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Introduction to Tax Link

Welcome to the Spring edition of Tax Link.

This edition is a combination of globally sourced articles contributed by the member firms across the Nexia network, that provide up to date information on areas of the industry that have moved quickly and gained traction with other articles providing a review of national and international legislation, policy change and how it can affect businesses and individuals.

The articles in this edition include Australia's 'High Court decisions to tax residency of a company', Swiss relaxation in procedure towards 'withholding tax', the United states' advice to your 'tax planning toolkit' and information on 'Federal reform'.
I must extend a huge thank you to all of the contributors and publication team for their articles and commitment in producing this publication.

If you would like any further information on the topics in this edition, the contributor's details are provided for each article and they are happy to give further detail.

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Australia

Recent Australian High Court decision on tax residency of a company

A recent Australian High Court decision (Bywater Investments)[1] confirmed that a company not incorporated in Australia can still be a resident of Australia for tax purposes even if the company has foreign directors and the board meetings are held outside of Australia.

It should therefore not just automatically be assumed that because a company is not incorporated in Australia (with foreign directors and board meetings held outside Australia) the company will be a non-resident for Australian tax purposes.

An analysis of all relevant factors is required to determine whether the real central management and control (CMC) of the company is situated in Australia.

Background to Australian tax residency

Pursuant to Australia's residency based system of taxation, tax residents[2] of Australia will be taxable on their worldwide income (i.e. income from Australian and non-Australian sources), whereas non-residents will only be taxable on Australian sourced income.

However, determining the tax residency of a company is not a simple exercise – mainly because a variety of factors (e.g. place of incorporation, place of carrying on business, place of CMC or tax residency of the shareholders) as well as the taxpayer's particular circumstances – affects such a determination.

1 Bywater Investments Limited v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation [2016]HCA 45 (16 November 2016) [Bywater Investments]

2 Tax residency is a concept determined specifically by the Australian tax rules. It is different from the concept of residency for immigration purposes.

As a rule of thumb, a company that is incorporated in Australia will be a tax resident of Australia (regardless of where the company conducts business or holds board meetings). However, a company that is not incorporated in Australia will only be an Australian tax resident if the company is at least carrying on business in Australia **and either:**

1. the central management and control (CMC) of the company is also situated in Australia; **or**
2. the majority of voting-class shares (by value) are controlled by Australian resident shareholders

Consequently a company not incorporated in Australia that carries on a business in Australia, will be an Australian tax resident if the CMC of the company is also situated in Australia (regardless of the tax residency of the shareholders).

But what is central management and control (CMC)?

The recent Australian High Court case of Bywater Investments provides further guidance on how to determine where a company's CMC is exercised.

The specific case involved four companies incorporated in different overseas countries – involving foreign directors and board meetings that were not conducted in Australia. However, the companies did carry on business in Australia through buying and selling shares on the Australian Securities Exchange (ASX).

A question arose where the decision to buy and sell such shares were made (i.e. where the CMC of the companies was exercised).

As illustrated in the table below, the CMC of a company will generally be where the directors hold their board meetings to make high-level decisions about the company's general policies, the direction of its operations and the type of transactions the company will enter into:

Examples of actions that are CMC

1. Setting investment and operational policy such as:
2. Appointing company officers to carry on the company's business
   a. Setting the policy on disposal of trading stock & capital assets
   b. Deciding to buy & sell significant assets of the company
3. Overseeing and controlling these company officers to carry out the day-to-day business of the company.

However, merely conducting a company's day-to-day activities and operations (e.g. company administration activities) will not be an act of CMC

Examples of actions that are not CMC

Company administration activities such as:

1. Keeping a company's share register
2. Keeping a company's accounts
3. Where a company pays dividends;
4. The minimum acts necessary to maintain a company's registration

Furthermore, it is a question of fact who really makes the substantive decisions of the company (e.g. a majority shareholder does not necessarily control and directs a company's operations and activities).

The board of directors were not the real decision-makers

In Bywater Investments, the High Court held that although the board meetings were held outside of Australia, the CMC was in Australia because the real substantive control of the companies was actually exercised by an Australian accountant in Sydney.

This Australian accountant made the real business decisions in Australia (e.g. setting the investment and operational policy) and the foreign board of directors merely implemented these decisions (i.e. the board meetings were mere window dressing and effectively only rubber-stamped decisions that were already made[3]).

These artificial arrangements (i.e. overseas board meetings) were designed to give the impression that the company's CMC was not in Australia – however the Court looked beyond the form of the arrangement and looked at the substance / reality of what was actually going on.

The Court found that, in substance, these board meetings were not the real "engine room" of important decision making of the company since these non-resident directors merely recorded and implemented decisions (already made by the Sydney accountant) in a mechanical fashion.

Therefore the companies were held to be Australian tax residents and subject to tax in Australia on their worldwide income.

The road ahead

The recent Australian High Court decision of Bywater Investments is a sober reminder of the importance of substance over form. The determination of where CMC is exercised is a question of fact and depends on the specific circumstances of the particular taxpayer.

The decision highlights the complications of determining the tax residency of companies incorporated in foreign jurisdictions that conduct business in Australia.
Beware! Such companies may be Australian tax residents and subject to Australian tax on their worldwide income.

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3 Paragraph 80 of Bywater Investments

Australian and UK Estate Planning and the 87% Tax Rate

The application of Australian Capital Gains Tax (CGT) and UK Inheritance Tax (IHT) can lead to an aggregate tax rate of 87% following the death of a loved one. Such a high tax rate should cause with clients who have lived in both jurisdictions to obtain specialist advice before they die to implement effective tax planning.

The Basics

UK IHT

The UK charges IHT at 40% on estates that are above the lifetime nil rate band of £325,000. Other reliefs such as the main residence nil rate band (which is £100,000 from 6 April 2017 to 5 April 2018 for estates valued at £2 million or less), business and agricultural property reliefs may also apply. Furthermore transfers between married couples are exempt from UK IHT where both spouses have the same domicile for UK tax purposes.

UK IHT is levied on the basis of whether a person is UK domiciled for UK IHT purposes. UK domiciled persons pay UK IHT on their worldwide assets. Those persons not domiciled in the UK on their death, are only assessed to UK IHT on assets situated in the UK, but assets elsewhere in the world will not be subject to UK IHT.

'Domicile' is a term used to describe the country in which a person has their permanent home. Determining domicile can be complex and the tax law definition of domicile is different in the UK to that in Australia.

Broadly speaking, an individual will be UK domiciled if:

1. Their parents were British;
2. They were born and raised in the UK until at least age 16; and
3. They still retain a permanent home in the UK or an intention to return to the UK as their long term home, or have not established a domicile of choice in another country.

Historically the UK IHT law stated that a person was 'deemed domiciled' in the UK for UK IHT purposes, if they were a UK tax resident for 17 out of the last 20 tax years. From 6 April 2017, an individual will be 'deemed domiciled' in the UK, after they have been a UK tax resident for 15 out of the last 20 tax years (subject to the passage of Finance Bill 2017). Therefore, if a person was born in Australia, but they have been a UK tax resident for 15 years or more, they may shortly become UK domiciled for UK IHT purposes. Individuals, who ceased to be UK tax residents prior to 6 April 2017, are not affected by the new 15 out of 20 years rule.

The UK government intends to change the law for individuals who were born in the UK with a UK domicile; so that where the individual is a UK tax resident for the current tax year and at least one of the two preceding tax years, they will be deemed to be UK domiciled.

Under UK tax law, an individual can change their domicile by moving to another country, but the onus is on the party concerned to prove that there has been a change in domicile status which in practice may be difficult to substantiate.

UK CGT

The CGT base cost of assets for the estate and the beneficiaries will be the market value of the asset at death. Therefore for a UK only estate with no Australian aspects, UK IHT is payable on the value of the worldwide estate on death and any increase in the market value of the asset from the date of death until the disposal is subject to UK CGT.

Australian CGT

There is no IHT in Australia, but this does not mean that there are no tax implications of death. Australian CGT can apply on death.

The beneficiary inherits the deceased individual's CGT cost base for asset acquired by the deceased after 19 September 1985 (the date of commencement of Australian CGT law). Therefore if an asset is sold by an Australian estate with no UK aspects, Australian CGT is payable on the difference between the deceased's cost base and the sale price, assuming that the asset was purchased after 19 September 1985 by the deceased. Assets acquired by the deceased prior to 20 September 1985 are CGT free until the date of the deceased's death; in this case the asset's cost base is its market value on date of death. No CGT will be payable, where the asset was the deceased's main residence and the property is sold within two years of death, but many taxpayers are unaware of this rule.

Complications when both UK IHT and Australian CGT Apply

There is no provision for UK IHT to be offset against Australian CGT under the UK/Australian Double Tax Agreement (or vice versa). The withdrawn Australian Taxation Office ID 2005/40 confirmed this position.

The consequence is that complications arise in the following scenarios involving UK IHT and Australian CGT on death:

1. Where the deceased is UK domiciled and UK tax resident, but dies holding Taxable Australian Real Property (TARP), UK IHT will be payable at 40% (subject to reliefs). If the asset is sold Australian CGT will also be payable, on the

difference between the cost to the deceased and the sale price. If tax is payable in Australia at the top marginal rate this will be 47% (excluding Medicare Levy – which does not apply if the beneficiary is not an Australian tax resident). The 50% CGT discount was abolished for those who are not Australian tax residents from 8 May 2012. This results in an effective tax rate of 87% (i.e. 40% UK IHT plus 47% Australian CGT) on the inherited asset.

2. Where the deceased dies domiciled and tax resident in Australia for (Australian and UK tax purposes) and holding CGT assets situated in the UK. UK IHT will be payable at 40% (subject to reliefs) on the UK situated assets. If the assets are sold Australian CGT will also be payable, on the difference between the cost to the deceased and the sale price. E.g. an Australian tax resident beneficiary who is not a UK tax resident, earns over $180,000 AUD pa, CGT will be payable on the gain at 24.5% assuming that the 50% CGT discount applies (49% x 50%). If the cost base of the asset is low, this results in an effective tax rate of 64.5% (i.e. 40% UK IHT plus 24.5% Australian CGT) on the inherited asset.
3. Where the deceased dies as a tax resident in Australia for Australian tax purposes, but is UK domiciled for UK IHT purposes, UK IHT will be payable at 40% (subject to reliefs). If the assets are sold by the estate, Australian CGT will also be payable, on the difference between the cost to the deceased and the sale price. I.e. 40% UK IHT plus 24.5% Australian CGT on the inherited asset (assuming that the 50% discount applies).
4. Where an Australian tax resident beneficiary inherits assets from a UK estate that paid UK IHT at 40%, and later sells the asset, an effective tax rate of 64.5% is payable (i.e. 40% UK IHT plus 24.5% Australian CGT) on the inherited asset, assuming that the 50% Australian CGT discount applies.

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France

Tax update

Applicable penalties for failing reporting foreign accounts and trusts - French Constitutional Court's decision and consequences

French tax law provides obligations to French tax residents to disclose every account held abroad or any trust when it involves a French tax resident or a French asset is involved.

Failing these filing obligations was sanctioned by:

For foreign accounts:

A proportional fine of 5% of the account's value which cannot be lower than €1,500 or €10,000 for accounts held in a State which has not signed with France a convention of administrative assistance aiming at eliminating tax fraud and evasion.

For trusts:

A proportional fine of 12.5% of the trust's assets value which cannot be lower than €20,000.

Proportional fines have been judged unconstitutional by the French Constitutional Court (on 22nd July 2016 for foreign accounts and on 16th March 2017) because of the disproportion between the application of an uncapped fine calculated on the account or trust's assets values, even when the assets or income has been effectively taxed, and the gravity of failing to comply with a filing obligation.

The Constitutional Court leaves an unanswered question regarding the disproportion that may occurred if the account or the trust's assets value is lower, equal or slightly higher than the amount of the flat fine.

Consequently, today:

- Penalty applicable for non-disclosing trust is only the flat penalty of €20,000;
- Penalties for non-disclosing foreign accounts have been amended by the 2017 Finance law; as from 2017, if reporting the account triggers taxes, the penalty is 80% of the tax due that cannot be lower than €1,500 ; if reporting the account has no consequence on the tax due, the penalty is of €1,500.

Reinforcement of the impatriate tax regime (Finance Law for 2017, art. 71)

French impatriates tax exemption regime may apply to employees and executive officers which are hired by a French company or transferred by a foreign company to its French affiliate (French Tax Code, art. 155 B) during a limited period. This period has been increased by the 2017 Finance Law and is now applicable until the 31st December of the 8th civil year following the beginning of their work position in France (5th year before).

To benefit from this tax regime, individuals, should particularly, have not been French tax residents during the last five years and have to become French tax residents as from the beginning of their work position in France.

The impatriate tax regime provides several tax exemptions:

- Under option and conditions, a flat 30% exemption of the remuneration;
- Exemption of the remuneration related to work carried out abroad and the impatriation premiums capped to:
  - 50% of total remuneration including the remuneration related to activity carried out abroad and the impatriation premiums;
  - remuneration related to activity carried abroad is limited to 20% of the remuneration related to the French activity and the impatriation premiums are fully exempted.
- Exemption concerns 50% of the investment income, capital gain on financial assets registered abroad.

Furthermore, article 885 A of the French Tax Code also provides, for impatriates, an exemption of the French Wealth Tax for property assets abroad. However the exemption period has not been modified and still last until the 31st December of the 5th year.

The French Constitutional Court's decision on the reimbursement of social contributions

French tax non-residents taxpayers are subject to social contributions, “CSG” and “CRDS”, relating to their real estate rental incomes and capital gain realized in France.

On the 26th February 2015, the Court of Justice of the European Union (CJEU) in its decision Ministre de l'Économie et des Finances c/ Gérard de Ruyter (CJEU, No C-623/13) sentenced France because, under Regulation No 1408/71 (substituted with Regulation No 883/2004), taxpayers should only be subject to a one State social security system and pay social security contributions only in that State.

Consequently, the French Tax Authorities have accepted to reimburse the social contributions unduly paid in France from 2013 to 2015 by non-resident taxpayers subject to a foreign social security system. However, the reimbursement has been limited to taxpayers subject to social security contributions in a State of the European Union, of the European Economic Area or of Switzerland.

2017 finance law has modified the budget allocation of the "CSG" and "CRDS" in order for them to avoid the qualification of social contributions and be considered as taxes. However, this position of the French Administration is yet disputable.

The exclusion of taxpayers who are not resident of an EU or EEA State or Switzerland has been also challenged. On the 9th March 2017, the French Constitutional Court has considered that the difference of treatment between these two categories of taxpayers, according to the French law is conform to the French Constitution (QPC 9-3-2017, No 2016-615) and respects the principle of equality before the law.

These debates are not yet closed and claims on these two topics before the CJEU is highly anticipated.

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India

Cashless Economy: Budget Perspective

India is now on the cusp of a massive digital revolution and the promotion of digital economy is the backbone of the Government's vision to fight out against the corruption and black money. The demonetization of high value currency notes announced in early November 2016 has led to the re-monetization of digital economy. Digital transactions have been on a sharp upswing after the government's demonetisation drive to move towards a less-cash economy.

The Union Budget 2017 ("the budget") has also played vital role in promoting the vision og digital economy and It is evident from the move of the government that the country is set to embrace a radical change in achieving this vision. This budget shapes initiatives in transforming the country from discretionary-based to policy-based administration and from an informal to a formal economy. The Budget has proposed a slew of measures to hasten India's movement to a cashless economy.

The following tax amendments were made to make the existing law in consonance with the idea of the government in promotion of the digital economy by incentivizing cash-less transactions and dis-incentivizing cash transactions. All the amendment would take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-2019 and subsequent years.

1) Restricting Cash Donation
Prior to Budget proposal, provisions of Section 80G bars deduction in respect of donation made of any sum exceeding Rs.10, 000 if it is paid by cash and not through any other mode. The amended section, clearly bars the deduction in respect of donation of any sum exceeding two thousand rupees, unless such sum is paid by any mode other than cash.

2) Disallowance of Depreciation and Capital Expenditure
Section 35AD of the Act, inter-alia provides for investment linked deduction on the amount capital expenditure incurred, wholly or exclusively for the purpose of business, during the previous year to specified business except capital expenditure incurred for acquisition of any land or goodwill or financial instrument.

In order to promote digital economy, there is a need to discourage cash transaction even for capital expenditure. To discourage the use of cash for capital expenditure, the payment in excess of INR 10,000 in cash would not be included in the cost of asset for the purpose of computing depreciation. Similarly, investment linked deduction in respect of capital expenditure in specified business will not be allowed in case payment in cash exceeds INR 10,000 to a person in a day.

3) Restrictions of cash transaction
Prior to the Budget, the existing provisions of sub-section (3) of Section 40A of the Act, provides that any expenditure in respect of which payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees, shall not be allowed as a deduction. Further, sub-section (3A) of Section 40A also provides for deeming a payment as profits and gains of business of profession if the expenditure is incurred in a particular year but the payment is made in any subsequent years of a sum exceeding twenty thousand rupees otherwise than by an account payee cheque drawn on a bank or account payee bank draft. The amendment has been proposed in order to disincentive cash transactions, it is proposed to amend the provisions of section 40A of the Act to provide the following:

I. Reduction of existing threshold of cash payment to a person from twenty thousand rupees to ten thousand rupees in a single day; i.e., any payment in cash above ten thousand rupees to a person in a day, shall not be allowed as deduction in computation of Income from "Profits and Gains of business or profession.
II. Deeming a payment as profits and gains of business or profession if the expenditure is incurred in a particular year but the cash payment is made in any subsequent years of a sum exceeding ten thousand rupees to a person in a single day; and
III. Further expand the specific mode of payment under respective sub-section of section 40A from an account payee cheese drawn on a bank or account payee bank draft to by an account payee cheque drawn on a bank account or account payee bank draft or use of electronic clearing system a bank account.

4) Promoting Digital Payments in small unorganized business
Presumptive income scheme in case of eligible assesses carrying out eligible business is dealt under Section 44AD of the existing. Under this scheme, eligible assessee who are engaged in eligible business having total turnover or gross receipts not exceeding two crore rupees in a previous year, a sum equal to 8% of the total turnover or gross receipts or as the case may be, a sum higher than the aforesaid sum declared by the assessee in his return of income is deemed to be the profits and gains of such business chargeable to tax under the head "profits and gains of business or profession". In order to adhere to the objective of the vision of digital India and to encourage small unorganized business to accept digital payments, the amendment of section 44 AD of the Act has been proposed to reduce the existing rate of deemed total income of eight per cent to six per cent in respect of the

amount of such total turn-over or gross recipients received by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account during the previous year or before the due date specified in sub-section (1) of section 139 in respect of that previous year. However, the existing rate of deemed profit of 8% shall continue to apply in respect of total turnover or gross receipts received in any other mode.

Restrictions of cash transactions

The quantum of black money in India is infinite; the revenue of the Government is affected creating a resource crunch for various development programmes. Cash is the medium for transactions of black money. Similarly, the large amount of unaccounted wealth is stored and used in form of cash. In order to achieve, the mission of the Government to move towards a less cash economy to reduce generation and circulation of black money, Section 269ST was inserted in the Act to provide that no person shall receive an amount of two lakh rupees or more;-

a. In aggregate from a person in a day
b. In respect of a single transaction
c. In respect of transaction relating to one event or occasion from a person.

Otherwise, than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account.

The newly inserted section shall not apply to Government, any banking company, post office savings bank or co-operative bank. It shall be notified by Central Government about the persons upon whom the restrictions on cash transaction are not applicable. Transactions of the nature referred to in Section 271 DA in the Act shall provide for levy of penalty on a person who receives a sum in contravention of the provisions of the proposed section 269ST. The sum equal to the amount of receipt shall be levied as penalty by the Joint Commissioner. Section 206C is also proposed to be amended to omit provisions in relation to collection of tax at source at the rate of one percent of sale consideration on cash sale of jewellery exceeding five lakh rupee.

With the idea of development of the vision of digital economy, the government has taken all the possible steps. Accordingly, relevant changes have been proposed and new provisions have been proposed to be introduced to set the country on a path of digitization, by adopting a two-pronged approach of encouraging cashless transactions and penalizing cash transactions.

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Isle of Man

Consultation published on bringing non-UK companies within scope of UK corporation tax

HMRC announced last year it was considering bringing all non-UK companies receiving taxable income from the UK within scope of UK corporation tax. HMRC has now published a consultation document setting out its proposals on how this may be achieved. This is of particular interest to non-UK companies in receipt of UK rental income.

Background

At present, non-UK companies pay basic rate income tax on their annual net rental profits (the rate of tax payable is 20%). In calculating the net rental profits, a tax deduction is generally allowed for interest paid by the company on loans relating to the rental business, assuming the interest is representative of arm's length terms. Also, brought forward tax losses of the UK rental business can be offset against current year rental profits without restriction.

Key points from the consultation document

The intention is to ensure that the profits of a UK property business of a non-UK company are brought within the scope of UK corporation tax. This will align the computation of rental profits of non-UK companies with those of UK companies. In particular, it would ensure that the interest restriction rules to be introduced in Finance Act 2017 and the restrictions on carry-forward loss relief apply to both UK and non-UK companies owning UK real estate.

In addition, HMRC propose bringing capital gains on disposals of UK residential property by non-UK companies within scope of corporation tax. This could potentially simplify the tax position of effected companies as currently there are two capital gains regimes which apply (ie non-resident capital gains tax and ATED related capital gains tax).

The consultation document highlights a number of issues that will need to be addressed, for example the timing of the introduction of the new regime. Furthermore, there will need to be transitional provisions dealing with the move from income tax to corporation tax for affected companies including rules for brought forward tax losses. HMRC have suggested grandfathering in brought forward tax losses from the current income tax regime allowing the losses to be carried forward for use against the profits of the UK property business under the new corporation tax regime.

Abacus comment

The consultation document addresses ambiguous comments made in the recent Spring 2017 Budget that HMRC may use these new measures to bring profits on sale of UK commercial property by non-UK companies within scope of UK tax. However, the consultation document makes it clear the proposal is aimed specifically at bringing UK property income within the corporation tax net (at the same time applying recently introduced restrictions on the use of tax losses and deductibility of interest). Non-resident investors in UK commercial property will welcome the clarity provided by HMRC in this regard.

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Italy

Non-resident individuals who transfer their place of residence to Italy

Starting from 2017, non-resident individuals who transfer their place of residence to Italy may opt for a preferential tax regime with regard to foreign source income.

Under a subjective standpoint, the preferential tax regime shall apply under the condition that the individuals have not been resident in Italy for nine years out of the previous ten years. In order to assess that the individuals meet the conditions required, a specific ruling may be submitted to Italian tax administration. In any case, it is not mandatory to submit a ruling for exercise the option and the individual can self-assess that all the requirements are met.

The option can be exercised within the deadline for filing the income tax return referred to the fiscal period in which the residence is transferred to Italy, or in the following one. The detailed rules for exercise of the option are provided in the Decree of the Director of the Italian tax agency dated 8th March 2017.

The option can be revoked; in any case, it is valid for not more than 15 years.

Under an objective standpoint, the preferential tax regime regards the individual income tax (IRPEF), the inheritance and gift tax and other indirect taxes applicable to immovable and financial activities held abroad, IVIE and IVAFE.

Individual income tax (IRPEF)

According to the preferential tax regime at issue (a sort of "resident non domiciled" regime), individuals shall be taxed as follows.

National source income

With regard to national source income (such as, immovable property existing in Italy, activities carried on in Italy, dividends distributed by Italian companies, capital gains from sale of shares of Italian companies, etc.), individuals shall be taxed at IRPEF ordinary rates. In particular, IRPEF is a progressive tax which is applied according to the following tax rates:

- up to EUR 15K: 23%
- over EUR 15K up to EUR 28K: 27%;
- over EUR 28K up to EUR 55K: 38%;
- over EUR 55K up to EUR 75K: 41%;
- over EUR 75K: 43%.

Furthermore, individuals income is subject to a regional tax ranging from 1,23% to 3,33%, and a municipal tax up to 0,9%.

For the purpose of IRPEF individuals have to file the tax return to Italian tax administration.

Anyway, income of financial nature (such as interests, dividends, and capital gains from sale of non-qualified shares) are subject to a uniform 26% tax rate (bonds issued by Italian State and other public entities or States included in the white list are subject to 12,50% rate). Taxes on such income are levied by the intermediary, thus no tax return has to be filed.

Foreign source income

With regard to foreign source income (for example, immovable property existing abroad, activities carried on abroad, dividends distributed by foreign companies, capital gains from sale of non-qualified shares of foreign companies, , etc.), individuals shall pay a flat tax equal to EUR 100K for each fiscal year, and no tax credit for foreign source income is provided.

Capital gains from sale of qualified shares (shareholding higher than 20%) realized in any of the five fiscal periods following the option, are excluded from the preferential tax regime and subject to the ordinary income tax. Starting from the sixth year after the option, those incomes as well shall be subject to the preferential tax regime.

Income from one or more foreign countries may be excluded from the option and thus benefit of the tax credit for foreign income.

Any family member who meets the conditions requested may apply for the preferential tax regime and pay a flat tax equal to EUR 25K for each fiscal year.

Inheritance and gift tax

With regard to individuals whose estate is being administered during the period of validity of the option, the inheritance tax shall apply only to goods and rights existing in Italy. The same rules shall apply with regard to gift made over the lifetime of the option. Thus goods and rights existing abroad shall not be taxable for the inheritance and gift tax purposes.

IVIE and IVAFE

Furthermore, such individuals and their family members are exempt from the Real estate abroad value tax ("Imposta sul valore degli immobili all'estero", IVIE) and from the Financial activities abroad value tax ("IVAFE"), respectively applicable at a rate of 0,76% and 0,2%.

RW

Lastly, such individuals and their family members do not have to comply with the rules regarding the so called "monitoraggio fiscale". Thus they do not have to show in the tax return the goods and rights held abroad.

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Kenya

Tax Predictability in Kenya

Adam Smith in his book "Wealth of Nations" enumerated four principles of fair taxation which are still relevant today. These are Proportionality or Equity, Certainty, Convenience and Simplicity. Smith's second principle of certainty or predictability was that "the tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person"

Strathmore Business School, a leading business school in Kenya, recently held a forum to discuss tax predictability in Kenya. The forum was held ahead of the budget statement reading for fiscal year 2017/2018. There was consensus amongst the speakers that the country's fiscal policies should not simply be crafted to achieve short-term results, such as meeting annual budgets, but should be aligned to the economic growth plans. The wider implications of any tax measure should also be considered. Planning on long-term investment by local and foreign investors requires predictability and transparency in tax rules and in how tax authorities administer a country's tax system. Maintaining a stable, transparent and fair tax regime is therefore an important component of attracting and retaining local and foreign investment.

The question then begs; is the Kenyan tax regime predictable? To a great extent; yes. The VAT act was overhauled in 2013 followed by the Excise Duty Act in 2015. Though there are areas of improvement, the revised acts are simple and incorporate international best practices. The implementation of iTax, a web based platform which centralises all tax processes including registration, returns filing, tax payments and self-service tax ledgers has been largely successful. This has cut down the administrative time spent on routine tax compliance work.

The current Income Tax Act, however, is more than four decades old. Changes made each year through the budget and finance acts has resulted in the act containing contradicting provisions and attempts by the Kenya Revenue Authority to resolve them has led to more confusion. Luckily, the government has realised that the act lacks clarity and is complicated for taxpayers. Plans are underway for a complete overhaul of the act to "make it productive, simple to comply with and supportive to the growth of the economy" according to the treasury. The initiative is long overdue but it may be delayed further as the legislators focus is currently on the elections slated for August 2017.

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Russia

A review of key tax events in Russia

1. In 2017 Russian taxpayers are, for the first time, required to submit, to the tax authorities, notification regarding Controlled Foreign Corporations (CFC).

   In this connection, an important event is the issuing, by the Russian Ministry of Finance, of special clarifications regarding controlled foreign corporations. In response to a request from the Russian Union of Industrialists and Entrepreneurs the Russian Ministry of Finance has expressed the following positions:
   - they confirmed the possibility to apply 50% of the participation share threshold value for the purposes of recognising a CFC, for 2015 (and, for the purposes of including the profit made by a CFC in the taxable base of its controlling body, for 2016);
   - the date of determination of the list of CFC is considered as the date on which the decision on distribution of the CFC's profit was taken, or in the absence of such a decision – 31 December of the year following the year for which the CFC's profit has been calculated (provided that the CFC's financial year coincides with the calendar year);
   - when calculating the CFC's profit, the calculation must not include indicators reported in any other comprehensive income statement;
   - for the purposes of calculating the profit threshold value (RUB 50 million in 2015), the CFC's profit cannot be reduced by the amount of distributed dividends in cases where the CFC's profit does not exceed this and, thus, is not included in the taxable base of the controlling body;
   - when calculating the CFC's profit, dividends paid both at the expense of the year's profit, for which the financial report is being drawn up, and at the expense of any non-distributed profits from previous years (including profit formed prior to 2015), can be accepted for reduction purposes;
   - for the purposes of carrying forward losses, the balanced result for the three financial years, preceding 1 January 2015, is taken into account. In doing so, such losses must be corrected in accordance with the provisions of paragraph 3 of Article 309.1 of the Tax Code of the Russian Federation;
   - issues related to the documentary confirmation of a CFC's profit calculation, and to the application of exemptions were also clarified.

2. On 1 January 2017 a new tax, called by the media the 'Google tax', was introduced in Russia. It involves the introduction of 18% VAT for foreign companies providing services in electronic form to buyers in Russia. To pay the tax, the foreign companies have to register with the Federal Tax Service and pay taxes on a par with Russian companies.

   Sales of computer software programs (including computer games), electronic books, online databases, pictures, music and videos are subject to payment of the VAT. The new tax also applies to companies providing domain names and hosting services, etc.

   The authors of the draft law noted that, in international practice, the rules of taxation involving value added tax regarding electronic services already exist, and are based on the taxation of electronic services being carried out in the territory of the state where the consumer lives, in accordance with its national legislation.

   Such an approach ensures equal conditions for national and foreign companies selling content to end consumers, by levelling-out the tax advantages for foreign organisations, including those that are located in low-tax or tax-free jurisdictions.

3. A review has been published on the web site of the Supreme Court of the Russian Federation regarding the practice of consideration, by the courts, of cases related to the particularly controversial issues of transfer pricing and of insufficient capitalisation. It is expected that this document will become a point of reference for the subordinate courts, tax authorities and taxpayers.

   Key provisions:
   - Price control cannot be a subject of field or desk audits; to control prices, separate types of audit are provided for. Transfer pricing related issues do not fall within the competence of territorial tax bodies. Transfer pricing methods can be used by territorial tax bodies only when a particular part of the Tax Code of the Russian Federation provides for making use of market prices when calculating taxes (gratuitous receipt of property, etc.).
   - Multiple deviations of a transaction price from the market level may constitute an indication of receiving an unjustified tax advantage, but only when aggregated and linked with other circumstances discrediting the business goal of such a transaction.
   - In the case of non-compliance with the official interdependence criteria, the court may recognise persons to be interdependent if the tax authority submits proof of the fact that the counteragent had the possibility to influence the determination of the conditions of transactions carried out by the taxpayer, and that the taxpayer was bound to fully and freely make decisions in its field of financial and business activity, that should have had an impact on the conditions and results of the performance of the corresponding transactions.

4. From 1 January 2017, in order to apply the provisions of international tax treaties, a foreign organisation **is required** to confirm its actual right to receive income. Previously, such confirmation only had to be provided upon request of a Russian company.

   We recommend those foreign companies, which receive dividends from their Russian subsidiaries, to pay special attention to the new procedure.

5. From 1 January 2017, a taxpayer's tax may be paid by another person. To pay the tax, no special grounds are required, and the tax authorities do not have the authority to verify the grounds.

   In certain cases a foreign organisation can also be a payer of Russian taxes, levies, and insurance premiums, so the new rules also apply to such organisations.

   A person who has paid tax on behalf of another taxpayer, cannot request its return. If a payment goes to the budget, in future, it can only be clarified. Only the taxpayer, for which such tax was paid, has the right to do it.

   A third person's tax can be paid, for instance, to repay obligations arising out of a supply agreement. In such a case, a party, when purchasing goods from another party, instead of paying the price of the goods, pays the supplier's tax to the budget.

6. From 1 January 2017, taxation covering retailers' loyalty programmes is to be significantly simplified. It will no longer be necessary to calculate tax on the income that individuals have received in the form of bonuses and points awarded by a retailer to its buyers. Neither will there be a need to inform the tax authority about the impossibility of withholding tax from such income, since it will be included in the list of non-taxed income.

   We would like, specifically, to draw your attention to the fact that some media reports have emerged with hasty judgments regarding the new norm. There have been a number of articles stating that, from 2017, cashback on bank cards is not subject to taxation.

   According to clarifications provided by the Russian Ministry of Finance, of 07 December 2016, No. 03-04-06/72935, cashback is not subject to taxation only if the bank's loyalty programme is aimed at stimulating the activity of its clients related to buying the **services of the bank concerned**, and the bonuses (points) awarded within the above-specified programme are aimed at characterising the client's activity when purchasing **such services.**

   However, the majority of the loyalty programmes of Russian banks are aimed at the stimulation of repeated consumption of goods and services, not of the banks themselves, but of their partner organisations: petrol stations, airline companies, etc.

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Spain

Annual Tax Control Plan for 2017

The Tax Agency will strengthen the control mechanisms for large fortunes and will perform "sweeps" to check the VAT at retail outlets

The Tax Agency Directorate have approved a Resolution with the Annual Tax Control Plan for 2017 (published on the past 26th of January) with general guidelines focused on the following control actions:

Control of the large fortunes

The Tax Administration will reinforce their newly created ad hoc computer tools for detecting, among others, the following tax risks:

- Changes in net worth and transfers of incomes made in order to deferring or limiting the effective taxation of assets controlled by individuals.
- Use of intermediary companies being used as complex financial or corporate frameworks, in order to channel a low-tax threshold for individual gains.
- Analysis of the real purchasing power of taxpayers that are not consistent with personal income tax returns, inconsistencies with their formal ownership, beneficiaries of credit cards issued in Spain or abroad, and the use of cash, while also maintaining the actions carried out to verify the compliance with limitations on cash payments (€ 2,500 up to 31 December 2016, and € 1,000 from 1 January 2017 onwards).

In addition, through the information obtained within the framework of the **FATCA** Agreement of Spanish residents holding accounts in the United States, and, at the end of the year, through the **CRS** model, the information available on bank accounts will be increased up to 54 tax jurisdictions.

Also it is expected that taking advantage of the overall information already obtained from **Informative Declaration of Individual Residents in Spain with assets and/or rights abroad (Form 720)**, and from those others Individuals who have established their tax residency in a low-tax country while effectively living in Spain.

VAT fraud and the fight against the shadow economy

The Tax Agency will put special emphasis in those supplies of goods or services on which there is not a correct output VAT, in particular, when affecting the end-consumers and a commercial software used to conceal sales is used.

The Tax Agency will also reinforce their on-site inspections at the premises of the taxpayer in order to verify and regularize situations of underdeclaring of income.

Multinational tax evasion

The Tax Agency will work on analysis models that will enable anticipating and optimizing the use of the information on ´tax rulings´ and ´Country by Country´ reports, also focusing their attention on the correction of elusive practices by multinationals according to BEPS risks areas of the OECD (in particular, aggressive tax planning structures, hybrid structures, artificial generation of financial expenses, abusive use of intragroup transfer price policies, profit allocation to permanent establishments in Spain of nonresident entities, and taxation of operations carried out by residents in tax havens).

Fraud in the digital economy

Special attention will be paid to controlling importing operations associated to e-commerce transactions and the analysis of new payment methods being implemented on a growing scale -cryptocurrencies, payment mediation platforms, payments from mobile devices, etc.,- since they can facilitate opacity in transactions.

The Tax Agency will strengthen collaborations with the tax authorities of other countries in order to verify profits obtained by economic agents using the internet as a means of advertising goods and services.

Use of straw men and shell companies, or the control of VAT scams in imports of products from Asia and the hydrocarbons sector.

With regard to money laundering, the Tax Agency shall promote the development of tools to facilitate investigations into large criminal organizations.

Control of major debtors

The Tax Agency will be controlling and monitoring those debtors with large tax debts, previously deemed as defaulters, in order to bring to light fake insolvencies. Similarly, control actions regarding bankruptcy cases will also be intensified to prevent fraudulent conduct aimed at evading taxes.

In short, out of all the aforementioned measures, it is noticed what the Control Plan mentions as ´a reinforcement of the fight against the shadow economy, in particular on the VAT scope´ with ´on-site inspections in sectors with high risk of VAT fraud´, regardless of the size and industry, in order to raise fiscal awareness among taxpayers.

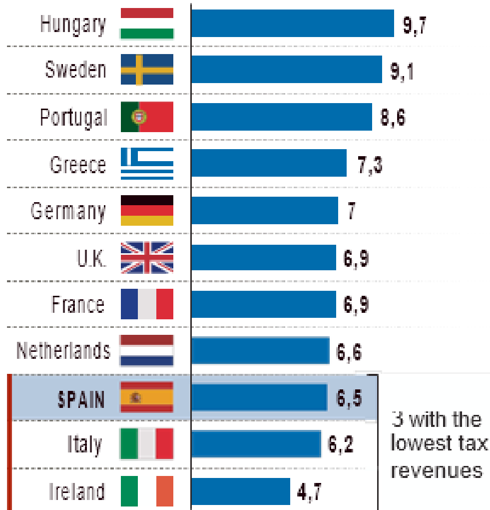
These measures are also aimed at tackling the low VAT collection, since Spain is still the third EU country with the lowest tax revenue coming from VAT (see chart).

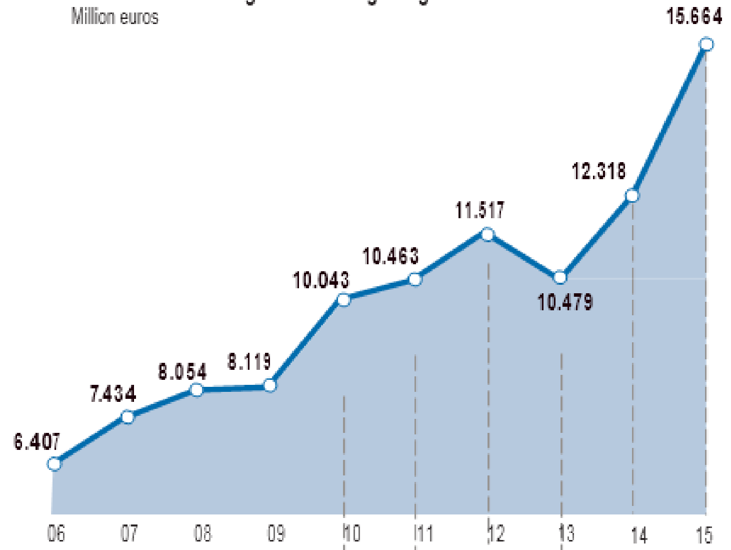
To do this, the Tax Agency has offered their staff a bonus whose total amount is estimated to be around 50 million euros, linked to the VAT collection, so VAT is the tax on which it has been detected a high level of fraud, following the formal complaint recently reported by the European Commission.

The Spanish Association of Tax Advisors disagree on the basis that such incentive is linked to the tax collection, so this is ´not only detrimental for the taxpayers´ but also for ´the tax inspectors themselves, who will prefer to conduct many small VAT audits with easy resolution than longer VAT audits with a lot of time and efforts on large and mediums companies where perhaps the raised tax-quota, if any, might be higher, although more difficult to be detected".

Along with these measures controlled by the Tax Inspection, it is worth to mention the incoming system of Immediate Delivery of VAT Information, effective on 1 July 2017, which will provide the Tax Administration with comprehensive information over more than 80% of the turnover in Spain.

OVERVIEW ON VAT FRAUD





Source: Eurostat and Tax Agency

Chart: Expansión

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Switzerland

Withholding tax: relaxation of notification procedures

Previous practice

Swiss companies are subject to a withholding tax of 35 percent if they distribute a dividend. Such dividend withholding tax needs to be declared and paid to the Swiss Federal Tax Administration (SFTA). If the conditions for the reimbursement of withholding tax are fulfilled, the recipient of the dividend is entitled to reclaim the withholding tax ("reclaim procedure").

For certain cases (e.g. cash dividends and constructive dividends within a national and international group), the law foresees the possibility to fulfil the withholding tax liability by a notification of the dividend ("notification procedure"). Instead of paying the withholding tax, the Swiss dividend payer merely files a tax form with the SFTA declaring the amount of dividend distributed as well as the identity of the recipient. The notification form is to be submitted to the SFTA within 30 days after the date the dividend became due.

In 2011, the Federal Court denied the application of the notification procedure for a particular case, since the necessary tax form was filed after the 30-day deadline. The court decided that instead, the Swiss dividend payer was obliged to follow the reclaim procedure and thus pay the withholding tax as well as a late payment interest.

Due to intensified efforts by the Swiss Federal Tax Administration (SFTA) it was since then critical for Swiss companies to comply with notification deadlines regarding open and hidden profit distributions. If the 30-day deadline for submitting a notification of withholding tax on a dividend was not complied with, the SFTA refused a late notification. Instead of the notification, the company liable for taxation had to pay the withholding tax of 35 percent, irrespective of whether the dividend recipient was entitled to the reimbursement of withholding tax. Furthermore, a late payment interest penalty of 5 percent was charged for the time between the payment due date and actual date of payment of the withholding tax. According to estimations this practice generated additional income of approximately CHF 600 million for the government.

New law

The Swiss Parliament has now ended this practice in the autumn session of 2016 with an amendment to the law. The amendment entered into force on 15 February 2017. According to the new law, the late notification of withholding tax is permitted if the material prerequisites for the notification have been fulfilled. In this case, a late payment interest penalty will no longer be issued. It is, however, permissible to impose an administrative fine of up to CHF 5,000 for a late submission of notification forms.

Consequently, the amended legislation means that the notification deadline of 30 days is to be interpreted as a mere reference deadline – and no longer as a deadline with forfeit character. This relaxation affects all cases in which withholding tax is owed on proceeds from capital, and the regulation provides for the notification procedure. Therefore, it particularly concerns cash dividends and constructive dividends within a national and international group, as well as dividends in kind and bonus shares.

Retroactive effect

The change in legislation may also be applied to circumstances which occurred before 15 February 2017. This does not, however, apply when the tax receivable or the interest penalty receivable has (i) become time-barred or (ii) was ruled by an unappealable judgement before 1 January 2011. All proceedings still pending will thus benefit from the change in legislation. Furthermore, its scope also stretches to those cases which had become legally binding after 2010.

The affected taxpayers are granted the possibility of reclaiming interest penalty charges paid since 2011. For this purpose, they must submit an application (form 1 RVZ) to the Swiss Federal Tax Administration (SFTA) no later than 14 February 2018.

Please do not hesitate to contact us, should you have any questions regarding this topic, or if we may be of assistance to you in reclaiming previously paid interest penalty charges.

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Turkey

Opportunity for Real Estate Acquisition in Turkey!

Do not miss the limited time tax offer that has been presented by the Republic of Turkey; You may purchase a residential building or business premises in Turkey by not paying VAT until 31.03.2018

A recent tax law amendment which exempts the **residential buildings** (such as houses) or business premises (such as offices) sales from **VAT** to the selected buying groups has already passed into law on **23 February 2017** and it has also published in the **Official Gazette on 08 March 2017**.

Who will actually benefit from this limited time opportunity?

Not everyone but only the qualified real or legal persons are eligible to benefit from this exclusive tax advantage. Those beneficiaries are listed as below;

1. **The Turkish citizens who reside abroad more than six months** by having **a legal work** or **residence permit.**
2. **The Real person foreigners (individuals)** who do not legally reside in Turkey.
3. **The Legal person foreign entities** (such as companies and corporations) which legal head offices or business centers are not located in Turkey and those do not generate income or profit in Turkey by having a **workplace in Turkey** and/ or by employing a **permanent representative in Turkey.**

Then, when regarding the legal conditions to benefit from this law, we understand that the Turkish citizens who live in Turkey are not going to be able to benefit from this exclusive opportunity while the privileged buyers are (both Turkish citizens reside outside of the country and the foreigners).

Then, it is understood that the Turkish Parliament (actually the **Turkish Government**) took an legal initiative for both **boosting the construction sector** and also for **financing the balance of payment deficit of the country** by offering a lucrative tax advantage by exempting VAT on sales of **residential buildings or business premises** just for the eligible buyers who are ready to bring currency to the country. By the way, it is being predicted that; this initiative may bring about **10 billion US Dollar** currency to the Turkish economy.

Thus, when regarding that the VAT rates related to the sales of the **luxurious residences** and the houses classified as **first class constructed buildings** is between **8-18 %** depending of their square meter **land property tax values**, besides regarding also that the sales of the business premises are only subject to the flat rate of **18 % VAT**, then, this law means, the eligible buyers could purchase a house or office in Turkey as much as **8-18 % cheaper** as compare to a non-eligible Turkish citizens. So, when regarding the tax savings to be realized, it seems as a very good opportunity to make extra money by first purchasing an eligible residence and/or office, then, by selling it after the legal waiting period passed. But on the other hand, the law has some legal conditions and the prospective eligible buyers should meet or fulfill those legal conditions stated below to fully enjoy from that VAT exemption.

Those legal conditions are as below:
The VAT exemption would only be applied **on the first sales of the newly constructed residential buildings or business premises.**

1. **The price of** the residential buildings or business premises purchased shall have to be **transferred to Turkey as in a foreign currency.** (There is no specific currency stated in the text of the law, then, every kind of convertible currency seems welcomed.)
2. The buyers shall not sell the purchased residential buildings or business premises **at least for one year.** If it happens, the buyers would have to pay **the VAT not paid before** and the **deferment interest rate would be calculated.**

Besides, if the seller applies the VAT exemption to the non-eligible immovable or to a non-eligible buyer, both seller and buyer would **jointly and severally be liable** from the paying of **VAT unpaid before, tax penalty** as much as the tax amount and **the late payment fee.**

In addition, please be also informed that, most of the luxurious houses, residences and offices in Turkey are being priced and sold by using a foreign currency (mostly **US dollar or Euro**). Thus, if the foreigners buy a house and if they sell this house only after holding its property for one year and one day, even if the price of the immovable would stay the same level, they would get at least as much as **8-18 %** gross profit on that trade just because of the VAT free purchasing advantage. Besides, the buyers, of course, would be able to rent those immovable and get rental income during this legal waiting period. It is of course that the eligible buyers would pay income tax as much as 15-35 % over the net capital gain and / or rental income, but they would still have significant profit on that business when regarding that the interest rates are still negative or very low at the **EU member countries** because of **global quantitative easing policy.** Please be also noted that,

the title deed fees related to **the housing purchases** are also discounted from **20 in one thousand to 15 in one thousand** for the real estate transactions that would be completed until **30 September, 2017**. Then, we think this is also another reason for the eligible buyers to be quick for that opportunity.

The VAT exemption law has already come into effect starting from **the very first day of April, 2017** and it will last until **March 31, 2018**. Then, we kindly ask for you to inform your Turkish citizen customers who reside outside of Turkey and /or your local non-Turkish customers who may have interested in purchasing a residential building or office **in Turkey** just for the sake of significant capital gain.

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United Kingdom

Disclosure of offshore tax irregularities

The UK government is to introduce a statutory 'Requirement to Correct' (RTC) any offshore non-compliance. It has therefore never been more important for anyone with potential exposure to UK tax on income, capital gains or assets originating from or located overseas to ensure their UK tax reporting is in order.

In 2017, HM Revenue & Customs (HMRC) will start to receive details of bank accounts and other financial assets held in many overseas jurisdictions. By late 2018, information will have been received from over 100 countries, providing HMRC with unprecedented amounts of data to compare against tax returns submitted.

The government's view is that taxpayers have been given a number of opportunities in the past to report any irregularities. They are now providing one last opportunity, extending to 30 September 2018, for taxpayers to ensure that their offshore reporting is correct.

The final disclosure opportunity is known as the Worldwide Disclosure Facility (WDF). Unlike previous disclosure regimes, it does not offer reduced levels of penalties. The incentive is simply to avoid the harsh penalty regime that will exist after September 2018.

Penalties

If, after 30 September 2018, HMRC discovers that a taxpayer has not fully disclosed liabilities in respect of offshore assets, it will seek to collect not only the tax due and interest on late payment but also penalties at levels unprecedented in the UK. The starting level for penalties will be 200% of the tax previously undeclared. The penalty may be reduced if the taxpayer co-operates with HMRC's enquiries, but it will not be reduced below 100% of the tax unless there is a reasonable excuse for the irregularity. Generally, it will not be easy to demonstrate that a reasonable excuse exists.
In addition, if the tax involved is more than £25,000 in any one tax year, a further penalty of up to 10% of the value of the relevant overseas assets may be levied.

Finally, the taxpayer faces the prospect of being named and shamed as a tax defaulter.

Method of disclosure

Disclosures under the WDF are intended to be made online, but in more complex cases, or where deliberate omissions have been made, other existing disclosure routes may be more appropriate. Whichever method of disclosure is chosen, the minimum requirement will be for HMRC to have received sufficient information by 30 September 2018 to enable them to quantify any unpaid tax liabilities for all years covered by the disclosure.

What period is disclosure required for?

The RTC will apply to undisclosed liabilities which are within time for assessment on 6 April 2017. The assessment time limits vary according to the particular circumstances in any case. The normal time limits are:

- Innocent error, despite taking reasonable care: four years from the end of the year of assessment.
- Careless error: six years from the end of the year of assessment.
- Deliberate error or failure to make tax returns: 20 years from the end of the year of assessment.

Thus, any innocent error arising in the tax years 2013-14 to 2016-17 is covered by the RTC, whilst for deliberate omissions or complete failures to make a tax return, the disclosure may have to go back to 1997-98. Identifying the period to be covered by the disclosure will be essential, but establishing the category into which particular omissions fall may not always be straightforward.

Who is affected?

It is important to understand that the RTC does not simply target individuals who have set up complex structures to hide money in tax havens abroad. It may equally affect anyone with income, capital gains or assets outside the UK who has not taken sufficient care to ensure that complete and accurate tax returns have been submitted each year.

Please contact your usual Saffery Champness partner if you have any questions or would like to discuss your position.

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United States

Gearing up for the future
6 ways to bolster your tax-planning toolkit

International tax professionals and business owners might feel apprehensive about how to proceed in a climate in which change is certain, but the details have not yet come into focus. A proposed 20-point decrease in the corporate tax, a repatriation tax, a border adjustment tax and an end to interest deductibility could mean sweeping changes to how multinational companies conduct their businesses.

How can one prepare in the face of such uncertainty? By incorporating concepts known to remain relevant — regardless of the outcome of proposed legislation — into your repertoire of tax-planning resources. Here are six ideas to help you begin.

1. **Earnings and profits/tax pool studies:** Being as familiar as possible with earnings and profits (E&P) and tax pools may be very important for a couple of reasons ahead of anticipated tax reform. Repatriation planning for both inbound and outbound companies may turn out to be a high priority, and knowing E&P is necessary in order to characterize cash repatriation as dividends or return of capital.

   Tax pools are important for understanding the foreign tax credit impact of dividends coming from controlled foreign corporations (CFCs). Additionally, if tax reform replaces our current foreign tax credit system with a territorial system, it is likely that offshore E&P will be deemed to be repatriated either immediately, or over some transition period yet to be determined.
2. **Corporate financial structure:** Reviewing the corporate finance structure will be important ahead of tax reform. It is likely that — with anticipated changes to corporate income tax rates and the possible change to a territorial taxing system— cross border movements of cash will be necessary or desired. Knowing the cash position and intercompany debt structure of U.S. multinational companies ahead of cash movements will be necessary to be economically and tax efficient.
3. **Basis studies:** In addition to the aforementioned E&P and tax pool attributes, knowing the basis of CFCs and U.S. inbound companies will be necessary when repatriating cash to either U.S. or foreign parent companies. Ordering rules generally provide that distributions with respect to shares owned will be treated as dividends to the extent of E&P. Distributions in excess of the E&P amount will be a return of basis. Therefore, the amount of basis is important to avoid eroding the basis amount too much. Additionally, tax basis of CFCs is necessary to complete proper interest expense apportionments for foreign tax credit planning.
4. **Territorial taxing system:** Replacing the current foreign tax credit with a territorial taxing system will be a major shift in taxing policy as it relates to U.S. multinational companies. Effectively, non-U.S. dividends will not be taxed when repatriated (or mostly exempted via a participation exemption mechanism), as opposed to being taxed in the U.S. with an offsetting foreign tax credit. As noted above, this policy change is likely to come with an acceleration of income inclusions via deemed dividends of earnings currently held offshore. Modeling of the cash and tax rate impact of this major policy shift is recommended.
5. **Intangible property planning:** Intangible property (IP) planning opportunities are always fact specific. Earnings from IP owned in the U.S. will generally be taxed at U.S. income tax rates. Historically, U.S. income tax rates have been (and currently are) among the highest corporate income rates in the world. Ahead of the proposed U.S. corporate income tax rate reduction, potential IP planning that would typically include migrating IP out of the U.S. and away from high-income tax rates will need to be reconsidered.
6. **Foreign tax credit planning:** As a general consideration, foreign tax planning will be necessary because many of the aforementioned planning opportunities and pretax reform preparation will impact — and be impacted by — the utilization of foreign tax credits.

Rather than allowing the unknown of proposed tax reform to stifle your international business activities, use the possibility of reform as an opportunity to perform a health check for your business. In doing so, you'll have a stronger, more comprehensive set of tax-planning tools to utilize in the vast array of possibilities future tax reform could bring.

About the Author

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Have foreign bank or financial accounts?
The opportunity to mitigate penalties may end in 2017

U.S. taxpayers who have foreign bank and/or financial accounts should be watching the clock. The window to voluntarily report foreign accounts in order to mitigate IRS penalties may be at the end of 2017. Like all IRS amnesty programs, the Offshore Voluntary Disclosure Program (OVDP) was not meant to be left open indefinitely. While the voluntary disclosure programs have been proven to be quite effective and lucrative for the IRS, there are four significant reasons the program will likely come to an end in 2017. The Wolf Group takes an in-depth look at the reasons for the program's potential closure and what taxpayers with foreign bank and financial accounts should be doing now to mitigate the penalties that they may otherwise be subject to after the end of 2017.

Amnesty programs generally end – listed below are some examples[1]:

Amnesty	Begin Date	End Date	Disclosures	Revenue Collected by the IRS
2003 OVCI and OCCP	1/14/2003	4/15/2003	1,299	$75,000,000
2009 OVDP	3/23/2009	10/15/2009	18,000	$3,400,000,000
2011 OVDI	2/8/2011	9/9/2011	15,000	$1,600,000,000
2012/2014 OVDP	1/9/2012	Ongoing	22,800	$4,400,000,000
Streamlined Procedures	7/1/2014	Ongoing	48,000	$450,000,000
		Total	**105,099**	**$9,925,000,000**

What is OVDP?

OVDP is an amnesty program that falls under IRS voluntary disclosure practice (see IRM 9.5.11.9)[2]. The program provides taxpayers with a path to resolve previous omissions, errors, and unreported forms while mitigating the potential penalties of continued non-compliance. Under normal IRS procedures, once detected, a taxpayer would be placed under audit procedures, assessed penalties for all failure to file informational reports such as FBARs, and taxes, interest, and all associated penalties for failing to report associated income such as interest, dividends, and capital gains from the foreign financial account(s). If the error has a basis of criminality, the taxpayer may be referred to Criminal Investigations for criminal penalties and/or prosecution. This can be quite expensive for both the IRS and the taxpayer. Additionally, the IRS has identified that the number of individuals that could have issues that fall within this realm is substantial (i.e., well beyond the 105,099 disclosures submitted to date). In lieu of this, if the taxpayer voluntary comes forward and discloses this information under OVDP, then the associated penalties to the taxpayer will be far less than if they were detected and undergone a full audit.

Why it is likely that OVDP is ending

Having serviced some of the most complex OVDP cases and navigating the tangled rules of OVDP compliance since the program's inception, The Wolf Group takes a look at the four significant reasons why the OVDP program will likely come to an end in 2017.

First, the IRS does not have sustainable staffing on its present and prospective budgets. President Trump recently called for a $239 million cut to the IRS budget in 2018. The proposed spending cut is similar to a reduction proposed in the House last year and represents about 2% of the budget. This alone is not enough but taken in conjunction with recent historical budget cuts and/or lack of increased budgets the IRS staffing has decreased 30%[3] over the last couple of years. The average OVDP takes roughly 2 years to complete from submission to receipt of the closing form 906. There are multiple administrative, examination, technicians, and managers involved in this process, especially if there is an opt-out. The amount of time, energy, and resources that the IRS must allocate to this area cannot be sustained. This is akin to the status of normal IRS audit or examination. In that area, the IRS has been very created and resorted to automated matching and computer generated notices as a substitute to the lack of workforce.

Second, the Foreign Account Tax Compliance Act (FATCA)[4] and Intergovernmental Agreements (IGAs) have produced a treasure trove of information that has been exchanged between foreign countries and the US. Most of the agreements have been in place since 2014 with most information being shared between 2015 and the current year. As mentioned above, like IRS normal audit or examination, the IRS could use this information to conduct a match against tax returns and FBARs that have been filed to see

1 https://www.irs.gov
2 https://www.irs.gov/irm/part9/irm_09-005-011-cont01.html#d0e1302

3 http://www.latimes.com/politics/washington/la-na-essential-washington-updates-trump-budget-to-slash-irs-funding-1489665882-htmlstory.html
4 https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx

which taxpayers may have delinquent (or inaccurate) FBARs and 8938s. They could then use this information to generate computer notices with informational penalties.

The third reason is the ICIJ Panama Papers case. The panama papers leaked offshore holdings from 1977 to 2015. The papers revealed 11.5 million records including the holdings of 140 politicians, 214,088 offshore entities, and 33 persons/companies blacklisted by the US government[5]. This information is public and can be readily used by the IRS as an investigative and matching tool. The offshore entity disclosure is particularly intriguing. With a targeted John Doe Summons, these entities could further produce undetected individuals or companies.

Finally, with over 100,000 disclosures in the previous and current OVDP programs it must be noted that the IRS uses the information it receives to conduct internal data mining. The data mining can be used to identify taxpayers that have not voluntarily disclosed information, businesses or entities in tax havens that need further scrutiny via John Does Summons, and/or the paper trail showing the flow of unreported funds from tax haven country to tax haven country.

5 https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx

What should taxpayers with undisclosed accounts do next?

Before considering next steps, taxpayers should decide on what to do now. Taxpayers with willful noncompliance should enter the full Offshore Voluntary Disclosure Program as soon as possible. The potential criminal exposure is significant otherwise.

Taxpayers that are non-willful and currently setting up for a Streamlined Filing or considering a Streamlined Filing, should get this process started as early as possible. Unlike OVDP, Streamlined Filing does not have a pre-clearance or acceptance process before submission. The IRS will not know about the disclosure until it is submitted to them. The submission requires three years of delinquent or amended tax returns plus six years of FBARs. The time needed to correctly put together one of these submissions can be extensive. Therefore, planning accordingly and allowing enough time to gather all the information needed, provide representatives with this information via their internal organizers and format, and follow their internal procedures for review and submission. The goal simple. The submission must be clean, comply with all of the Streamlined Procedure rules, and easy to follow for IRS processing.

Should these programs close before a taxpayer can get an accepted pre-clearance under OVDP or submission for Streamlined Filing, then one must revert to the standard Voluntary Disclosure Practice under IRM 9.5.11.9. Most

practitioners are familiar with OVDP but very few are familiar with the VDP practice that was enacted prior to 2009. These practitioners will be few and far in-between so verifying the practitioner's experience in this area is essential. VDP may end up looking like the current versions of OVDP and Streamlined Procedure but there will be much more work at the beginning with the disclosure of facts and the agreed upon terms for submission.

For those that receive automated notices with FBAR, 8938, and/or other international informational related penalties, they should immediately seek a firm that has experience representing taxpayers with the IRS international audit team.

Contact

The Wolf Group has assisted hundreds of clients in making voluntary disclosures of unreported foreign accounts in order to avoid the draconian penalties that may be assessed by the IRS. Please contact our New Client Lead, Fan Chen, at 703-652-1737 or at fanchen@thewolfgroup.com to learn how we can help with U.S. tax compliance complexities

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Federal Tax Reform

Since the very beginning of Donald Trump's campaign to become President of the United States, he has emphasized the need for individual and business tax reform. The last time major tax reform occurred in the United States was over 30 years ago, in the more collegial Reagan-era, Washington, D.C.-atmosphere that brought us the Tax Reform Act of 1986. Despite the various tax proposals introduced by the Trump campaign and Congressional leaders, the timing and certainty surrounding passage of tax legislation in 2017 remains unclear. The political battles being waged between Republican and Democratic members of Congress make bipartisan support for a tax bill highly unlikely. Similarly, the in-fighting amongst members of the Freedom Caucus and less conservative Republicans within the House of Representatives casts doubt on whether the controlling party can reach consensus on any legislation, as exhibited by its recent failure to repeal and replace The Affordable Care Act ("Obamacare"). Notwithstanding the current political theater in Washington, DC, many proposals warrant serious consideration as they represent a drastic change to current U.S. Federal income tax law.

Corporate Tax Reform

Over the last thirty years, the United States has been home to one of the highest corporate income tax rates in the world, prompting many companies to relocate their operations to lower tax jurisdictions. Indeed, the current combined U.S. Federal and state corporate income tax rate (approximately 40 percent) is more than fourteen points higher than the thirty-five industrialized nations of the Organization for Economic Co-operation and Development ("OECD") and ranks as the third highest among 188 nations[1]. Many commentators believe these high tax rates and corresponding migration of capital have stunted corporate reinvestment in the U.S., leading to slower economic growth and a stagnant job market.

The Trump campaign proposed jump-starting economic growth by lowering the corporate income tax rate from 35 percent to 15 percent and repealing the corporate alternative minimum tax which ensures a minimum amount of federal tax is paid by limiting certain deductions. In addition, multi-national corporations would be incentivized to repatriate earnings from overseas to the United States by paying a one-time repatriation tax at a rate of 10 percent. Tax benefits for small- and medium-sized businesses exist as well. As part of the Trump campaign's tax plan, pass-through entities such as partnerships as well as sole proprietors would have the option to be taxed on their active business income at a 15 percent corporate rate. In many cases, this will benefit sole proprietors and owners of pass-through entities, who frequently pay tax at individual federal income tax rates of approximately 44 percent. Not to be overlooked is the president's heavy bias towards domestic manufacturing. The administration has proposed allowing U.S. manufacturers to elect 100 percent expensing of their property, plant and equipment, in lieu of deducting interest expense, and the president has lent support to a "border tax" sponsored by House Republicans.

Turning to Congress, House Republicans have introduced similar measures as the president, albeit at different tax rates. Under the House Republicans' proposal, the U.S. corporate income tax rate would be reduced from 35 percent to 20 percent, and the tax rate on active business income of pass-through entities would be 25 percent. Republican House members have also proposed changing the U.S. corporate income tax system from a worldwide tax system to a territorial dividend exemption system. In addition, there would be a mandatory repatriation tax at 8.75 percent for cash and 3.5 percent for non-cash foreign earnings, payable over eight years. Moreover, certain deemed dividend rules on tainted income, commonly known as "Subpart F income," applicable to controlled foreign corporations, would be simplified. Last, as mentioned above, certain members of the House have introduced the concept of a border-adjustable destination-based cash flow tax system as a means for discouraging imports and boosting domestic manufacturing. In essence, this would be accomplished by denying tax deductions for the cost of imports. There appears to be little support for this proposal outside the White House and core group of House Republicans, and there are serious concerns over whether such a system would comply with the World Trade Organization's ban on export subsidies.

Corporate Tax Reform Proposals

	Trump Campaign	House Republicans
Corporate tax rate	15%	20%
Repatriation tax	One-time tax at a rate of 10%	8.75% for cash and cash-equivalents
Credits	R&D maintained	Business credit to encourage R&D
Worldwide Tax System	No reform stated	Territorial System, with 100% dividend exemption system Border adjustment tax
Section 199 DPAD Expensing	Repeal	Repeal
Interest Expense Deductibility	U.S. manufacturing will lose deductibility of interest expense when full expensing of PP&E is elected	Deductible only against interest income
Corporate AMT	Repeal	Repeal

1 https://taxfoundation.org/corporate-income-tax-rates-around-world-2016/

Individual Tax Reform

Every four years the main issue that arises during a presidential election is individual income tax rates. Under the current U.S. tax system there are seven individual income tax brackets with rates that range from 10 percent to 39.6 percent. The Trump campaign proposed a reduction to three brackets with rates of 12 percent, 25 percent, and 33 percent. Also, the standard deduction would increase for single and joint filers; itemized deductions would be capped at $100,000 for single filers and $200,000 for joint filers; the 20 percent long-term capital gains rate would be retained and the 3.8 percent net investment tax would be repealed; and personal exemptions, exemptions for dependents, and the head of household deduction would be eliminated. By contrast, the House Republicans' plan would repeal all itemized deductions except the mortgage interest deduction and the charitable contribution deduction.

As it pertains to high-income and high-net worth taxpayers, both the Trump campaign and House Republicans have proposed repeal of the estate and gift tax, with the campaign proposing an income tax at death. The campaign's plan would tax carried interest at ordinary income tax rates. In addition, the House Republicans' plan would tax capital gains under an exclusion system, whereby 50 percent of capital gains would be excluded from taxation and the remaining 50 percent would be subject to ordinary tax rates.

Individual Tax Reform Proposals

	Trump Campaign	House Republicans
Income tax brackets	Reduce from 7 to 3	Reduce from 7 to 3
Tax Rates	12%, 25%, 33%	12%, 25%, 33%
Standard Deduction	Single Filers: $15,000 Married Joint Filers: $30,000	Married filing Jointly: $24,000 Single with child: $18,000 Other individuals: $12,000
Itemized Deductions	Single Filers: $100,000 Joint Filers: $200,000	Keep the charitable deduction and mortgage interest deduction
AMT	Repeal	Repeal
Estate and Gift Tax	Repeal, replaced by income tax	Repeal

CLA's Take

Although it is tempting to live by the words of the late President Ronald Reagan, "the glass is not half empty, it is half full," even the most casual observer of Washington politics can appreciate the animosity harbored by the various political factions. Whether the issue is healthcare, environmental, or tax law reform, while one side of the aisle is committed to dismantling the Obama administration's legacy, the other appears intent on defending it at all costs. We believe this tug-of-war will persist through the end of the year, severely limiting the opportunity for monumental, once-in-a-generation tax law changes in 2017.

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