constitutional Court Issues Ruling on Retroactivity of Tax Laws

On December 17, 2013, the German Constitutional Court (*Bundesverfassungsgericht*) issued a decision in respect to a tax law that had retroactive effect when it was enacted.

International tax observers are always concerned about the practice of the German legislature to enact tax laws with retroactive effect. Under German law, a distinction must be made between true retroactive effect and pseudo retroactive effect. The latter is permitted and applies when a legislator changes the law before a relevant tax period is completed. With respect to the income and corporation tax, the tax period is completed at the calendar year-end. Consequently, changes to the tax law during a calendar year (in many cases at the end of a calendar year) that will be effective as of the beginning of the same year are permitted under constitutional law and are referred to as "pseudo retroactive." One may well dispute whether such changes are in fact pseudo retroactive, but it has been the longtime position of the German Constitutional Court.

In cases where the tax year is already completed, a retroactive change to the tax law is generally not permitted and is referred to as "true retroactive." However, there are some exceptions to this rule. In the past, the legislature enacted laws retroactively and argued that the new law does not change the legal position of the taxpayer because the new law is only a clarification of existing law. Thus, it has retroactive effect and should be applicable to all open cases.

The Constitutional Court has now taken the position that the unclear wording of the existing law does not justify the retroactive implementation of a new law because such wording can be interpreted by the courts. Thus, there is no need for the legislature to protect the public from the existing law. Further, the legislature has no right to determine how a law is to be interpreted simply by enacting a new law retroactively. It may, however, change the law going forward and clarify the content.

Through this decision, the Constitutional Court

narrowed the cases where the implementation of law with retroactive effect is permitted under German law.

German Tax Court Rules on Termination of Fiscal Unity under International Reorganization

In November 2013, the German Federal Tax Court (*Bundesfinanzhof*) held that an intra-group reorganization involving the transfer of shares in a German subsidiary does not constitute a good cause to terminate the fiscal unity (*Organschaft*).

According to the German Corporate Income Tax Act, the formation of a fiscal unity that enables the netting of profits and losses of the parent and its subsidiary is based on a corporate agreement. The tax law stipulates that such agreement requires a minimum term of five years. As an exception to this five-year minimum term, the law permits an early termination based on good cause. Generally, the sale and transfer of a subsidiary is such good cause and has been recognized by the German tax authority when the five-year minimum term has not been adhered to.

In contrast to long-standing practice, the German Federal Tax Court now holds that an internal share transfer does not qualify for a termination for good cause. Consequently, if the five-year minimum term is not respected, the fiscal unity will be invalid and not effective from the very beginning. The affected entities will be treated as if no fiscal unity had ever existed and will be taxed on a stand-alone basis. The German Federal Tax Court does not comment on third party transactions.

This new case law will affect many group internal reorganizations since the fiscal unity is a very common structure to optimize the tax bill. The adherence to a five-year minimum term will become a crucial issue in such cases.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Italy

New Decree Expands the Scope of the International Ruling Procedure
The main area of application is transfer pricing, in particular advance pricing agreements, but it may also apply to (i) the attribution of income or losses to Italian permanent establishments of nonresident taxpayers and to foreign permanent establishments of Italian-resident taxpayers, or (ii) the application of tax treaties to dividends, interest, and royalties.

The Decree Law No. 145 of December 23, 2013 (ratified by Law No. 9 of February 21, 2014) broadens the scope of the international ruling procedure. The main area of application is transfer pricing, in particular advance pricing agreements, but it may also apply to (i) the attribution of income or losses to Italian permanent establishments of nonresident taxpayers and to foreign permanent establishments of Italian-resident taxpayers, or (ii) the application of tax treaties to dividends, interest, and royalties. Rulings issued under this procedure are binding on the taxpayer and the tax administration for the tax year in which they are issued and the following four years (two years under the regime applicable before the recent amendment).

Clarifications with Respect to Deductibility of Losses on Receivables
The Finance Act 2014 clarifies the conditions that must be met to deduct losses on receivables. Under the Italian Income Tax Act, companies may deduct these losses only if they are evidenced by certain

IN THIS ISSUE

and precise facts (*elementi certi e precisi*). The Italian Tax Authorities and the Italian Supreme Court have very often taken a conservative approach and have rarely recognized the existence of such certain and precise facts. In particular, they have denied deduction of the loss deriving from the sale of a receivable for a price lower than its book value if the taxpayer could not give conclusive evidence that it could not collect the receivable from the debtor. Companies adopting IAS/IFRS to draft their financial statements were deemed to have fulfilled the condition for deductibility if they had properly written off (derecognized) the receivable according to IAS/IFRS. Finance Act 2014 amended the Italian Tax Act so as to extend this latter rule to companies that adopt Italian GAAP to draft their financial statements. Therefore, the Italian Income Tax Act now clarifies that certain and precise elements are deemed to exist if a company has duly derecognized the receivable from its balance sheet in compliance with Italian GAAP.

Amendments of the Tax Regime for Financial Leases

The Finance Act 2014 amended the tax regime applicable to financial leases for corporate income tax ("IRES") purposes, making it more favorable than before. Under Italian tax law, a lessee that does not follow IAS/IFRS to draft its financial statements can deduct the lease payments, regardless of the method used to account for the financial lease. Under the previous regime, which still applies to financial leases executed until December 31, 2013, the lease payments had to be deducted over a period that could not be shorter than two-thirds of the statutory depreciation period of the asset (or the entire statutory depreciation period in the case of leasing of motor vehicles). Moreover, if the leased asset was real property, the lease payments had to be deducted over a period that could not be shorter than two-thirds of the statutory depreciation period of the asset and that could not, in any case, be shorter than 11 years or longer than 18 years. Under the new regime, which applies to financial leases executed as of January 1, 2014, the lease payments must be deducted over a period that is not shorter than half of the statutory depreciation period of the asset (or the entire statutory depreciation period in the case of leasing of motor vehicles). If the leased asset is real property, the lease payments must be deducted over a period of no less than 12 years.

Global Tax Update
Issue 1 | May 2014

JONES DAY

What's New

Japan

Changes to Permanent Establishment Allocations

Under the most recent tax reform, approved by the Diet in March, Japan has changed its general tax rules applicable to a foreign corporation having a permanent establishment in Japan ("FCPE"). Under the current Japanese domestic tax law, which adopts the "force of attraction" principle, all income arising from sources within Japan is fully taxable regardless of whether such income is attributable to the FCPE. Under the revised Japanese domestic tax law (the "New Domestic Rules"), (i) income attributable to an FCPE will be taxable regardless of the source; and (ii) income attributed to an FCPE will be calculated in line with the Authorized OECD Approach (the "AOA"). Please note that the concept of an FCPE under the Japanese domestic tax law will remain unchanged. FCPEs are generally divided into the following three categories: (i) a branch, or any other fixed place where business in Japan is conducted; (ii) a construction site or installation project; and (iii) an agent PE. The concept of PE under Japanese domestic law is slightly broader than that under the OECD Model Tax Convention.

Under the New Domestic Rules, (i) internal dealings within a single entity will be recognized (e.g., internal royalty, internal interest, internal service fees (including appropriate mark-ups), etc., will need to be charged to calculate Japanese corporation tax); (ii) a mere purchase by an FCPE of goods for its head office will generate profits; (iii) prices of internal dealings not in line with the arm's-length principle

IN THIS ISSUE

will trigger the taxation equivalent of transfer pricing taxation; and (iv) an FCPE may claim a foreign tax credit on its Japanese corporation tax return. Reasonable cost allocation from a head office to an FCPE, such as the allocation of overhead expenses related to administrative functions performed by the head office for the benefit of the FCPE, without any mark-ups, will continue to be deductible. In addition, some documentation requirements (including documentation similar to transfer pricing documentation) will be imposed on FCPEs.

Note: The New Domestic Rules explicitly provide that if an income tax treaty not incorporating the AOA is applicable, internal interest for non-financial enterprises and internal royalties will not be recognized, and a mere purchase of goods will not generate profits for Japanese corporation tax purposes.

The New Domestic Rules will apply to the corporation tax for a fiscal year commencing on or after April 1, 2016.

Revision of the Japan–UK Income Tax Treaty
On December 17, 2013, the Protocol Amending the Convention between Japan and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains (the "Protocol") was executed in London.

The Japan–UK income tax treaty amended by the Protocol (the "Revised Treaty") will be the first income tax treaty for Japan that adopts the Authorized OECD Approach (the "AOA"). Under the Revised Treaty, (i) shareholding requirement with regard to dividends exempted from taxation by the source country will be reduced from "50 percent or more" to "10 percent or more"; (ii) interest income will, in principle, be exempted from taxation by the source country; (iii) capital gains arising from the transfer of shares similar to business transfers by the source country will, in principle, be exempted; (iv) arbitration proceedings under the mutual agreement procedure will be introduced; and (v) the tax authorities of Japan and the UK may assist each other in the collection of revenue claims (specifically for consumption tax, value added tax, inheritance tax, and gift tax, to which the Revised Treaty is not applicable).

The Protocol will take effect 30 days after the date of the exchange of diplomatic notes indicating the approvals required under the legal procedures of both Japan and the UK.

For additional reference, as of March 1, Japan has concluded 51 income tax treaties applicable to 62 jurisdictions and eight tax information exchange agreements applicable to eight jurisdictions. Japan is also a member country of the "Convention on Mutual Administrative Assistance in Tax Matters." The income tax treaty between Japan and Germany is currently undergoing official negotiations.

Increase of Consumption Tax Rate

Effective as of April 1, the combined rate of national and local consumption taxes has increased from 5 percent to 8 percent (6.3 percent national tax and 1.7 percent local tax). The consumption tax rate is planned to further increase from 8 percent to 10 percent (7.8 percent national tax and 2.2 percent local tax) on October 1, 2015. Accordingly, subject to certain exceptions, consideration paid for the transfer or lease of assets or the provision of services for business purposes on or after April 1, is subject to the new 8 percent consumption tax rate. However, the consumption tax rate of 5 percent will apply to any transfer or lease of assets or provision of services for business purposes occurring prior to April 1, even if such consideration is actually paid on or after April 1.

The Japanese consumption tax is characterized as an indirect tax. Therefore, almost all domestic transactions and all transactions concerning the importation of foreign goods are subject to taxation. Under the Consumption Tax Law, taxable domestic transactions are defined as domestic transactions in which consideration is paid for the transfer or lease of assets or the provision of services for business purposes. Exceptions include transfers of accounts receivable, transactions involving securities and other financial or capital, and the provision of medical, welfare, educational, and other services, all of which are outside the scope of the Consumption Tax Law. The consumption tax is structured to ultimately be passed on to consumers by affixing it to the price of products and services provided by a taxable enterprise. In order to eliminate multiple taxation at each stage of manufacturing and distribution, crediting the consumption tax on purchases against the consumption tax on sales is allowed. The basic formula for calculating the consumption tax is: <total amount of consumption tax on sales> minus <total amount of consumption tax on purchases>.

New Reporting System for Offshore Assets

The 2012 tax reform, which was approved by the Diet in March 2012, introduced a reporting requirement for offshore assets. Starting from January 1, 2014, under the new reporting system, a permanent resident in Japan whose offshore assets

exceed JPY 50 million (or US$500,000 at the exchange rate of JPY 100 equal to US$1) as of December 31 of the previous year must submit an Offshore Assets Report Form to the relevant tax office by March 15. This reporting requirement applies not only to Japanese citizens but also to non-Japanese citizens who have lived in Japan for more than five of the past 10 years.

"Offshore assets" means anything that has economic value and is located outside Japan, including, but not limited to, movable property, immovable property, loans receivable, intellectual property, savings, and securities and stock options. The fair market value or estimated value of each offshore asset as of December 31 must be reported on the Offshore Assets Report Form.

Any person who fails to submit the form on time without a justifiable reason or submits a false form may be subject to imprisonment of up to one year or a criminal fine of up to JPY 500,000 (this sanction is applicable to forms to be submitted on or after January 1, 2015). Further, if a form is not submitted on time or is missing a description of relevant offshore assets, and an additional tax for deficient returns or for a non-filing or delayed filing of a tax return is imposed in connection with such offshore assets, the amount of additional tax will be increased by 5 percent of the income tax imposed in connection with the offshore assets.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Mexico

New Withholding Tax on Dividends in Mexico
Up to December 31, 2013, Mexico did not tax dividend payments. However, the Mexican Income Tax Law ("MITL") that entered into force on January 1, 2014 established a new 10 percent withholding tax on the gross amount of dividend payments made by legal entities resident in Mexico for tax purposes to its shareholders.

The 10 percent withholding tax will be applicable to the following shareholders of the relevant entity paying dividends: individuals who are tax residents in Mexico and foreign shareholders. No withholding tax is triggered when a legal entity resident for tax purposes in Mexico pays dividends to other Mexican resident legal entities.

Most of the 57 tax treaties executed by Mexico include either a reduced withholding tax rate on dividend payments for some qualified shareholders (e.g., 5 percent for the tax treaties with the United States, Germany, Belgium, Spain, Canada, France, Luxembourg, South Africa, Panama, Uruguay, Japan, or China, among others) or a source taxation exemption (e.g., the tax treaties with the U.S., Singapore, Australia, Colombia, Hong Kong, Japan, Kuwait, Qatar, Sweden, Switzerland, or the United Kingdom, among others).

As established in the former income tax law, the MITL provides that all Mexican entities are obligated to keep and calculate the after-tax profit account ("CUFIN," for its Spanish acronym), in order to

IN THIS ISSUE

identify all profits that were already subject to corporate taxes in Mexico. In this respect, the transitory provisions of the MITL establish that the 10 percent withholding tax on dividends will be applicable only to those dividends paid from the CUFIN generated after 2013.

Finally, in order to avoid distortions when paying dividends between Mexican legal entities, the administrative regulations issued by the tax authorities clarified that dividend payments made by a Mexican tax resident legal entity to another Mexican legal entity from the 2013 CUFIN will be considered as an increase of the 2013 CUFIN of the entity receiving the dividends.

Claiming Tax Treaty Benefits in Mexico as of January 1

The new Mexican Income Tax Law ("MITL") that entered into force on January 1 modified the so-called procedural provisions concerning the application by multinational companies of benefits set forth under tax treaties negotiated and executed by Mexico.

Accordingly, foreign residents claiming tax treaty benefits (either for a tax exemption or for a reduced withholding tax rate) should comply with the following requirements; otherwise, withholding agents will not apply these benefits and could withhold taxes up to a 35 percent general tax rate for Mexican-source taxation for foreign residents:

- Provide a certificate of tax residency issued by foreign tax authorities or a certification from these authorities that the foreign resident filed its tax return (this is the only requirement that was needed up to 2013).
- Appoint, through a power of attorney (granted before a foreign notary and apostilled or legalized by the Mexican consulate) a Mexican tax resident as its legal representative for tax purposes in Mexico.
- File, through the legal representative for tax purposes, either an informative tax return or a tax report.

For related party transactions, the tax authorities may request that the filer, through the legal representative for tax purposes, file a declaration under oath stating that the income subject to income tax in Mexico is also subject to income tax in the country of its residence. This declaration should expressly indicate the specific legal grounds for such foreign taxation, as well as any other documentation that, to the taxpayers' criteria, may be useful to prove such circumstance.

According to Article 26, Section V of the Federal Tax Code, and Article 208 of the MITL, Mexican taxpayers that accept the role of legal representative (for tax purposes) of a foreign taxpayer will be jointly and severally liable for the unpaid taxes of the foreign taxpayers and will be obligated to keep, for a period of five years, all documents and information related to Mexican source income of said foreign taxpayers.

Follow us on:

Jones Day is a legal institution with 2,400 lawyers on five continents. We are One Firm Worldwide[SM].

Global Tax Update
Issue 1 | May 2014

JONES DAY

What's New

The Netherlands

Supreme Court Takes Formal Approach and Sides with Taxpayer in Landmark Hybrid Instrument Case

The Netherlands takes a rather formal approach with respect to the tax characterization of a financial instrument, as the form of the instrument is generally decisive for its character for Dutch tax purposes. A substance-over-form exception applies, however, for a debt instrument that (i) has no term or a term in excess of 50 years, (ii) carries a profit contingent interest, and (iii) is subordinated. The Dutch Revenue Service argued that a substance-over-form exception should be made as well with respect to certain debt-like equity instruments, but this argument has been dismissed by the Supreme Court in a February 7, 2014 ruling. The case related to redeemable preferred shares issued by an Australian company to a Dutch company that sought to apply the participation exemption with respect to its income from the shares. The shares had the following characteristics: (i) an entitlement to cumulative and fixed dividends, (ii) seniority over other share classes, (iii) redemption after 10 years, and (iv) limited voting rights. Furthermore, the Australian issuer was entitled to deduct the dividends for Australian tax purposes.

With its decision, the Supreme Court settles a long debate in favor of the taxpayer by rejecting that equity can be recharacterized into debt for purposes of the participation exemption, even if a deduction is available for the issuer. Taxpayers that seek to benefit from this ruling need to be cautious,

IN THIS ISSUE

however, in view of the recent proposals to amend the EU Parent-Subsidiary Directive and the OECD work on hybrid mismatch arrangements, which both seek to deny the participation exemption in case the issuer is entitled to a deduction.

Introduction of New Reporting Requirements for Certain Intra-Group Lending, Licensing, and Leasing Activities

Beginning on January 1, Dutch companies that are predominantly involved in intra-group back-to-back lending, licensing, or leasing transactions and that seek benefits under a tax treaty or the EU Interest & Royalty Directive with respect to their income must report in their tax return that they meet certain minimum substance requirements. If not all requirements are met, the Netherlands will exchange information with source countries. The new substance requirements are the following:

- At least 50 percent of the statutory directors with the authority to vote on the board is Dutch resident, with sufficient knowledge to carry out their duties;
- The company should have sufficient staff—employed by the company or hired from a third party—to carry out its activities;
- The resolutions of the board are passed in the Netherlands;
- The company should manage its main bank accounts from the Netherlands;
- The company should have a Dutch address;
- The company should keep its books in the Netherlands;
- The company is not regarded as a tax resident of another country;
- The company runs a real risk with respect to its activities within the meaning of the law; and
- The company's equity is appropriate in view of its real risks.

Very similar requirements have already been in existence since 2001 for companies that seek to obtain an Advance Tax Ruling and/or Advance Pricing Agreement.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

Spain

Government Launches Tax Reform
The government of Spain has launched a tax reform that "will not be a simple retouch" but that will entail major changes that, as announced by the government, will place us before a simpler, fairer tax system that will offer greater flexibility to the private sector."

The messages from the various public and private sectors that will be affected by the change in the tax system anticipate "that they will not be short-term measures," but "they will extend a tax cut in order to boost the economic activity and encourage savings."

The establishment by the government of an Experts' Committee for Tax Reform, which has been entrusted with the production of a report reflecting its recommendations, will be crucial to draw the general lines that will shape the tax reform that will become effective on January 1, 2015.

Such reform will include a modification of individual income tax, corporate income tax, nonresident tax, or the taxation of property owned in Spain. Hence, beginning in September 2014, careful attention should be paid to the measures that are approved and that will become effective from 2015, in case any operation was to be carried out before the entry into force of the new regulations.

Changes to Exit Tax
With effect from January 2013, the Law on Corporate Income Tax has been modified in cases of change of

IN THIS ISSUE

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

United Kingdom

EU Investigates the Legality of the UK Patent Box Regime
The recently introduced UK patent box regime is under renewed investigation by the EU. The EU has asked the UK to provide it with certain documents in order to enable it to investigate whether the patent box regime constitutes state aid. The UK government is robustly defending its position. If the regime is found to have breached EU legislation on state aid, the consequences could be significant and would fall not on the UK government but on the companies having claimed the relief, which could expect to be asked to pay a greater amount of tax on income within the regime.

The patent box regime was introduced by the current UK government soon after it was elected. Under the regime, certain income linked to the exploitation of EU patents is taxed at a reduced rate. The effective rate of tax for income within the regime is 10 percent, i.e., half the UK corporation tax rate on profits.

It was thought that the EU's challenge to the UK patent box regime had been "kicked into the long grass" at the end of last year but *Financial Times* recently reported that the EU had requested further documents from the UK in the course of examining the lawfulness of the regime. The UK did not consider that the patent box was a form of state aid and therefore did not seek clearance from the EU before introducing it. If it is finally determined that the UK patent box regime is a form of state aid, the

IN THIS ISSUE

fact that it was not cleared by the EU before it was introduced could lead to the regime being held to be unlawful.

Court Case Arguably Clarifies UK Source Rules with Respect to Interest

A recent case heard by the First Tier Tribunal (the junior UK tax tribunal) serves as a timely reminder of the complexities that surround the UK's regime for deduction of tax from interest paid. In general, the payer of UK-source interest to a recipient outside the UK is required to withhold 20 percent from the interest. This obligation can be reduced (either in whole or in part) under the terms of a tax treaty entered into by the UK. The recent decision, *Andrew Collins Perrin v the Commissioners for Her Majesty's Revenue and Customs*, although decided in favor of HMRC rather than the taxpayer, arguably clarifies how the question of whether interest has a UK source will be decided.

The source of the interest is to be distinguished from the situs of the debt. It is relatively easy to identify the situs of the debt—usually the place of residence of the debtor—but UK courts have consistently refused to identify the source of the interest with the situs of the debt. Instead, a number of factors must be weighed. The tribunal clarified which factors carry the most weight in determining the source of the interest. The most important factors are : the residence of the debtor, the location of any security, and the place where the debt can be enforced. Others, for example the place where the interest is contractually stipulated to be paid, are less important and in some cases completely irrelevant.

The *Andrew Collins Perrin* case serves as useful reminder that interest paid between two non-UK bank accounts can nonetheless have a UK source and therefore require the payer to deduct UK tax at 20 percent. Even if the recipient is in a country that has a double tax treaty with the UK, reduced withholding under such treaty is possible only if the payer has first received a direction from HMRC authorizing payment gross or deduction at less than the full 20 percent UK rate.

Increased Use of UK Tax Resident Holding Companies

There have been a significant number of high-profile transactions where UK tax resident companies have become new holding companies of multinational groups. In 2013, LyondellBassel Industries NV (market capitalization: $49 billion) moved to the UK, and Fiat Industrial and CNH Global merged and established UK residence. In 2014, Fiat, Chrysler, Omnicom, and Publicis announced similar transactions.

The UK has established itself as a very attractive holding company jurisdiction. Various changes to the UK rules (e.g., exemptions for dividends received, amendments to UK CFC rules) and existing features of the UK (no withholding tax on dividends, wide treaty network) make it a favorable environment in which to operate. Just as important, UK company law is flexible and familiar for common law jurisdictions. A number of these transactions have used EU style mergers to redomicile the company for corporate law purposes. Although the UK does not have a domestic merger regime, it has adopted legislation to confirm with the EU mergers directive, which allows UK companies to merge into EU companies or vice versa. We would expect more of these transactions to be announced in the future. Significant acquisitions/mergers provide a compelling rationale for redomiciliation, especially where neither of the companies involved wants to be perceived as becoming a subsidiary of the other, and both would prefer to find a neutral third party jurisdiction. Jones Day has been involved in a number of similar transactions and has the experience to implement them both on the tax and corporate side.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

What's New

United States

Senate Hearing on Profit Shifting
On April 1, the Senate Permanent Subcommittee on Investigations held another hearing on multinational corporations that actively reduce their worldwide tax burdens by shifting profits out of the U.S. Senators and witnesses disagreed as to whether the specific transactions that U.S. corporate taxpayers use to move income to entities outside the U.S. (to other entities in their worldwide group) should be subject to scrutiny or praised. Some senators even questioned the propriety of the hearing itself.

Unlike prior similar hearings that focused on IT companies, this hearing focused on domestic manufacturing companies. In the typical transactions, companies restructured their foreign operations so that non-U.S. subsidiaries organized in low-tax jurisdictions would pay the domestic operating subsidiaries a small markup in exchange for providing all of the services and support required to perform certain foreign sales, resulting in a significant amount of the profits being reported abroad as opposed to the U.S. Although the location of the profit-making activities did not change, in one cited case, this activity netted $2.4 billion in U.S. tax savings over a 12-year period. While a few senators and witnesses argued that these type of arrangements were unsupported by the tax law and should have been challenged by the IRS, many others argued that these arrangements complied with all relevant statutes, regulations, and case law, and in fact represented activities that reasonable businessmen and businesswomen should engage in

IN THIS ISSUE

as fiduciaries of the company.

While the subcommittee members argued that the real problem was a broken tax code, many suggested that different flaws were to blame. Republican members argued that the high corporate tax rate causes U.S. multinationals to move their activities offshore, and that the U.S. corporate rate needs to be reduced in order to maintain worldwide competitiveness. Democratic members argued that the rules regarding interparty and cross-border transactions need to be fixed so as to prevent income from domestic activities from being reported abroad. Due to disagreements about the appropriateness of subjecting any specific taxpayer to this type of public scrutiny and the egregiousness of the transaction at issue, the Republican members refused to sign onto the subcommittee's scrutiny of these taxpayers.

This type of congressional action seems to be the precursor to a meaningful debate that could result in a significant reduction in the U.S. corporate tax rate, or a change in the rules that would make is difficult for U.S. multinationals to move their operations, and hence profits, to non-U.S. group members located in jurisdictions that offer more competitive corporate tax rates. It is unlikely that any changes will occur before the 2014 mid-term elections in November, but depending on the outcome of those elections, the landscape upon which U.S. multinational do business could change significantly.

New FATCA Guidance

On April 2, the U.S. Treasury released Announcement 2014-17 under the Foreign Account Tax Compliance Act, sections 1471 through 1474 of the Internal Revenue Code ("FATCA"), broadening the scope of when an intergovernmental agreement ("IGA") is considered to be in effect and extending the registration timeframe for foreign financial institutions ("FFIs").

FATCA Overview. Pursuant to FATCA, beginning on July 1, a U.S. withholding agent (e.g., a U.S. person who is an obligor on a debt instrument issued after July 1 or an issuer of stock) will be required to withhold 30 percent of certain U.S. source payments (e.g., interest or dividends) made to an FFI (e.g., a non-U.S. bank or potentially a non-U.S. investment fund), unless the FFI (i) enters into an agreement with the IRS or is located in a jurisdiction that has entered into an IGA with the U.S., (ii) registers with the IRS and (iii) obtains a global intermediary identification number ("GIIN") that it provides to U.S. withholding agents, and satisfies or is exempt from IRS or other governmental reporting requirements with respect to U.S. account holders.

For more information, visit Jones Day's website for our FATCA *Commentaries* ("Six-Month Extension of FATCA Deadlines—Another Joy of Summer," July 2013; "Treasury Issues Proposed Regulations on the Information Reporting and Withholding Tax Provisions of FATCA," April 2012; and "New FATCA Proposed Regulations: Eased Deadlines but the System Moves Forward," February 2012).

Broadened Scope of IGAs. The IRS maintains a published list identifying all jurisdictions that are treated as having an IGA with the U.S. (Model 1 or Model 2), including those jurisdictions that have signed IGAs that are not yet in effect. Pursuant to Announcement 2014-17, the IRS list will be expanded to include jurisdictions that, before July 1, have reached agreements "in substance" on the terms of an IGA, though not yet signed, and have consented to be included in the IRS list. Such IGAs will be considered in effect from the date the jurisdiction provides its consent through December 31. The IGA list can be found here.

Extended Registration Timeframe for FFIs. Pursuant to final regulations under FATCA, an FFI must register with the IRS on the FATCA registration website and obtain a GIIN that appears on an FFI list maintained by the IRS. For FFIs in Model 1 (but not Model 2) IGA jurisdictions, GIINs are not required until January 1, 2015. Pursuant to Announcement 2014-17, the IRS has extended the FFI registration date to May 5 for an FFI that wishes to have its GIIN included in the June 2 FFI list, and to June 3 for an FFI that wishes to have its GIIN included in the July 1 FFI list. For planning purposes, please note that the IRS is expected to continue to publish additional FFI lists beyond July 1, and withholding agents that receive a Form W-8 indicating the payee has applied for a GIIN have 90 days to verify the GIIN against the published FFI lists.

JONES DAY | **Global Tax Update**
Issue 1 | May 2014

JONES DAY

Who's Who

Getting to Know Blaise Marin-Curtoud, UK Tax Partner
Jones Day partner Blaise Marin-Curtoud helps his clients plan and conduct their businesses to manage tax liabilities, which in today's global business environment requires vast knowledge of multiple and changing tax codes as well as strategic problem-solving skills. Based in London, Blaise focuses on tax aspects of mergers and acquisitions and real estate transactions, both of which are thriving areas of law in the United Kingdom.

With its corporate tax rate of 20%, tax exemptions on dividends received from UK and foreign subsidiaries, and a capital gains tax exemption on the disposal of substantial interests in companies, the United Kingdom has become a very attractive environment in which to put the holding company of a corporate group. The country's flexible corporate law systems, which are familiar to clients in the European Union and clients from common law countries, make it even more attractive. In just the last year, the UK has been the site of several big-ticket transactions, including some where none of the parties to the transaction is a UK tax-resident

IN THIS ISSUE

company.

London's real estate sector is booming also, having come back strongly from the financial crisis and now reaping the benefits of a REIT (real estate investment trust) regime that was introduced in 2007. Blaise is pleased that Jones Day is representing several of the country's largest listed invested trusts.

Blaise enjoys both the intellectual challenges of tax law and the challenges of explaining issues that are quite complicated in ways that are relatively easy for clients to understand. "It is up to us as tax lawyers to read the source legislation and cases and come up with advantageous solutions, but we serve our clients best when we can distill all our knowledge and deliver it in an understandable way—yet without glossing over any of the essential content." While the stereotypical tax lawyer is a bit of a nerd, Blaise finds that his colleagues in Jones Day's Tax Practice are very bright people who work hard and know their stuff but are also approachable and personable.

Blaise also thinks that beyond the experience and sensitivity of individual Jones Day lawyers, the size and structure of our Firm and our Tax Practice allow us to serve our clients well. "With at least one tax lawyer in almost all our offices on six continents, we have geographic coverage and breadth of experience that very few other law firms can offer," he says. "And we are a truly integrated partnership operating as one Firm rather than a collection of profit centers, so we can assign the best individuals to meet our clients' needs, no matter where they are headquartered or do business. We also have a full range of other practices that we can draw on as needed—whether it is intellectual property, real estate, capital markets, or any other practice."

On a personal note, Blaise is the son of a United Nations diplomat who worked in New York and Geneva, and Blaise lived in the United States and France before studying law in the UK. These days, when he's not analyzing the intricacies of international tax laws or advising clients, he spends most of his time with his wife and two young children. If time allows, he'll also head to the kitchen to prepare dishes from complicated recipes that require every pot and pan in the kitchen, to the dismay of his wife. Cycling is another passion: Last year he trained for a stage of the Tour de France that was open to the public. Unfortunately he wasn't able to participate, but he may try again next year.

Blaise has written on a number of tax topics. If you'd like to read what he has to say about tax-transparent funds in the UK, reforms to the UK-controlled foreign companies regime, or a variety of

other topics, view his online profile here.

Blaise can be reached at +44.20.7039.5169 or by email at bmarin@jonesday.com.

Follow us on:

Jones Day is a legal institution with 2,400 lawyers on five continents. We are One Firm Worldwide[SM].