Facts about FACT

- Tax, Advisory, Auditing
- Located in Kassel, the Ăheartñof Germany
- Experienced in International Taxation

TOPIC

FACT

Anti-Treaty-Shopping Rules:

Development in selected countries and the increasing importance of these rules

ITPG meeting in Cape Town
16th October 2014

Overview

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1. Definitions

FACT

„Treaty shopping“:

- The practice of structuring a multinational business to take advantage of more favorable tax treaties available in certain jurisdictions.

- ĂTreaty shoppingògenerally refers to a situation under which a person, who is not entitled to the benefits of a tax treaty, uses an intermediate entity that is entitled to such benefits in order to obtain those benefits indirectly.

Purpose of anti-treaty-shopping rules:

- The purpose of these rules is to ensure that the tax benefits granted on the basis of the tax treaty are restricted to the intended beneficiaries.

2. Example

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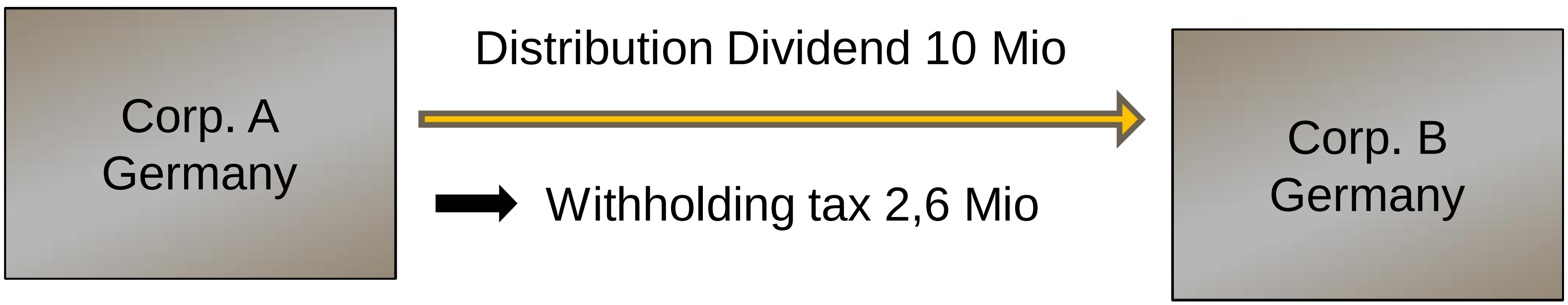

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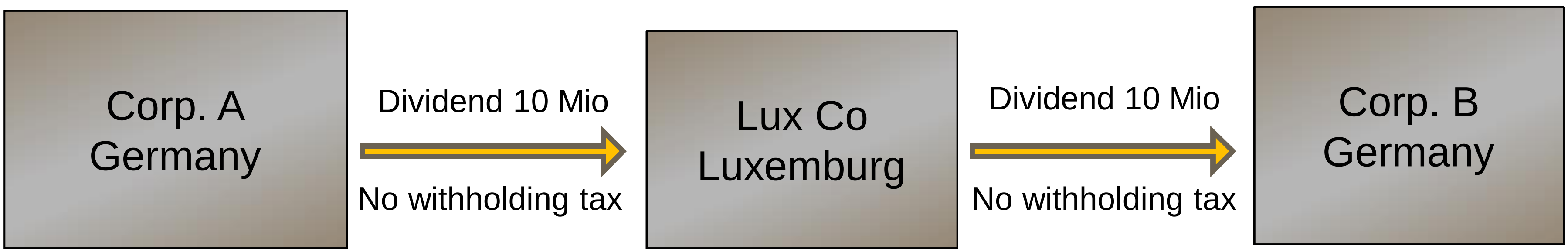


3. Germany´s Anti-Treaty-Shopping Rule

EACT

- tightened as of January 2007
- changed again January 2012, now less strict

New rule is hugely complex, companies to do the so-called three-factors-test:

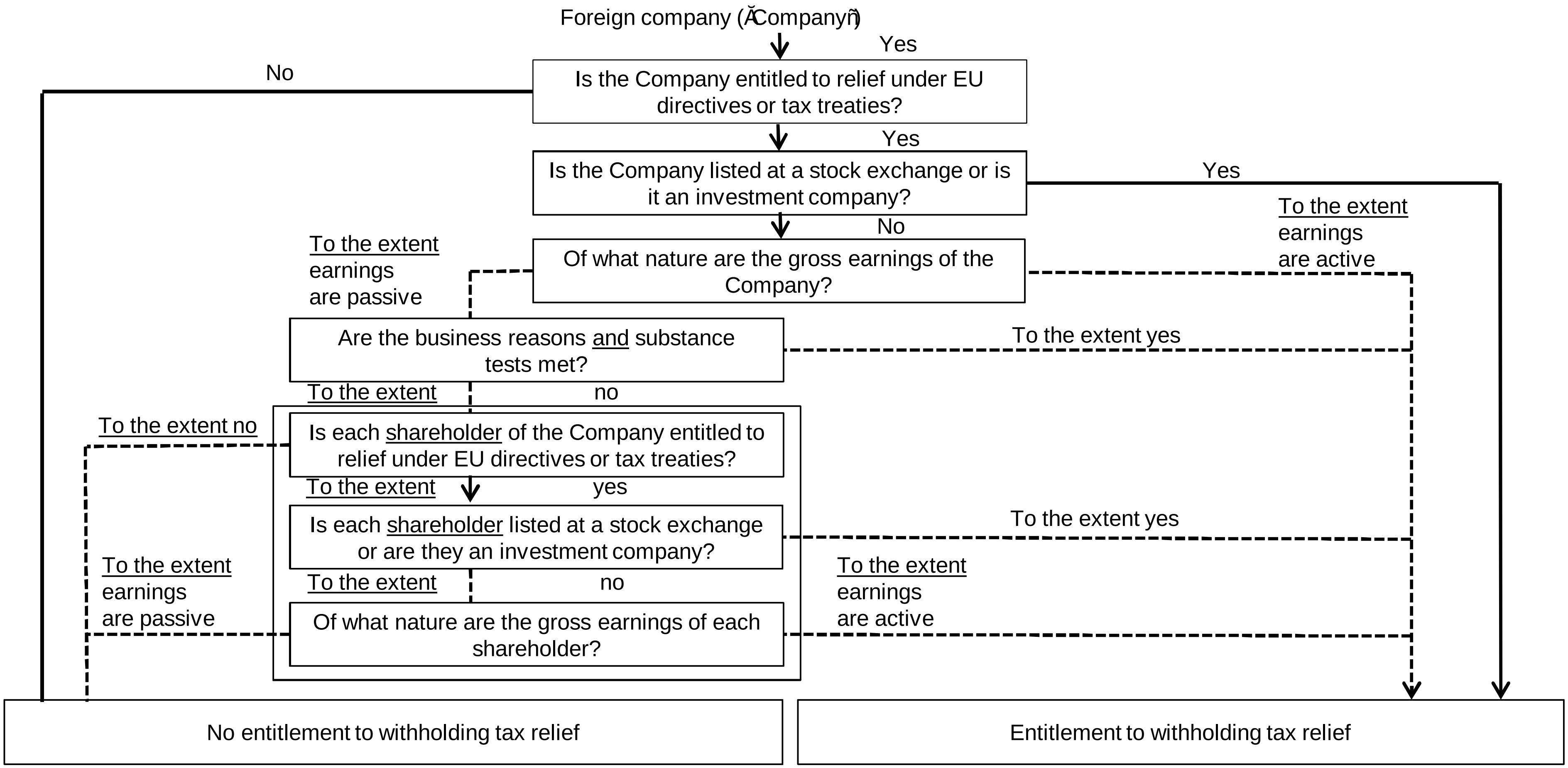
I. There must be economic or other non-tax-driven reasons for the interposition of the foreign corporation.

II. The foreign corporation must generate more than 10 percent of its gross revenues from “own business activities”.

III. The foreign corporation must actively engage in general commerce with adequate business equipment.

3. Germany´s Anti-Treaty-Shopping Rule

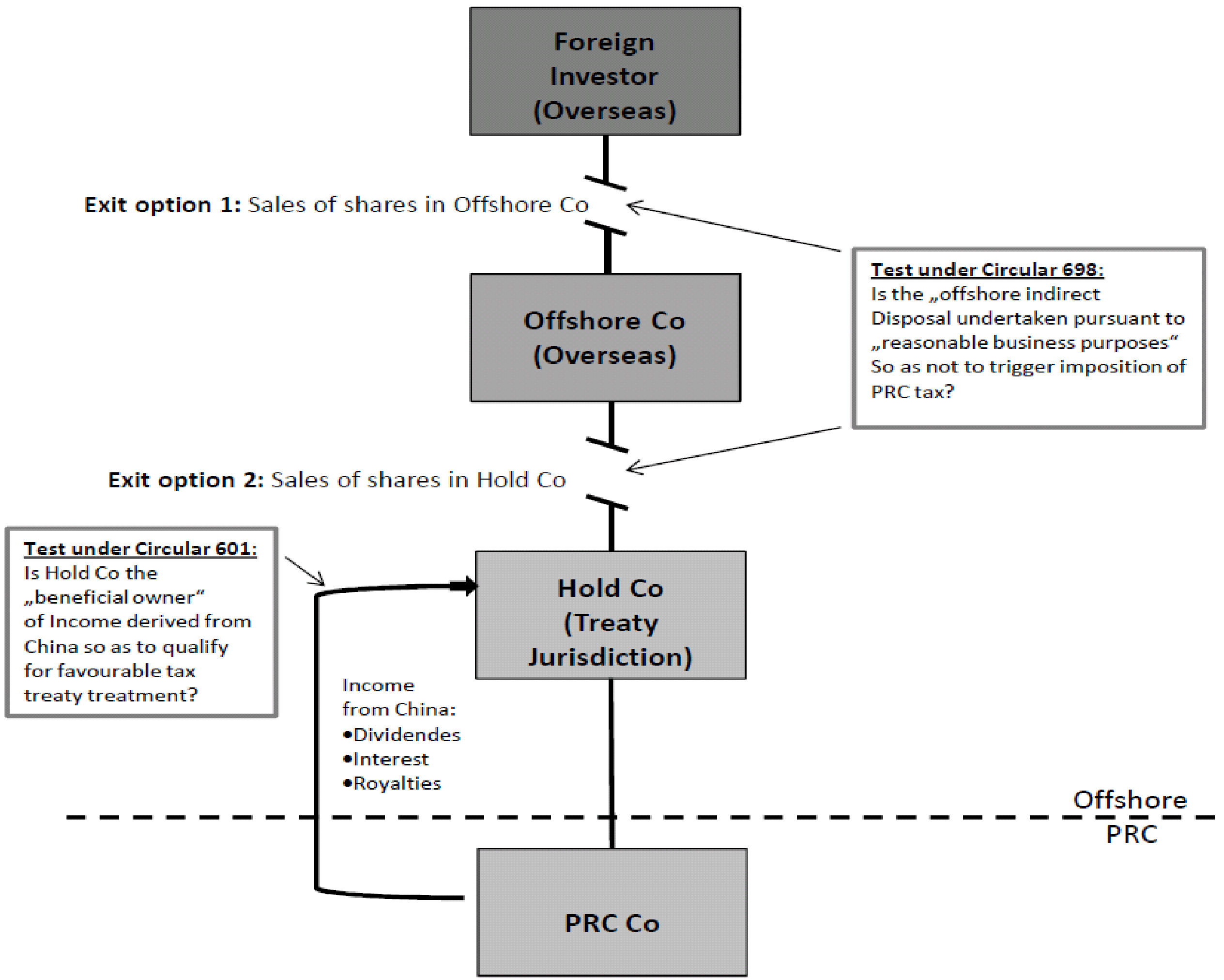
The following flow-chart illustrates the tests:



* This is to be checked in multi-layer structures until the first (indirect) shareholder is encountered which does not benefit from an EU directive or tax treaty

4a) China

FACT



Since 2008, PRC tax Authorities have introduced several significant tax circulars, which impose far-reaching compliance requirements and hurdles for foreign investors seeking to implement tax effective investment holding structures.

4a) China

FACT

SAT Guoshuihan (2009), Ciruclar 601, in accordance with ñsubstance over formòprinciple, try to find out whether the recipient of income (dividend) can be qualified as the beneficial owner, checking whether the recipient:

- is obliged to distribute all/significant portion of income to another jurisdiction
- does not undertake other business activities apart from holding the investment
- assets, size of operations, personnel are too small compared to the income derived
- does not have the right to dispose of the assets
- is subject to very low taxation in the treaty jurisdiction
- has implemented some effective ñback-to-backòarrangements concerning loan or royalties arrangements

Most of Double Taxation Treaties, signed by PRC include a 10% rate of withholding tax on dividends. Due to PRC Income Tax Law, in some case a reduction to 5% is applicable.

4 b) USA

FACT

Anti-Treaty Shopping Measures in the U.S. Model Tax Convention

- The United States has taken an aggressive approach to shutting down treaty shopping techniques through a limitation on benefits ("LOB") clause in its treaties and protocols.
- The LOB clause is contained in Article 22 of the U.S. Model Tax Treaty. In general, the provision does not rely on a determination of purpose or intention but instead sets forth a series of objective tests. A resident of a Contracting State that satisfies one of the tests will receive benefits regardless of the motivation in choosing its particular business structure.
- The LOB provision attempts to distinguish between treaty shopping arrangements (the target of the LOB clause) and *bona fide* transactions of enterprises operating internationally.
- The LOB Clause uses three principal tests to determine eligibility for treaty benefits:
  - Public company test
  - Ownership / Base-erosion test
  - Active Business Test
  - Note that the tests are not concurrent tests. Only one test needs to be satisfied.

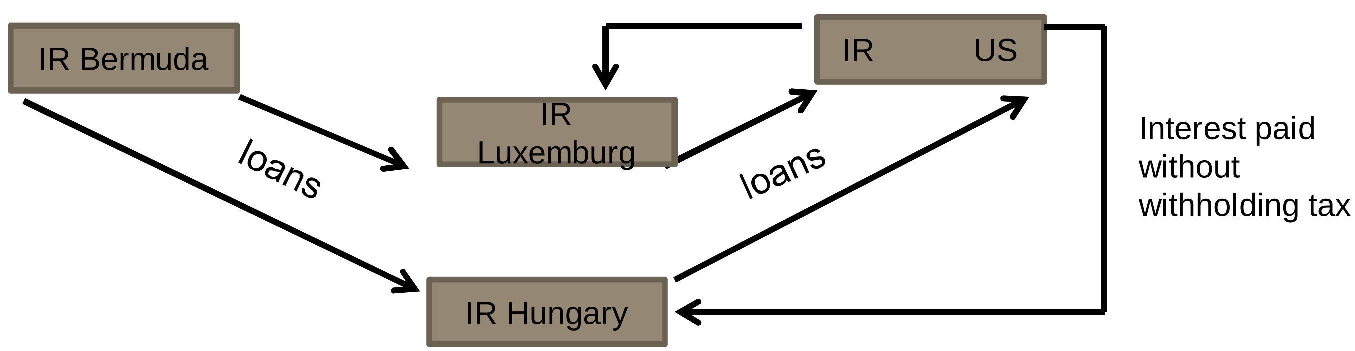
4 b) USA

FACT

Ingersoll-Rand- (IR) Case

<u>2001</u>	**IR (US-Corp) moved from US → Bermuda (so-called: Inversion)**
	Year 2000: tax rate 34 %
	Year 2002: tax rate 0 %
<u>2009</u>	**IR moved from Bermuda to Ireland**
Today	**IR is confronted with tax bill (IRS) about $774 Mio**

Because from 2002 – 2007:



4 c) Canada

FACT

- In the federal budget of February 11, 2014, Canada announced its own proposed initiative to combat "treaty shoppingñ

- The proposed new rule would **dramatically change Canadian tax policy** with a "go it alone" approach: Canada proposes to enact domestic legislation that will effectively override all of its tax treaties with other countries by imposing a new test for when a tax treaty will reduce Canadian tax.

- If enacted, this sweeping new rule will affect non-residents earning Canadian-source income or gains, Canadians who are liable for withholding tax on payments to non-residents (e.g., interest, dividends and royalties), and ultimately (since Canada's treaty partners are likely to respond with similar rules) Canadians with foreign subsidiaries or earning foreign-source income.

4 d) France

FACT

Under the European Parent Subsidiary Directive, French domestic tax law rules that foreign companies located in the EU may benefit from withholding-tax relief.

But France implemented its Anti-Treaty-Shopping Rule directly in the paragraph, stipulating its potential withholding exemption by saying that a foreign company will not benefit in case that its structure is tax driven.

What´s the procedure in France:
In case of distribution of dividends, the subsidiary located in France has to apply for the exemption by providing:

- a residence certificate of the foreign holding company and
- a declaration that the recipient of the dividends is the beneficial owner of the source.

⟹ Preliminary withholding tax exemption but subject to review

(checking of holding companyˆs status in a subsequent tax audit)

RISK !!! To be asked for a payment of withholding tax years later.

5. Summary

FACT

The future of Treaty Shopping in the world of:

Base Erosion and Profit Shifting (BEPS)

➡ **PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES**
as BEPS Action 6

➡ *Treaty Shopping is mentioned in the EPS initiative of the OECD under Action 6:*

"Treaty abuse is one of the most important sources of BEPS concerns"

5. Summary

FACT

Recommendations of OECD:

- **First**, it is recommended to include in the title and preamble of tax treaties a clear statement that the Contracting States, when entering into a treaty, wish to prevent tax avoidance and, in particular, intend to avoid creating opportunities for treaty shopping .

- **Second**, it is recommended to include in tax treaties a specific anti-abuse rule based on the limitation-on-benefits provisions included in treaties concluded by the United States and a few other countries.

- **Third**, in order to address other forms of treaty abuse, including treaty shopping situations that would not be covered by the specific anti-abuse rule described in the preceding paragraph (such as certain conduit financing arrangements), it is recommended to add to tax treaties a more general anti-abuse rule.

Many thanks for your attention!