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Clear. Concise. Commercial.

The MO

Welcome to the April edition of the MTN.

Just when we thought the economic problems globally (and particularly within the EU) couldn't get any worse, along comes Cyprus. The recent developments are of grave concern, not least for smaller EU Member States that must now wonder what lies in store, Germany seemingly having had enough of propping up its partners.

From a tax point of view, the damage has surely been done to Cyprus' reputation. Whilst the corporate tax regime remains very attractive (albeit an increase in tax to 12.5%), it is difficult to see how advisers can safely recommend Cyprus in international structures. Needless to say, the anti-tax haven campaigners have latched on to Cyprus' demise with demonic fervour. The conflation of Cyprus as a low tax jurisdiction and Russian tax avoidance is very convenient but it is has nothing to do with the economic crisis. Headline grabbing is all too familiar but the debate demands substance over form.

In this vein, Miles and Andy attended the CIOT / IACF conference in Paris at which our brave leader spoke about *Current Tax Controversies and Internet Companies in the UK*. If you would like a copy of Miles' slides please contact Lianne. The conference was well attended and an open debate was encouraged by the excellent Chairman, David Sayers of Mazars. A very thought provoking session was that of Caroline Silberztein of Baker McKenzie, who spoke about the "*Collin and Colin*" report – a proposal to tax data collected by internet companies operating in the French market. Sally has summarised this "madcap" paper below.

Whilst left-field in its thinking, it is further evidence that international tax systems are under pressure to change. The OECD's *Base Erosion & Profit Shifting Report* is likely to be the cornerstone of any such change and the G20 meeting in Moscow will be interesting to say the least.

This month's MTN includes a Brazilian Deal of the Week, thoughts on the recent Anson case (which we have been following through the courts), the Spanish Royal Decree in respect of offshore assets and of course the (uneventful) UK Budget and much more.

Happy reading!
The Milestone Tax Team

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ALSO IN THIS ISSUE...

DEAL OF THE WEEK

Brazil

With the Confederations Cup being held in Brazil this year, followed by the World Cup and Olympics in the coming years, we have been advising a UK based client in the hospitality sector on the Brazilian tax profile of their Brazilian activities.

Historically, Brazil has been a capital importing jurisdiction and has been slow to expand its tax treaty network. This is by design: the absence of tax treaties is generally to the advantage of a capital importing jurisdiction because it allows it to impose withholding tax on outbound payments under its domestic law without treaty limitation. As the Brazilian economy matures and the country changes to a capital exporter we might expect to see Brazilian treaty policy change. However, for now, Brazil has a mere 29 tax treaties and, in particular, does not have a tax treaty with the UK (or the US).

The consequence in this case is that in determining whether a UK (or US) company doing business in Brazil has a Brazilian tax exposure, the answer begins and ends with Brazilian domestic tax law.

The first issue to contend with is that Brazil generally imposes a 25% withholding tax on Brazilian source contractual payments made to foreign entities. In this particular case, our client was providing hospitality services to the UK parent of a multinational so this issue did not arise as the payer was not Brazilian. However, one would be concerned where a payment obligation is artificially routed through a non-Brazilian payer since Brazil does have a General Anti-Abuse Rule.

Having established that the withholding tax does not apply, one must still confirm that the activities of the UK client do not give rise to a Brazilian taxable branch. There are also charging provisions which affect foreign entities who sell goods in Brazil through Brazilian commercial merchants or who enter contracts in Brazil through representative agents. These Brazilian domestic tax rules share some similarities with the OECD “permanent establishment” concept but they are not identical. As such the operational procedures which would serve to avoid a permanent establishment in a typical OECD jurisdiction may not necessarily suffice to avoid a Brazilian taxable presence. We produced bespoke operating guidelines to ensure our client’s activities did not trigger a Brazilian taxable presence.

Investors doing business in Brazil need to bear in mind that specific guidance must be sought in relation to Brazilian activities, particularly since Brazil does not have a developed tax treaty network.

UK

Budget 2013

On Wednesday 20 March, the Chancellor delivered his 2013 Budget Statement outlining how much tax the Government expects to collect, how much it needs to borrow and how much it will spend.

We didn’t expect much from this Budget. With the economy flat-lining, fears of a triple-dip recession and the current Government’s perseverance with austerity measures, there weren’t going to be any radical changes.

The announcement that corporation tax will fall to 20% in April 2015 will be of greatest interest to many, arguably cementing the UK’s status as a beneficial jurisdiction for multinational companies. The key features of the corporate tax regime are:

- the low rate of corporate income tax;
- dividend and capital gains tax exemptions;
- no withholding tax on outbound dividends;
- a patent box regime; and
- a CFC regime that (at last) is fit for purpose.

With regard to the Patent Box our concern is that it flatters to deceive (despite some left-field commentators arguing that it amounts to tax avoidance). The legislation, which is thankfully relatively short, has been drafted like so much other UK tax legislation - almost second guessing how it might be abused. The CFC rules are similarly complex: Only when kicking the tyres does it become apparent that obtaining the benefits is not straightforward.

Notwithstanding the above, the UK corporate tax regime is undoubtedly attractive, so let’s roll out the red carpet!

UK

The Curious Case of George Anson (Continued and Concluded!)

On 12 February 2013, the Court of Appeal published its decision in *Revenue & Customs Commissioners v Anson*. The case concerns the classification of a Delaware LLC for UK tax purposes and the creditability for UK purposes of US tax withheld on allocations of profit by the LLC.

The Court of Appeal held that a Delaware LLC should be taxed as an opaque entity for UK tax purposes (whereas for US tax purposes a Delaware LLC is tax transparent). As a consequence of this conflict of entity classification, the judgment held that the UK/US tax treaty does not oblige the UK to give double tax relief to a UK resident person in respect of US tax charged on distributions from the LLC.

We were pleased to see that Counsel for the taxpayer (Ernst & Young) adopted a technical argument on the interpretation of the UK/US tax treaty which had been originated by Conor in an article published in *Tax Planning International Review* in September 2011. Conor's article highlighted that the High Court judgment had failed to properly consider the terms of the new UK/US treaty, and in particular had omitted to consider a provision in the Exchange of Notes which extends the obligation of the UK to give double tax relief in cases where there is a conflict of entity classification.

We were disappointed that the Court of Appeal rejected this argument with a somewhat flaky judgment. Although we acknowledge that the relevant provision in the Exchange of Notes is open to debate, the manner of the Court of Appeal's judgment on this point is unsatisfactory. In particular, the judgment takes a narrow literal interpretation of the relevant provision (whereas the Vienna Convention on the Law of Treaties requires purpose and context to be considered) and also seems to place too much emphasis on HMRC's submissions about the intentions of the US in negotiating the provision in the Exchange of Notes. This latter point is evidenced in the US Technical Explanation (whereas the Vienna Convention does not permit unilateral documents such as the US Technical Explanation to be used to interpret the meaning of a bilateral agreement). But with the Court of Appeal refusing to grant permission to appeal we may have to wait for another case to make its way to the House of Lords for a more convincing judgment on this point.

It is perhaps noteworthy that the composition of the Court of Appeal included not a single specialist tax judge (let alone a judge with specialist expertise in interpreting international tax treaties).

GUERNSEY / MALTA

Income Tax Treaty 2012

Reporting another double tax treaty for the Channel Islands – barely an MTN goes by without one!

Guernsey has entered into a comprehensive double tax treaty with Malta that is based on the OECD Model. One notable deviation is the term "*collective investment scheme*" which is extended to include any pooled investment vehicle irrespective of legal form. Interestingly, the business profits article follows the UN Model rather than the OECD Model. This gives rise to subtle differences in the treatment of deductible expenses and profit calculation when determining the profit to be attributed to a permanent establishment.

Like the Jersey / Malta treaty there is no withholding tax on dividends, interest payments or royalties. The scope for using the treaty may be limited in that Malta does not, under its domestic legislation, deduct withholding tax on outbound payments. It does, however, operate a unilateral credit method in respect of certain baskets of income such that the headline rate of 35% is reduced to c.5% upon dividends being distributed. This raises an interesting question in light of the Cyprus debacle: paying 10% income tax is one thing, but paying 35% to the state and relying on a refund to achieve the tax benefits the system offers is a completely different kettle of fish. The Cyprus dilemma is unique, but its effect will be felt globally, not least in the offshore world, for a long time to come.

THE WORLD

Current International Tax Controversies

As mentioned in the MO, Miles spoke at the CIOT Paris Conference about the media war on tax avoidance, and in particular the focus on internet companies such as Google and Amazon. He raised the point that other internet companies are as much "over here" and paying little or no tax but don't get a mention. Such companies are of course engaged in rather more nefarious activities than selling books (i.e. the on-line porn industry). It seems to us that the unregulated access to porn (of all shades of grey) is more concerning than Amazon or Google's antics but that's another story for another day. The real controversy is not so much the business structures adopted by Amazon and Google, but that these companies are not avoiding UK tax. More on this next month.

While the pressure remains on large corporates, so it mounts on individuals with claims of widespread tax evasion in the Caribbean. The Guardian reported this week an exposé of the British Virgin Islands offshore industry. The article, a collaboration with The International Consortium of Investigative Journalism, claimed to send "*a seismic shock worldwide to the booming offshore trade*". It then went on to name and shame various political and business figures from far flung corners of the world. The article ironically pours water on its own claims that offshore jurisdictions are "secrecy havens" – clearly not that secret if Washington hacks can obtain it!

On a more serious note the article itself and the reporting of it borders on hysteria and sensationalist conspiracy theory. The article names officials in Mongolia, Azerbaijan and so on but fails to take note that the laws in such places may well be so unsophisticated that placing funds in tax haven structures is actually legitimate, i.e. the anti-avoidance rules don't operate or exist to prevent this. The use of common law trusts and Cyprus as a jurisdiction by Russians is an example of this and why the recent reporting of Russian funds in Cyprus is bordering on the scandalous (not least because Russian money had nothing to do with the banking crisis).

Also, the fact that it exposes a French politician as a liar and tax fraud is a good thing and he should be brought to justice accordingly. Likewise the squirreling away of funds to protect against divorce proceedings is reprehensible.

As one would imagine there is absolutely no technical content / recognition in the article; it merely paints the usual picture of dodgy advisers and even dodgier clients evading tax and using secrecy as a means to an end. As we have stated many times in this publication and others, tax evasion is a crime and should be dealt with by the full force of the law. Jurisdictions (dare we say it like Switzerland, Liechtenstein and the Caribbean) have for too long promoted secrecy as a form of tax planning. This must end – but naming and shaming without any proof of wrongdoing (other than an account in a tax haven – more of this below) is not right.

The irony of recent developments, in particular, the plethora of Tax Information Exchange Agreements that have been signed since 2000 is that tax havens per se no longer exist! So, whilst anti-tax haven legislation might be introduced by a high tax jurisdiction (Germany, for example, introduced the *Steuerhinterziehungsbekämpfungsverordnung* in 2010), in many instances the effect is neutered by the existence of a TIEA.

Perhaps the answer to the abuse of tax havens is that proposed by Spain… for which see below!

SPAIN

Worldwide income reporting by residents

We just love a beautiful segue!

Spain's answer to the debt crisis (or at least partial answer) has been to focus on undeclared assets of Spanish tax residents. Royal Decree 1558/2012 was published on 24 November last year and entered into force on 1 January 2013. The fact that the law was introduced as a Royal Decree allowed the Government to act swiftly without significant debate or opposition.

The new law obliges individuals and companies resident in Spain to disclose three categories of assets and rights on Form 720 by 30 April 2013 and 31 March in subsequent years. The obligation is subject to a *de minimis* threshold of €50,000 in the aggregate per category as at 30 December in the relevant year.

The three categories of assets covered are as follows:

i) Foreign bank accounts that the Spanish resident is the owner, holder or signatory of. The details to be provided include:
   - the name and address of the bank / financial institution;
   - the date the account was opened; and
   - the balance(s) as at 31 December.

ii) All shares or rights in respect of shares, including those in:
   - any foreign corporate entity;
   - foreign collective investment funds;
   - any fiduciary or trust; and
   - life assurance policies.

iii) All foreign immovable property and rights thereto.

The penalties for non-compliance are, by any standard, eye watering and one can already hear the stampede for the hills of Ronda (or farther afield)! The penalty regime can be summarised as follows:

- Late filing of form 720: €1,500
- Non-filing of form 720 (if the authorities subsequently determine): €10,000
- Ad valorem penalty of undisclosed assets of up to 52% of their value; and
- A fine of 150% of the tax due and interest fees for late payment.

It is distinctly possible that an undisclosed bank account of, say, €100,000 could be subject to a total penalty of up to €150,000.

So that is the new law in a nutshell. It raises the following question: Does the Hacienda have the resources to a) enforce the law, b) collect the data and c) prosecute? The answer is surely a resounding "no" to all three, the Spanish tax authorities being woefully understaffed. However, non-compliance is simply not an option and to this end the alternative is that we expect to see many expatriates living across Spain leaving over the next 12-18 months. Adios amigos!

FRANCE

Collin et Colin propose taxing data in the digital sector

International tax law has, it would be fair to say, not adapted to the internet age and, with this in mind, Monsieurs Collin et Colin were commissioned by the French government to look at how pesky US internet companies could be taxed in France in the absence of a French permanent establishment (**PE**).

The perceived problem is that the location of value creation achieved by online data is not included in the OECD Model Convention (or any specific double tax treaty for that matter).

The main issue addressed in the report is that the data collected by internet companies is of intrinsic value to the business in question. For example, Amazon collects data from French customers and uses this to build profiles, analyse buying behaviour and so on. It collects this data by the user inputting via his PC, phone, tablet etc.. Collin and Colin argue that this data is of value to Amazon (which it undoubtedly is) and that the French punter is almost a virtual PE.

Various problems arise with the proposal. For instance, if, when I was in Paris I wrote a glowing review of my Parisian hotel on TripAdvisor, I am arguably adding to the value of TripAdvisor. However, I am a UK resident individual and not French, so should the tax attach only to French taxpayers or to any data collected via a French hosted site?

Secondly, how does one quantify the value of the data collected? If TripAdvisor was subject to a cyber-attack (for example, a rogue competitor bombards the site with data), how would this be accounted for?

One aspect of the Collin and Colin report that is sensible, is the acknowledgement that, as currently drafted, the tax rules do not appear to adequately cater for the online world. In doing so, it recommends that the rules be amended accordingly rather than castigate the likes of Amazon and Google for operating within the current framework. A reasoned response at last. Never thought we'd see this, especially from our French cousins.

UK

Joint Share Ownership Plans under the microscope

While the UK and a number of other jurisdictions offer tax incentives, typically by way of a relaxation of tax charges which would otherwise arise, for certain types of employee share option and share incentive arrangements, these invariably come at the cost of the satisfaction of numerous conditions. These conditions can be restrictive and difficult, if not impossible, to satisfy. For example, non-UK companies who have UK employees but do not have any UK subsidiaries or otherwise trade through a permanent establishment will not be able to put in place tax advantaged Enterprise Management Incentive share options.

This is where a joint share ownership plan ('JSOP') could provide the solution for UK tax resident employees. A JSOP is designed to enable employees to acquire shares as a result of their employment in circumstances where it is possible to avoid an income tax and national insurance contribution liability and where any growth in value of the shares falls to be taxed under only capital gains tax principles.

The basis of a JSOP is the joint ownership of the shares in relation to which the employees are to benefit. Typically the shares are jointly acquired and held by an employee benefit trust and the relevant employee. However, the joint ownership is in unequal shares. The employee's entitlement is to the future growth in value of the company's shares from the date of acquisition until the end of a predetermined period.

The employee pays a price equal to the initial unrestricted market value of the rights that he / she acquires in the shares; that is, the value of the rights on the assumption that there are no restrictions, e.g., rights of forfeiture attaching to the shares or the rights relating to those shares under the JSOP arrangements.

Structured properly, a JSOP should result in no income tax on acquisition of the share rights, no tax charge on the growth in value of the shares and only UK capital gains tax on the disposal of the shares. As ever, the cliché, "the devil is in the detail", is relevant here. That said, the rewards replicate the tax effect of UK tax approved share options outside its detailed statutory framework.

MILESTONE

Milestone International Tax Partners LLP.
Registered office: 45 Clarges Street, London W1J 7EP
Registration number: OC 342622
VAT Reg no. 944 478291

LONDON

Milestone International Tax Partners LLP
45 Clarges Street
London
W1J 7EP

Phone: +44 (0)20 7016 5480
Fax: +44 (0)20 7016 5481
Email: info@milestonetax.com
www.milestonetax.com

DUBLIN

Milestone International Tax Partners Ltd
4th Floor
Ulysses House
Foley Street
Dublin 1

Phone: +353 (0) 1 876 4550
Fax: +353 (0) 1 888 1171
Email: info@milestonetax.com
www.milestonetax.com

UK Alliance Partner
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