Global Tax Update
Issue 2 | October 2014

JONES DAY

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What's New

Multinational

OECD Releases First BEPS Recommendations to G20 in Accordance with Action Plan
As a part of the OECD/G20 project to combat base erosion and profit shifting ("BEPS"), the OECD released the first set of reports and recommendations on September 16, 2014. These reports address seven of the actions described in the 15-point action plan to address BEPS published in July 2013.

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United States

Treasury Department and IRS Issue Long-Awaited Inversion Guidance
On September 22, 2014, the U.S. Treasury Department and the IRS issued long-awaited inversion guidance in the form of Notice 2014-52. The Notice sets forth rules that are generally effective for transactions completed on or after September 22, 2014, and will be included in regulations that will be issued in the future. The new rules address two aspects of inversion transactions. First, they increase the likelihood that the inversion ownership tests under section 7874 of the Internal Revenue Code will be met (the 60 percent and 80 percent tests). Second, they limit the tax benefits of certain types of post-inversion planning.

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IRS Issues Guidance Regarding the Deductibility of Litigation Fees Incurred by

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CONTRIBUTORS TO THIS ISSUE

Belgium

Howard M. Liebman
Brussels

Werner E. Heyvaert
Brussels

China

Fuli Cao
Shanghai/Beijing

France

Siamak Mostafavi
Paris

Emmanuel de la Rochethulon
Paris

Germany

Branded Pharmaceutical Companies When Defending Their Patents Against Challenges to Market Exclusivity by Generic Companies
There is welcome clarity for branded pharmaceutical companies seeking to deduct legal fees incurred in defending their patents against challenges to market exclusivity by generic companies. This clarity comes after a year of uncertainty arising from a negative opinion expressed by the IRS in a chief counsel memorandum in January 2013, which the IRS seems to have now reversed in a second CCM issued 20 months later.
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United Kingdom

Follower Notices and Accelerated Payments
The UK Finance Act 2014, enacted in July 2014, contains new legislation to deal with cases of purported tax avoidance, which marks a radical departure from previous policy in this area.
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SDLT and Property Investment Funds
The UK government has announced that it will be looking at whether any changes are needed to current stamp duty land tax rules to cater for two specific forms of collective investment scheme designed for investors in the UK market.
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Further Reference to CJEU on Card Handling Charges
The First Tier Tax Tribunal has referred certain questions regarding the liability for VAT of card handling charges to the Court of Justice of the European Union ("CJEU") in the case of *Bookit Ltd v The Commissioners For Her Majesty's Revenue & Customs*.
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The Netherlands

The Netherlands to Expand its Fiscal Unity Regime to Second-Tier Subsidiaries and Sister Companies Following EU Court of Justice Ruling
On June 12, 2014, the EU Court of Justice ruled in two joint cases that the Dutch fiscal unity regime infringes on the EU freedom of establishment, because it does not allow a fiscal unity between (i) a Dutch resident parent company and its second-tier Dutch resident subsidiary held through an EU resident intermediate company, or (ii) two Dutch resident sister companies held by the same EU shareholder.
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Martin Bünning
Frankfurt

Andreas Köster-Böckenförde
Frankfurt

Italy

Marco Lombardi
Milan

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Koichi Inoue
Tokyo

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Rodrigo Gómez
Mexico City

Spain

Pablo Baschwitz
Madrid

The Netherlands

Lodewijk Berger
Amsterdam

Lyda Stone
Amsterdam

United Kingdom

Blaise L. Marin-Curtoud
London

Charlotte L. Sallabank
London

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Washington

Joseph A. Goldman
Washington

Andrew M. Eisenberg
Washington

Colleen E. Laduzinki
New York

Edward T. Kennedy
New York

Todd Wallace
Dallas

Dutch Innovation Box Regime for Intangibles is Clarified in Decree
The Innovation Box was introduced in 2007 to encourage companies to innovate and increase their research and development activities. Under this optional regime, subject to certain conditions, Dutch corporate taxpayers are taxed at an effective rate of 5 percent. In the newly published Decree, the Underminister of Finance clarifies the scope of the Innovation Box, in particular addressing the types of qualifying intangibles and the level of involvement of the taxpayer required for the application of the regime.

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Spain

ECJ Rules that Spanish Law on Inheritance and Gift Tax is Contrary to Community Law
The Court of Justice of the European Union handed down a ruling on September 3, 2014 (C-127/12, Commission/Spain), in which Spanish law on inheritance and gift tax (*Impuesto sobre Sucesiones y Donaciones*) is considered to restrict the free movement of capital since it involves differences in tax treatment between tax residents in Spain and nonresidents.

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Parent–Subsidiary Directive
The Explanatory Memorandum to the Draft Law amending nonresident income tax points out that the main reason for the tax reform is to adapt it, to a greater extent, to the European Union regulatory framework. The draft law includes an anti-abuse clause, similar to the one currently in force, which prevents the application of the tax exemption in Spain on dividends paid when most of the voting rights of the European Union resident shareholder are held, directly or indirectly, by individuals or legal entities that do not reside in a European Union member state.

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Mexico

Tax Rules Included in the Mexican Energy Reform
On August 6, 2014, the Mexican Congress approved some of the secondary legislation related to the so-called Mexican Energy Reform. The approved laws were published in the Mexican Official Gazette on August 11, 2014. Among the approved secondary legislation is the Hydrocarbons Revenues Law, which includes: (i) special tax provisions for governmental and nongovernmental entities entering into agreements for the extraction and exploration of hydrocarbons; and (ii) a new hydrocarbons tax applicable to these entities.

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Three New Tax Treaties Signed by Mexico Will Be Applicable from January 1, 2015
During 2014, three new tax treaties signed by Mexico with Peru, the United Arab Emirates, and Malta have been published in the Mexican Official Gazette. According to the tax treaties, their benefits will be applicable from January 1, 2015, bringing Mexico's tax treaty network to 59. Treaties with Costa Rica, Malaysia, and Nicaragua are currently being negotiated by the Mexican government, and the modifications to the 1994 Mexico–Belgium treaty are currently pending.

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Japan

Tokyo District Court Allows Tax Saving from Share Repurchase
On May 9, 2014, the Tokyo District Court reversed a large tax that had been imposed on a large U.S. multinational's Japanese holding company.

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Judgment of Tokyo District Court: Application of a General Anti-Avoidance Rule Concerning Reorganization Transactions
On March 18, 2014, the Tokyo District Court affirmed corporate tax assessments against two tax payers: Yahoo Japan Corporation, a Tokyo Stock Exchange listed company, and IDC Frontier Inc., a wholly owned subsidiary of Yahoo Japan. The main issue of the Yahoo Japan case was whether, upon a tax-qualified merger, the surviving company (Yahoo Japan) was entitled to utilize net operating losses of the acquired company pursuant to Article 57 of the Corporation Tax Act of Japan.

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Italy

Repeal of the Interest-Withholding Tax on Certain Cross-Border Loans
As a rule, if a nonresident lender grants a loan to an Italian resident borrower, the interest paid on the loan is subject to a 26 percent withholding tax in Italy unless the lender is eligible for the exemption under the Italian laws that implemented the EU Interest and Royalties Directive. The withholding tax may be reduced (usually to 10 percent) or, in very few cases, zeroed under the double tax treaties entered into by Italy, where applicable.

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Withholding Tax Exemption on Bond Interest Broadened
Law Decree No. 91 of June 24, 2014, converted into law by the Italian Parliament on August 7, 2014, has broadened the scope of the withholding tax exemption applicable to eligible nonresident investors (i.e., investors resident in a white-listed country and with no permanent establishment in Italy) on certain debt-like securities.

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Germany

New Developments for Real Property Transactions
On July 9, 2014, the German Supreme Fiscal Court decided a real estate transfer tax case that shines a new light on RETT structures. Contrary to the long-standing interpretation of the law, the court took the position that aspects of economic ownership are also relevant for RETT purposes.

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France

Luxembourg–France Tax Treaty: Amendment Signed
On September 5, 2014, French Minister of Finance Michel Sapin and Luxembourgian Minister of Finance Pierre Gramegna signed an amendment to the France–Luxembourg Tax Treaty. The amendment, in line with the current OECD Model Tax Convention on Income and Capital, reverts to the tax treatment of capital gains arising on the direct and indirect disposal of real estate assets and puts an end to the potential double-tax exemption regularly applied until now regarding sale of real estate companies' shares.

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China

Draft Guidance for the General Anti-Avoidance Rule
On July 3, 2014, the State Administration of Taxation (the "SAT") released a discussion draft on the Administrative Measures on the General Anti-Avoidance Rule (the "Draft Measures). The General Anti-Avoidance Rule ("GAAR") was introduced in China Corporate Income Tax Law effective on January 1, 2008. However, the provision of law and

subsequent interpretation tax circulars provide only some basic principles. The Draft Measures provide comprehensive guidance on the implementation of GAAR.

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Belgium

Recharged Costs and Expenses of Stock Option Plans Not Tax Deductible for the Belgian Employer

On June 25, 2014, the Brussels Court of Appeal confirmed an earlier ruling (dating from 2010) from the Tribunal of First Instance. The tribunal had found that costs and expenses in connection with an international stock option plan recharged by a South African parent company to its Belgian subsidiary are not tax deductible by the latter to the extent a capital loss has been suffered on the shares that had to be acquired in order to be delivered to Belgian optionees following the exercise of their stock options.

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No Corporate Income Tax on an Undervaluation of Shares Acquired by Belgian Holding Company

Following a very long and winding road in several courts, it has finally been confirmed that Belgium cannot impose corporate tax on any undervaluation of or underpayment for shares acquired by a Belgian corporate taxpayer. Thus, when a Belgian corporation buys shares at a price below fair market and subsequently sells those same shares at the higher market value, the capital gain so booked qualifies, in principle, for the participation exemption.

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"Protectionist" French Excise Tax on Certain Types of Beer Complies with EU Law

On September 13, 2014, it was reported by the trade press that the European Commission had found that the increase by 160 percent of French excise tax on certain types of high-alcohol-content and luxury beers that was introduced on January 1, 2013 did not fall afoul of the free-market principles of the EU.

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What's New

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As a part of the OECD/G20 project to combat base erosion and profit shifting ("BEPS"), the OECD released the first set of reports and recommendations on September 16, 2014. These reports address seven of the actions described in the 15-point action plan to address BEPS published in July 2013 (the "Action Plan") and consist of the following items:

• Recommendations for domestic rules to neutralize hybrid mismatch arrangements and recommended changes to the OECD Model Tax Convention to deal with transparent entities (Action 2, the "Hybrids Report");

• Proposed changes to the OECD Model Tax Convention for preventing tax treaty abuse (Action 6, the "Treaty Abuse Report");

• Revisions to the OECD Transfer Pricing Guidelines to align transfer pricing outcomes with value creation in the area of intangibles (Action 8, the "Intangibles Report");

• Revised standards for transfer pricing documentation and a template for country-by-country reporting of income, earnings, taxes paid, and certain measures of economic activity (Action 13, the "Documentation Report");

• A report on the issues raised by the digital economy (Action 1, the "Digital Economy Report");

• A report on harmful tax practices, outlining the

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progress of the review of preferential regimes, etc. (Action 5, the "Harmful Tax Practices Report"); and

• A report on the feasibility of developing a multilateral instrument to amend bilateral tax treaties (Action 15, the "Multilateral Instrument Report").

These deliverables include specific proposed changes to domestic laws, tax treaties, and transfer pricing guidelines that, if adopted, could significantly affect both the taxation and compliance burdens of multinational enterprises ("MNEs"). After the discussions by G20 finance ministers in September 2014, these reports will be presented to G20 leaders in November 2014, and the OECD continues work on the remaining actions by 2015 in accordance with the Action Plan. As the 2014 deliverables are closely connected to the 2015 deliverables and there is still disagreement on some of the issues, the recommendations made in the 2014 reports will remain in draft form until then. However, it is expected that some countries may begin implementing some of the proposals before finalized versions have been released, and the United Kingdom has already announced its intention to implement country-by-country reporting along the lines of the suggestions in the Documentation Report. Some key points of the new reports are summarized below.

Hybrid Mismatch Arrangements (Action 2). The Hybrids Report, which differs little from the prior draft released in March 2014, provides a set of recommended changes to domestic law designed to prevent hybrid mismatch arrangements (as described below) even in situations where it is unclear which country has lost revenue. The report also provides proposed changes to the OECD Model Tax Convention regarding dual resident entities (a case-by-case approach) and fiscally transparent entities (rules in line with the OECD Partnership Report in 1999). Finally, the report raises additional issues, including intragroup hybrid regulatory capital and on-market stock lending transactions, which need to be further explored.

The report includes specific recommendations on improvements to domestic law, including denying participation exemptions for deductible payments and a set of hybrid mismatch rules. Although the report encourages all countries to adopt the recommended changes to domestic law, the hybrid mismatch rules are designed with both a primary rule and a secondary defensive rule to be applied in case the primary rule is not adopted by the relevant jurisdiction. The hybrid mismatch rules require linking of domestic law, whereby the tax treatment of a payment is determined, in part, by the treatment of that payment under the laws of another country. The report discusses some of the difficulties with implementing such a rule, and the OECD is still considering appropriate mechanisms for ensuring the necessary cooperation between taxing authorities for such a rule to be administrable. The scope of the primary and defensive rules has been narrowed from the prior draft, and the rules now generally are applicable only in related-party contexts (as defined below) and to payments made pursuant to an arrangement designed to produce the hybrid mismatch.

A brief overview of the hybrid mismatch rules is provided below. With regard to situations where a single payment gives rise to duplicate deductions in different countries, the report recommends as a primary rule that the payee's jurisdiction deny the duplicate deduction in all cases. As a secondary defensive rule, the report recommends that the payer's country of residence deny the deduction, but only in the case of payments between members of a control group (a 50 percent or greater ownership threshold). In the case of a payment that is deductible to the payer but not included into income by the payee, the primary rule is to deny the payer's deduction, and the defensive rule is to include the payment into the payee's ordinary income; both the primary and defensive rule apply only to payments between related parties (a 25 percent or greater ownership threshold, increased from the 10 percent proposed in the earlier draft). Finally, in the case of disregarded payments (i.e., payments deductible by payers while being disregarded in the payees' jurisdiction) involving a hybrid entity where the parties are members of the same controlled group, the primary rule is to deny the deduction, and the defensive rule is to require inclusion.

Preventing Tax Treaty Abuse (Action 6). The Treaty Abuse Report recommends three changes to the OECD Model Tax Convention. First, the report recommends inclusion in the preamble of treaties an express statement that the common intention of the treaty partners is to eliminate double taxation without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance. Such a statement would be relevant in the interpretation and application of the provisions of a given treaty.

Additionally, the report recommends including an objective anti-abuse limitation of benefits rule (a "LOB Rule") based on the provisions in existing tax treaties concluded by the U.S. and some other countries, as well as a more general subjective anti-abuse rule denying a treaty benefit where obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted in that benefit (a "PPT Rule"). While these rules are already recognized in the existing Commentary on Article 1 of the OECD Model Tax Convention, the report proposes to establish an independent article with a new Commentary for these rules.

The report recommends that tax treaties include both the LOB Rule and PPT Rule. However, in response to strong U.S. criticism of the subjective PPT Rule, the report's proposal allows some flexibility as long as countries effectively address treaty abuses. The report requires countries to have only a minimum level of protection against treaty abuse, which can be satisfied with the LOB Rule (supplemented by a mechanism to address conduit arrangements as necessary) without the PPT Rule. Under this flexible approach, U.S. tax treaties that include a LOB Rule (incorporating objective standards such as the publicly traded entity test, the ownership and base erosion test, the derivative benefits test, and the active trade or business test) could comply with the report's recommendations. However, countries lacking laws akin to the economic substance doctrine in the United States may need to apply a PPT Rule in order to meet this minimum standard.

In addition, the report recommends other anti-abuse rules to address some specific transactions such as certain dividend transfer transactions and transactions circumventing source taxation of shares in real property holding entities. The report indicates that further work will be needed with respect to the precise contents of the proposed model provisions and related Commentary, and that the drafts are subject to improvement before the final version is to be released in September 2015. In particular, some of the terms of the proposed LOB provision, such as the scope of the derivative benefits rule, are still under discussion. Additionally, there is still some uncertainty regarding the level of tax-motivated decision-making that is permissible under the proposed preamble language and the PPT Rule.

Transfer Pricing Aspects of Intangibles (Action 8). The Intangibles Report contains final and interim revisions to the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* . The report explains that due to the overlap of the transfer pricing aspects of intangibles with the other transfer pricing parts of the BEPS project (Action 9, transfer pricing aspects of risks and capital and Action 10, transfer pricing aspects of other high-risk transactions) large portions of the revisions are still in draft form pending the issuance of the deliverables under Actions 9 and 10 in 2015. In particular, the OECD is continuing to examine: (i) permitting taxing authorities to use actual results retrospectively to determine the value of transferred intangibles, (ii) treating entities whose activities are limited to funding intangibles development as lenders or otherwise limiting their returns, (iii) requiring contingent payment terms and/or the application of the profit split method to certain transfers of intangibles, and (iv) the treatment of situations involving excessive capitalization of low-function entities. These items are scheduled to be included in the 2015 deliverables.

Consistent with the Action Plan, the report does not propose a change from the arm's-length standard, but instead explains that the parties to a transaction should be compensated based on an analysis of the functions performed and risks assumed, and not just the legal ownership of the intangibles or the contractual arrangements in place. Significantly, the report provides in interim guidance that where the legal owner of an intangible outsources most or all of the important functions related to that intangible, it is "highly doubtful" that the owner is entitled to a material portion of the return derived from the exploitation of the intangible. Similarly, where an entity only bears funding risks associated with an intangible, the entity is generally only entitled to a risk-weighted return on such funding.

The report also contains final and interim guidance and examples regarding multinational group synergies, identifying intangibles, transfers of intangibles in development or that otherwise have uncertain value, the use of both the profit split method and "other methods," and valuation techniques (such as the discounted cash flow method) regarding transfers of intangibles.

Transfer Pricing Documentation and Country-by-Country Reporting (Action 13). The Documentation Report contains a new three-tiered documentation requirement to be included in the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* that is designed to provide tax authorities with additional information necessary for transfer pricing inquiries and risk assessment. In light of the global trend for increased transparency, the report proposes a set of standard documentation requirements so as to avoid countries from promulgating different increased documentation requirements. The proposal requires MNEs to prepare three separate types of documentation as described below:

• A "Master File" available to all relevant jurisdictions providing an overview of the MNE's global operations and policies so as to provide an appropriate context for the other information. The Master File would include information regarding organizational structure, the MNE's intangibles, intercompany financial activities, financial and tax positions, and a description of the MNE's business(es);

• A "Local File" for each country providing more detailed information relating to specific intercompany transactions, including relevant financial information and transfer pricing analysis (including a comparability and functional analysis and an indication of the most appropriate method) regarding those transactions; and

• A "Country-by-Country Report" for annual submission to each tax jurisdiction in which a business unit of the MNE that is included in the consolidated group for financial reporting purposes (a "Constituent Entity") is a resident for tax purposes. This Country-by-Country Report will provide aggregate information relating to the global allocation of income, taxes, and business activities among the relevant tax jurisdictions (specifically, jurisdiction-by-jurisdiction information relating to revenues, pre- and post-tax profits, income tax accrued and paid, stated capital, accumulated earnings, number of employees, and tangible assets), as well as a list of all of the MNE's Constituent Entities including jurisdiction of incorporation (if different from tax residence) and the nature of the entity's main business.

Some emerging market countries pushed to require reporting of additional transaction data regarding related party interest payments, royalty payments, and service fees in the Country-by-Country Report, concerned that if taxpayers are permitted the discretion to determine what information is relevant for transfer pricing purposes, the taxpayers may underreport. The compromise reached was to require a review of the country-by-country reporting before 2020 to determine if the information in the Country-by-Country Report is sufficient for the taxing authorities and not being abused by the taxing authorities.

In addition, the report gives some guidelines as to documentation-related issues including timing of the preparation of the documentation, materiality of transactions, frequency of documentation updates, and penalties. Additional work will be undertaken with respect to the means of filing the required information and disseminating such information to tax administrations over the next several months. As concerns have been raised regarding the disclosure by tax authorities of trade secrets or other commercially sensitive information, the report requires tax authorities take all reasonable steps to ensure the confidentiality of such information.

Issues Raised by the Digital Economy (Action 1). The Digital Economy Report discusses at length the various challenges raised regarding BEPS due to the advent of information and communication technology, particularly with regard to nexus issues, attributing value to transactions in which data is collected, used, or supplied, and the characterization of new products and services. Because such a significant part of the worldwide economy is now "digital," the report recommends against ring-fencing the digital economy from the rest of the economy for tax purposes. Additionally, the report identifies several BEPS strategies permitted by the digital economy, particularly regarding value added taxes, that currently attract concern. The report discusses potential options, such as modifying the "preparatory or auxiliary" exemptions from permanent establishment status in the context of a direct tax, and requiring nonresident suppliers to register and account for the VAT on cross-border business-to-consumer supplies. The report concludes that further consideration is needed regarding some of these structures, and it provides insight into how some of these concerns can be addressed in other parts of the BEPS project.

Harmful Tax Practices (Action 5). The Harmful Tax Practices Report is an interim report on the progress made by the Forum on Harmful Tax Practices (the "Forum") on the outputs to be delivered under Action 5, including the review of the preferential tax regimes of OECD member countries. Although the report does not conclude that any specific regimes are harmful, it lists some regimes that the Forum has concluded are not harmful. Additionally, the report discusses requiring substantial activity to access the benefits of a preferential regime, improving transparency and compulsory exchange of information on rulings for tax holidays, and establishing a strategy to expand participation to non-OECD member countries.

Developing a Multilateral Instrument to Modify Tax Treaties (Action 15). The Multilateral Instrument Report concludes that addressing certain of the treaty-based BEPS actions through a multilateral agreement, rather than through amendments to every bilateral treaty, would be both efficient and effective, particularly for issues that are multilateral in nature, including mutual agreement procedures, dual-residence structures, fiscally transparent entities, and triangular arrangements. Although there was some initial concern that such a multilateral agreement would attempt to address some of the more complex international tax issues such as controlled foreign corporation regimes and transfer pricing, the Multilateral Instrument Report confines its scope to traditional treaty provisions (The precise content of a multilateral instrument would not be fixed until 2015, however).

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United States

Treasury Department and IRS Issue Long-Awaited Inversion Guidance

On September 22, 2014, the U.S. Treasury Department and the IRS issued long-awaited inversion guidance in the form of Notice 2014-52. The Notice sets forth rules that are generally effective for transactions completed on or after September 22, 2014, and will be included in regulations that will be issued in the future. The new rules address two aspects of inversion transactions. First, they increase the likelihood that the inversion ownership tests under section 7874 of the Internal Revenue Code will be met (the 60 percent and 80 percent tests). Second, they limit the tax benefits of certain types of post-inversion planning.

Changes to the earnings stripping rules (which provide inverted U.S. target corporations an immediate tax benefit) are conspicuously absent from the Notice. However, the Notice indicates that Treasury and the IRS are considering (and request comments on) guidance to address strategies that shift U.S.-source earnings to lower-tax jurisdictions. Descriptions of the new rules are set forth below.

Increased Likelihood that Ownership Tests are Satisfied. Under section 7874, a foreign acquiring corporation is treated as a U.S. corporation for U.S. tax purposes (meaning that the foreign corporation is taxed by the U.S. on its worldwide income) if it acquires substantially all of the stock (or property) of a U.S. target corporation and the shareholders of the U.S. target corporation (or the U.S. target corporation) receive at least 80 percent of the foreign acquiror stock in the exchange. A lesser tax impact results if the U.S. target corporation's shareholders (or the U.S. target corporation) receive at least 60 percent, but less than 80 percent, of the foreign acquiror stock in the exchange. The Notice describes three new rules that increase the likelihood that the 60 percent and 80 percent ownership tests will be met. These changes will be effective for acquisitions that close on or after September 22, 2014.

• For the purposes of the ownership tests, a portion of the stock of a foreign acquiror is excluded from the denominator if more than 50 percent of the assets owned by the foreign acquiror's expanded affiliated group ("EAG") (not including the U.S. target corporation and its subsidiaries) are passive assets, which is determined on a consolidated balance sheet basis. An EAG is a group of corporations linked by more than 50 percent ownership.

• Non-ordinary course distributions (including redemption distributions) by the U.S. target during the 36-month period preceding the inversion transaction are disregarded in applying the ownership tests.

• Under the current section 7874 regulations, stock of the foreign acquiror that is held by members of its EAG is generally disregarded in applying the ownership tests. The Notice changes this rule for certain multistep transactions where a U.S. parent transfers its U.S. subsidiary to a foreign subsidiary and then distributes the stock of the foreign subsidiary to its shareholders (a so-called "spinversion"), subjecting the U.S. parent's ownership of foreign subsidiary stock to the ownership tests.

Each of these changes increases the percentage of foreign acquiror stock held by the shareholders of the U.S. target corporation (or the U.S. target corporation) under the inversion ownership tests, thus increasing the likelihood that the acquisition will be subject to the inversion rules.

Limitations on Inversion Benefits. The Notice also includes three new rules that affect the benefits of post-inversion planning. The first two rules would apply to acquisitions completed on or after September 22, 2014, but only if the shareholders of the U.S. target corporation (or the U.S. target corporation) receive at least 60 percent, but less than 80 percent, of the foreign acquiror stock in an inversion that closes on or after September 22, 2014. The third rule applies to acquisitions completed on or after September 22, 2014, whether or not there has been an inversion:

• The Code subjects foreign corporations controlled by U.S. shareholders ("CFCs") to current U.S. taxation on their investments in U.S. property, including loans to their U.S. affiliates. However, "hopscotch" loans from a CFC to its U.S. shareholder's foreign parent following an inversion (bypassing the CFC's direct U.S. parent) were not subject to this rule. The Notice creates a new rule whereby stock and obligations of the new foreign parent (and of related non-CFC foreign affiliates) that are held by a CFC of an inverted company are treated as investments in U.S. property for the 10-year period following the inversion.

• Under new rules to be issued under section 7701(l), when a CFC of the U.S. target is "de-controlled" in a transaction that involves a related foreign affiliate and does not otherwise give rise to the inclusion by the U.S. target of the untaxed earnings of the CFC, the event will be recharacterized as an issuance of an instrument by the U.S. target to the related foreign affiliate, and any distributions made by the de-controlled CFC to the related foreign affiliate will instead be treated as made by the CFC to the U.S. target, and then by the U.S. target to the related foreign affiliate.

Under the current section 304 regulations, in some situations, a foreign parent could transfer stock of its U.S. subsidiary to the U.S. subsidiary's CFC in exchange for cash or property tax-free, thus permitting the foreign parent to access the CFC's earnings without subjecting them to U.S. tax. The Notice prevents the foreign parent from accessing the earnings of the CFC in such a transaction, causing the CFC to retain its earnings for possible future taxable distributions to the U.S. subsidiary.

IRS Issues Guidance Regarding the Deductibility of Litigation Fees Incurred by Branded Pharmaceutical Companies When Defending Their Patents Against Challenges to Market Exclusivity by Generic Companies

There is welcome clarity for branded pharmaceutical companies seeking to deduct legal fees incurred in defending their patents against challenges to market exclusivity by generic companies. This clarity comes after a year of uncertainty arising from a negative opinion expressed by the IRS in a chief counsel memorandum ("CCM") in January 2013, which the IRS seems to have now reversed in a second CCM issued 20 months later. (CCMs are generic legal advice prepared by the IRS Office of Chief Counsel for IRS field agents and other employees conveying the chief counsel's legal interpretation of a tax matter.)

FDA approval must be obtained before a new drug may be legally marketed and sold in the United States. To expedite the availability of less costly generic drugs, an abbreviated new drug application

("ANDA") may be submitted by generic applicants. The ANDA applicant must make certifications regarding the existing patents owned by the branded pharmaceutical company. A common certification of generic applicants is a so-called "Paragraph IV" ANDA, in which the applicant asserts that the patent is invalid, unenforceable, or will not be infringed. The generic applicant is required to promptly notify the drug patent holder of its Paragraph IV ANDA, and the drug patent holder may file an infringement suit against the ANDA applicant to prevent the FDA from approving the ANDA.

Most branded pharmaceutical companies have historically deducted the costs of suing such generic ANDA applicants because, under the operative "origin of the claim" test, the litigation arises out of the taxpayer's ordinary business activity. This is supported by case law, including *Urquhart v. Commissioner*, which held that expenses incurred by a patent holder suing for infringement were deductible. This deductibility was further promulgated by the capitalization regulations of Treasury Regulations §1.263(a)-4, the preamble to which cited *Urquhart*, requiring capitalization of litigation costs only if incurred to facilitate the creation, acquisition, or defense of, or perfection of title to, intangible property.

Despite these established rules, on January 18, 2013, the IRS in CCM 20131001F concluded that certain legal fees incurred by patent holders suing generic applicants pursuant to Paragraph IV ANDAs were not deductible and instead must be amortized over the remaining lives of the asserted patents. The CCM reasoned that, where an alleged infringer raises an invalidity defense, proving validity constitutes the defense or perfection of title to the asserted patent even where ownership of the patent is not in dispute.

On September 12, 2014, the IRS released CCM AM 2014-006 concluding that legal fees incurred by patent holders bringing infringement lawsuits pursuant to Paragraph IV ANDAs are in most cases deductible as ordinary and necessary business expenses, regardless of whether an invalidity defense is raised. Although the 2014 CCM does not mention the 2013 CCM, the contrary conclusion in the later CCM suggests that the IRS Office of Chief Counsel has reversed its view regarding the deductibility of these expenses. The new CCM states that litigation fees may be capitalized if the true ownership of the patent is at issue in the litigation, but notes that such an ownership dispute would be highly unusual in the context of a Paragraph IV ANDA.

Interestingly, although the legal fees incurred by the patent holder are deductible under the new guidance, the legal fees incurred by the generic manufacturer in the same lawsuit are generally nondeductible according to the IRS Office of Chief Counsel.

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Follower Notices and Accelerated Payments

The UK Finance Act 2014, enacted in July 2014, contains new legislation to deal with cases of purported tax avoidance, which marks a radical departure from previous policy in this area.

Until Finance Act 2014, it was generally the case that where a taxpayer contested a direct tax assessment made by a tax authority, the appeal would suspend the need for paying the disputed liability (although interest would continue to run should the taxpayer prove to be unsuccessful). As part of its strategy to combat what it perceives to be unacceptable tax avoidance, the UK government has introduced legislation that reverses this principle in certain cases.

Under the new legislation, the UK tax authorities may issue so-called accelerated payment notices provided certain conditions are satisfied. In particular, notices may be issued where the arrangements giving rise to the tax dispute were earlier disclosed to HMRC under the disclosure of tax avoidance regulations ("DOTAS"). Under those regulations, avoidance arrangements promoters (or scheme users where there is no promoter) are required to notify of tax avoidance arrangements if they meet certain conditions. Once notified, the arrangements are given a scheme number, and a taxpayer entering into the arrangements is required to include the scheme number in his tax return.

HMRC has already issued a large number of accelerated payment notices for arrangements that are being litigated and that were disclosed under

DOTAS. There are very limited grounds for appealing an accelerated payment notice once it has been issued. The only grounds for appeal (outside the notice having been issued when the required conditions were not met) are that the amount of tax set out in the accelerated payment notice is incorrect. If the taxpayer believes this is the case, he has a limited amount of time to make representations to HMRC. If no representations are made or if they are dismissed, the amount specified must be paid within 90 days of the issue of the accelerated payment notice or the representations being dismissed.

Finance Act 2014 also contains provisions under which HMRC may issue so-called follower notices. These notices can be issued where a court ruling has been handed down in relation to a particular matter and HMRC believes that the ruling is relevant to an inquiry or appeal. Although on its face the legislation is not limited to marketed avoidance schemes, HMRC has stated that it would apply the legislation mainly in this area. Taxpayers receiving follower notices are not required to settle their case, but they will face specific penalties if they do not.

SDLT and Property Investment Funds

The UK government has announced that it will be looking at whether any changes are needed to current stamp duty land tax ("SDLT") rules to cater for two specific forms of collective investment scheme designed for investors in the UK market.

HMRC estimates that there is currently £60 billion of real estate in various forms of collective investment schemes, including schemes that are domiciled offshore. The real estate is largely commercial, rather than residential, and is held in a wide variety of vehicles. In addition, insurance companies and pension funds are thought to hold as much as £78 billion of UK real estate, again large commercial in nature.

In response to the demand for tax-efficient investment vehicles, the UK government has created two specific fund structures. Property authorized investment funds ("PAIFs") are open ended investment companies that are authorized by the UK's Financial Conduct Authority and that can invest in real estate directly or indirectly though shares in UK real estate investment trusts and similar offshore entities. Authorized contractual schemes were introduced in 2013, and the first such scheme has recently been launched in the market.

HMRC is consulting on the introduction of a seeding relief from SDLT for PAIFs under which the initial transfer of real estate to a PAIF would be exempted from SDLT. A previous similar relief for unauthorized unit trusts was withdrawn in 2006 because it was used as an avoidance mechanism, and HMRC is therefore careful to stress that the relief will be properly targeted.

Authorized contractual schemes are fully transparent and a transfer of an interest in such a scheme is treated in the same way as a transfer of the real estate itself. The government is consulting on the introduction of a relief for transfers of interest in these schemes (including a relief for the initial issue of units). In order to prevent avoidance, a specific charge would be introduced on acquisitions of real estate from connected parties.

Further Reference to CJEU on Card Handling Charges

The First Tier Tax Tribunal has referred certain questions regarding the liability for VAT of card handling charges to the Court of Justice of the European Union ("CJEU") in the case of *Bookit Ltd v The Commissioners For Her Majesty's Revenue & Customs*.

Bookit had previously litigated the VAT treatment of card handling charges in 2006. At that time, the Court of Appeal held that the card handling charges were exempt from VAT and fell within the exclusion for transactions concerning deposit and current account payments, checks, and other negotiable instruments in the Council Directive 2006/112/EC.

The Tribunal found that there were sufficient grounds on which to refer a question to CJEU on whether the card handling fees were exempt or not. In particular, the Tribunal found that it was unclear what factors distinguish the provision of financial information without which a payment would not be made. In a previous CJEU case, those factors had been held not to fall within the exemption, but data handling services, which functionally have the effect of transferring funds, CJEU had accepted were within the exemption. The tribunal dismissed an argument based on abuse of rights raised by the UK tax authorities in relation to the arrangements in the *Bookit* case.

As is sometimes the case, successive CJEU decisions on card handling charges have created some confusion as to whether the supply concerned is exempt. This is especially the case here because the decision turns on the exact nature of the services provided and the technical aspects of the process of transferring funds. As card handling charges have become extremely common, the reference to CJEU should provide much-needed clarity on the scope of the exemption.

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What's New

The Netherlands

The Netherlands to Expand its Fiscal Unity Regime to Second-Tier Subsidiaries and Sister Companies Following EU Court of Justice Ruling

On June 12, 2014, the EU Court of Justice ("ECJ") ruled in two joint cases that the Dutch fiscal unity regime infringes on the EU freedom of establishment, because it does not allow a fiscal unity between (i) a Dutch resident parent company and its second-tier Dutch resident subsidiary held through an EU resident intermediate company, or (ii) two Dutch resident sister companies held by the same EU shareholder. The ECJ further ruled that there is no justification available for this infringement. The Netherlands will have to eliminate this infringement from its tax law. In the meantime, the Dutch tax authorities will have to approve pending fiscal unity requests for these type of structures.

As a starting point, each Dutch resident entity has to file a corporate tax return and is liable to corporate tax on a stand-alone basis. The Dutch fiscal unity regime allows two Dutch corporate taxpayers to form a consolidated group, a "fiscal unity," for corporate tax purposes. The member companies of a fiscal unity may file a single, consolidated corporate tax return and pool their profits and losses. Transactions between fiscal unity member companies are ignored for Dutch corporate tax purposes. The minimum threshold currently requires a parent company to hold at least 95 percent of the shares, which should give right to at least 95 percent of the votes and profits, in a subsidiary to be able to form a fiscal unity.

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Initially, a fiscal unity was possible only between Dutch incorporated entities. The regime was broadened to include certain types of foreign incorporated companies, provided they were resident in the Netherlands, and, in accordance with the EU freedoms and international nondiscrimination principles, over time extended to include the Dutch permanent establishments ("PEs") of foreign resident entities. However, prior to the ECJ rulings, in order to be part of a fiscal unity, the regime required each company in the ownership chain—both the parent and the direct and lower-tier subsidiaries—to be resident (or have a PE) in the Netherlands.

In the 2008 *Papillon* case, the ECJ ruled that a French parent and its second-tier subsidiary should be able to apply the French tax consolidation regime, as long as the intermediate holding company is a resident of an EU member state. This ultimately led to the EU Commission formally requesting the Netherlands to amend its fiscal unity regime on June 16, 2011. So far, this has not happened. In the June 2014 cases, however, the ECJ did not find any justification for the limitations in the Dutch regime. It found that the rules cannot be justified by the need to prevent double loss deduction, nor are the rules sufficiently specific to be justified by the need to prevent tax evasion or tax avoidance. Many argue that these two ECJ cases may open the door to tax planning regarding double loss deduction.

A bill to amend the fiscal unity regime has not been presented yet and consequently, the measures that will be taken are not yet clear. However, based on the two ECJ cases, the Dutch tax authorities should technically have no choice but to approve pending fiscal unity requests between a Dutch resident parent company and its second-tier Dutch resident subsidiary held through an EU resident intermediate company or between two Dutch resident sister companies held by the same EU shareholder. Moreover, the ECJ rulings may have consequences for other tax consolidation regimes in the EU. These may be favorable developments for international groups structured through various EU member states.

Dutch Innovation Box Regime for Intangibles is Clarified in Decree

The Innovation Box was introduced in 2007 to encourage companies to innovate and increase their research and development ("R&D"). Under this optional regime, subject to certain conditions, Dutch corporate taxpayers are taxed at an effective rate of 5 percent. In the newly published Decree, the Underminister of Finance clarifies the scope of the Innovation Box, in particular addressing the types of qualifying intangibles and the level of involvement of the taxpayer required for the application of the regime.

The Innovation Box can apply to both intangibles for which the taxpayer has obtained a Dutch or foreign patent and intangibles originating in activities for which an R&D Certificate has been obtained from the Netherlands Enterprise Agency. An R&D Certificate can be obtained for most true R&D activities (generally speaking, all research, testing, adaptation and improvement should qualify, while testing, analyzing or supporting the R&D of another should not qualify) and does not require application (or an intention to apply) for a patent. Consequently, the Innovation Box can also be applied by taxpayers engaged in activity that is not patentable.

The Innovation Box can apply only to self-developed intangibles. As regards patented intangibles, this concept extends to the development of the intangible by another (affiliated or nonaffiliated) company, provided the development has taken place for the risk and account of the taxpayer (typically, contract R&D). This requires the taxpayer to avail of the necessary functions to coordinate and manage the activity and to take strategic decisions. It does not require that the contract R&D takes place in the Netherlands, so long as the coordination and management of the R&D are performed in the Netherlands.

As regards R&D Certificate intangibles, the concept of self-development is interpreted in a stricter way and requires the taxpayer to avail of research staff to carry out the R&D itself; management of R&D Certified activities performed by another is considered insufficient to apply the Innovation Box.

It is important to note that the Innovation Box regime extends to all economic benefits derived from the intangible, including profits from the sale of products, royalty income from licensing the patented intangible and capital gains derived from a disposal of all or part of the intangible. The amount of benefits is unlimited. Which part of the taxpayer's income can be considered to be derived from the intangible is a matter of transfer pricing and the challenge is therefore to substantiate optimal allocation under the arm's-length principle. The allocation of income may be confirmed by the Dutch tax authorities in an advance pricing agreement ("APA"), valid for a number of years.

What's New

Spain

ECJ Rules that Spanish Law on Inheritance and Gift Tax is Contrary to Community Law

The Court of Justice of the European Union handed down a ruling on September 3, 2014 (C-127/12, Commission/Spain), in which Spanish law on inheritance and gift tax (*Impuesto sobre Sucesiones y Donaciones*) is considered to restrict the free movement of capital since it involves differences in tax treatment between tax residents in Spain and nonresidents.

The controversy giving rise to the ruling of the court derives from the fact that regional/state law applies only in connection with the territory of a state. Thus, when an heir, donee, or legatee nonresident in Spain is involved, or in the event of an inheritance or donation of a real estate asset located outside the Spanish territory, given the lack of a state connection, the inheritance or donation will be subject to national law, with the tax cost thereof. However, in the event of inheritances or donations made between Spanish tax residents (that is, with a regional/state connection), the reductions envisaged by the various states are applicable, and the tax burden for a comparable situation is generally lower. We have, therefore, a situation in which nonresidents are normally subject to a higher taxation by the mere fact of being nonresidents and cannot benefit from the regional/state tax benefits that otherwise apply to residents in Spain.

Parent–Subsidiary Directive

The Explanatory Memorandum to the Draft Law amending nonresident income tax points out that the

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main reason for the tax reform is to adapt it, to a greater extent, to the European Union regulatory framework. The draft law includes an anti-abuse clause, similar to the one currently in force, which prevents the application of the tax exemption in Spain on dividends paid when most of the voting rights of the European Union resident shareholder are held, directly or indirectly, by individuals or legal entities that do not reside in a European Union member state.

The currently existing rule includes three exceptions to the application of the anti-abuse clause: (i) that the parent company actually performs a business activity that is directly related to the business activity performed by the Spanish subsidiary; (ii) that the purpose of the parent company is the direction and management of the Spanish subsidiary through an appropriate organization of material and human resources; or (iii) that it proves that it has been incorporated for valid economic reasons and not merely to take advantage of the exemption scheme.

With the new wording of the draft law, the current "safe harbors" are removed and are replaced by a generic requirement that the incorporation and operation of the nonresident parent company must be for "valid economic reasons" and "substantive business reasons."

What's New

Mexico

Tax Rules Included in the Mexican Energy Reform

On August 6, 2014, the Mexican Congress approved some of the secondary legislation related to the so-called Mexican Energy Reform. The approved laws were published in the *Mexican Official Gazette* on August 11, 2014. Among the approved secondary legislation is the Hydrocarbons Revenues Law, which includes: (i) special tax provisions for governmental and nongovernmental entities entering into agreements for the extraction and exploration of hydrocarbons; and (ii) a new hydrocarbons tax applicable to these entities.

The most relevant special tax provisions are:

• Special depreciation yearly rates applicable for assets and investment for the exploration and extraction of hydrocarbons, such as: (i) 100 percent depreciation rate for investments made for the exploration activities; (ii) 25 percent depreciation rate for investments made for the development and extraction of oil and natural gas; and (iii) 10 percent depreciation rate for investments made for the warehousing and transportation activities that are indispensable to complying with the agreements.

• Specific rules dealing with the way in which several entities participating as a "consortium" (for the exploration and extraction of hydrocarbons) could identify its accruable income and authorized deductions to calculate individual income tax.

• A tax loss carry-forward term of 15 years (the general carry-forward period provided in the Mexican

Income Tax Law is 10 years), for those taxpayers that carried out activities in maritime zones with a flow depth greater than 500 meters.

• A special 0 percent valued tax rate applicable for transactions related to the exploration and extraction of hydrocarbons.

• Rules for the creation of permanent establishments in Mexico when foreign entities perform activities related to the exploration and extraction of hydrocarbons.

The most important features of the hydrocarbons tax are:

• The taxpayers are governmental and nongovernmental entities entering into agreements for the extraction and exploration of hydrocarbons.

• The tax is calculated on a monthly basis and will be calculated by applying the following rates to each square kilometer in which the exploration and extraction of hydrocarbons takes place: (i) Mex$1,500 (approximately US$115) for each square kilometer used in the exploration phase; and (ii) Mex$6,000 (approximately US$460) for each square kilometer used in the extraction phase. These rates will be adjusted by inflationary effects on January 1 of every year. The tax return for this tax should be filed no later than the 17th day of the following month corresponding to the payment of the tax.

• In case it is impossible to explore or extract hydrocarbons, the taxpayer must justify the impossibility in order to obtain an exemption for paying the hydrocarbons tax from the Mexican tax authorities.

Three New Tax Treaties Signed by Mexico Will Be Applicable from January 1, 2015

During 2014, three new tax treaties signed by Mexico with Peru, the United Arab Emirates, and Malta have been published in the *Mexican Official Gazette*. According to the tax treaties, their benefits will be applicable from January 1, 2015, bringing Mexico's tax treaty network to 59. Treaties with Costa Rica, Malaysia, and Nicaragua are currently being negotiated by the Mexican government, and the modifications to the 1994 Mexico–Belgium treaty are currently pending.

The withholding tax rates under these three treaties and the Mexican Income Tax Law are the following:

	Mexican Income Tax Law	Tax Treaty with Peru	Tax Treaty with UAE	Tax Treaty with Malta
Dividends	10%	10% and 15%	0%	0%

Interest	4.9% up to 35%	0% and 15%	0%, 4.9%, and 10%	0%, 5%, and 10%
Royalties	25% and 35%	15%	10%	10%
Capital Gains	25% and 35%	0% if some ownership requirements are met	–	0% if some ownership requirements are met

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What's New

Japan

Tokyo District Court Allows Tax Saving from Share Repurchase

On May 9, 2014, the Tokyo District Court reversed a large tax that had been imposed on a large U.S. multinational's Japanese holding company ("Japan HoldCo").

Under the Japanese Corporate Tax Law, if a shareholder returns shares to an issuing company (i.e., the issuing company acquires treasury shares), a portion of the consideration paid to the shareholder is deemed to be a dividend. Further, all or a portion of such deemed dividend will not be considered taxable income (in the case at issue, the entire deemed dividend was not considered taxable income of Japan HoldCo) and will be subtracted for the purpose of calculation of a capital gain or loss. Therefore, if the sale price (paid by the issuing company to the shareholder) and the book value of the transferred shares are equal, the shareholder will incur a capital loss equal to the amount of the deemed dividend resulting from the share transfer to the issuing company.

On April 22, 2002, Japan HoldCo acquired all of the outstanding shares of an affiliated company ("Japan Ltd."). Thereafter, on December 20, 2002, December 22, 2003, and December 28, 2005, Japan HoldCo sold a portion of Japan Ltd.'s shares back to Japan Ltd. itself and incurred a total capital loss of approximately JPY400 billion. In 2008, Japan HoldCo and its subsidiaries (including Japan Ltd.) adopted a consolidated tax return and set off the JPY400 billion loss against the consolidated group's revenue. As a result, the amount of corporate tax imposed on

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Japan HoldCo and its affiliates was reduced by approximately JPY120 billion.

In response to the above transactions and tax filing, the tax authorities denied Japan HoldCo's recognition of the JPY400 billion loss pursuant to Section 132.1 of the Corporate Tax Law and reimposed taxes of approximately JPY120 billion with penalties and interest. Under Section 132.1 of the Corporate Tax Law, if an act or calculation made by a closely held corporation (including a wholly owned company such as Japan HoldCo) unfairly reduces the amount of corporate tax, the tax authorities may disregard one or more of such acts or calculations and recalculate the amount of corporate tax owed.

In the case at issue, the tax authorities argued that a series of transactions was made for the purpose of tax avoidance and thus unfairly reduced the amount of corporate tax. However, the Tokyo District Court, in ruling against the tax authorities, stated, among other things, that (i) it is difficult to say that the series of transactions did not have any reasonable basis, and (ii) there are several facts that are inconsistent with the tax authorities' argument.

The tax authorities appealed the judgment, and the case is now being reviewed by the Tokyo High Court.

Note: Due to the 2010 tax reform, if these transactions were to happen today, realization of the JPY400 billion loss would be denied.

Judgment of Tokyo District Court: Application of a General Anti-Avoidance Rule Concerning Reorganization Transactions

On March 18, 2014, the Tokyo District Court affirmed corporate tax assessments against two tax payers: Yahoo Japan Corporation ("Yahoo Japan"), a Tokyo Stock Exchange listed company, and IDC Frontier Inc. ("IDCF"), a wholly owned subsidiary of Yahoo Japan.

The main issue of the Yahoo Japan case was whether, upon a tax-qualified merger, the surviving company (Yahoo Japan) was entitled to utilize net operating losses ("NOLs") of the acquired company pursuant to Article 57 of the Corporation Tax Act of Japan ("Act"). In Yahoo Japan, while Yahoo Japan formally satisfied the requirements of Article 57, the tax authorities denied Yahoo Japan's utilization of the NOLs of the acquired company by applying Article 132-2 of the Act, a general anti-avoidance rule. Under Article 132-2, if the corporate tax burden is determined to be unduly decreased due to a reorganization transaction (i.e., it would be unfair for Yahoo Japan to utilize the tax losses of the acquired company after the merger), the Japanese tax authorities are empowered to deny the reorganization transactions (e.g., merger, company split, share exchange, etc.) or the book entries thereof and compute the taxable income or net operating losses as they deem appropriate

The main issue in the IDCF case was whether a company (IDCF) that was newly incorporated as a wholly owned subsidiary of the transferor upon a company split was entitled to recognize goodwill (which is recognized only in the case of a nonqualified company split and is depreciable for five years on a straight line basis) pursuant to Article 62-8 of the Act. In IDCF, the transferor company was scheduled to sell its shares in IDCF upon the completion of company split, and thus the company split did not formally fulfill the requirements of a tax-qualified company split. Accordingly, IDCF recognized goodwill pursuant to Article 62-8 of the Act. Nonetheless, the tax authorities also denied IDCF's recognition of the goodwill and deduction of depreciation expense for corporate tax purposes by applying Article 132-2 of the Act.

The court held in each case that Article 132-2 of the Act is applicable not only to (i) cases where the reasonableness or economic substance of a reorganization transaction is questionable, but also (ii) cases where acts constituting part of reorganization transactions formally satisfy certain requisite conditions of corporate reorganization taxation (by virtue of which the company can enjoy a decrease of its tax burden). However, the allowance of such a decrease in the tax burden would clearly conflict with the underlying policy of the corporate reorganization taxation system or the relevant provisions. Further, the court concluded in each case that the tax authorities' denial pursuant to Article 132-2 was legitimate and dismissed Yahoo Japan's and IDCF's claim.

These two judgments were the first judgment in which a court applied Article 132-2 of the Act, and the scope of the Article 132-2 was interpreted broadly. Both Yahoo Japan and IDCF appealed the judgments, and the cases are now pending in the Tokyo High Court.

If the decisions of the Tokyo District Court are upheld, the predictability of tax decisions for corporate reorganizations would regress, and tax practitioners would be required to give careful consideration to the risk of denial by the tax authorities pursuant to Article 132-2 of the Act when providing tax advice.

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What's New

Italy

Repeal of the Interest-Withholding Tax on Certain Cross-Border Loans

As a rule, if a nonresident lender grants a loan to an Italian resident borrower, the interest paid on the loan is subject to a 26 percent withholding tax in Italy unless the lender is eligible for the exemption under the Italian laws that implemented the EU Interest and Royalties Directive. The withholding tax may be reduced (usually to 10 percent) or, in very few cases, zeroed under the double tax treaties entered into by Italy, where applicable.

Law Decree No. 91 of June 24, 2014, converted into law by the Italian Parliament on August 7, 2014, repealed the interest withholding tax in cases of cross-border loans that meet certain requirements. As a result, no withholding tax is now levied on the interest if (i) the loan is a medium- or long-term loan; (ii) the borrower is an enterprise (e.g., an Italian commercial partnership, a resident company, or the Italian permanent establishment of a nonresident enterprise); and (iii) the lender is any of the following:

• A bank established under the laws of an EU Member State;

• An insurance company established and licensed under the laws of an EU Member State; or

• An unleveraged undertaking for collective investment (e.g., an investment fund) that is set up in an EU Member State or in an EEA country allowing for an adequate exchange of information with Italy (i.e., Iceland and Norway).

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Because the new rules state that the borrower must be an enterprise, the withholding tax exemption should not apply when the borrower is an Italian undertaking for collective investment (e.g., an Italian investment fund). Moreover, it will have to be clarified in due course whether the withholding tax exemption is available if the borrower is an Italian static holding company.

Withholding Tax Exemption on Bond Interest Broadened

Law Decree No. 91 of June 24, 2014, converted into law by the Italian Parliament on August 7, 2014, has broadened the scope of the withholding tax exemption applicable to eligible nonresident investors (i.e., investors resident in a white-listed country and with no permanent establishment in Italy) on certain debt-like securities.

Before the enactment of the new rules, nonresident holders could benefit from a withholding tax exemption on interest paid on the following securities:

• Bonds, bond-like securities, and commercial papers that were issued by Italian-resident banks, regardless of whether these securities were listed on a regulated market;

• Bonds, bond-like securities, and commercial papers, whether listed or not, that were issued by resident companies whose shares were traded on regulated markets or multilateral trading facilities of an EU Member State or an EEA country included in the Italian white list (i.e., Iceland and Norway); and

• Bonds, bond-like securities, and commercial papers that, although issued by nonlisted resident companies, were listed on a regulated market or a multilateral trading facility of an EU Member State or an EEA country included in the Italian white list (i.e., Iceland and Norway).

The Law Decree has added a new item to the list of exemptions—interest on bonds, bond-like securities, and commercial papers issued by nonlisted resident companies will be exempt from Italian withholding tax if the security holder is a "qualified investor" under article 100 of the Italian Unified Financial Act (e.g., banks, broker-dealers, investment funds, pension funds, etc.), regardless of whether the security is listed. It is not clear whether the exemption is available only in the event the entire bond issuance is subscribed to by "qualified investors."

Finally, the Law Decree has introduced a blanket withholding tax exemption that applies to interest deriving from any type of bond, bond-like security, and commercial paper and paid to undertakings for collective investment, whether set up in Italy or in another EU Member State, if: (i) their units are entirely held by "qualified investors"; and (ii) more than 50 percent of their assets are the aforesaid debt securities and commercial papers.

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What's New

Germany

New Developments for Real Property Transactions

On July 9, 2014, the German Supreme Fiscal Court decided a real estate transfer tax ("RETT") case that shines a new light on RETT structures. Contrary to the long-standing interpretation of the law, the court took the position that aspects of economic ownership are also relevant for RETT purposes.

Until now, it was the unanimous agreement of tax experts in literature, legislation, and courts that for RETT purposes, the civil law position and structure determines whether or not RETT is triggered in a transaction. Now the Supreme Fiscal Court has held that in cases where the law refers to indirect transfer of a property, the civil law structure is not relevant alone. In such a case, the rules stipulating economic ownership approach might be applicable.

The case dealt with a very common GmbH & Co. KG structure. The limited partnership owned real property. Two individuals held the GmbH, which was the general partner in the partnership. The general partner GmbH held no participation. In addition, the two individuals were the limited partners. Both partners sold their interests in the partnership except for a small interest of 5.6 percent, which was kept by one partner. The shares in the general partner GmbH were sold as well. Since less than 95 percent of the partnership interest was sold, no RETT incurred.

Several weeks after the sale, the partners in the transaction agreed on put and call options on the last 5.6 percent, agreed on the purchase price, and transferred the profit participation right immediately.

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The purchaser was granted power of attorney for representing the last partner, who still held the 5.6 percent.

This deal structure was evidently put in place to avoid the incurrence of RETT because under civil law principles, only 94.4 percent of the partnership interest was sold so that no RETT was incurred. This strategy was recognized by the Lower Fiscal Court. The Supreme Fiscal Court, however, overruled the Lower Court and argued that in the case of an indirect transfer of property, the civil law position might not apply in all cases. This is particularly true in cases such as the one at hand, where the purchaser of a partnership interest is able through multiple agreements to control the property, has the opportunity and risks of the property, and has a legal position similar to ownership.

Since real property transactions are in many cases structured as a sale of partnership interests, including a retention of 5.1 percent of partnership interest, the new decision plainly puts the focus of the tax authorities on an economic ownership approach. Therefore, agreements in connection with the transfer of a partnership interest that put a purchaser in the position of an economic owner must be avoided.

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France

Luxembourg–France Tax Treaty: Amendment Signed on September 5, 2014

On September 5, 2014, French Minister of Finance Michel Sapin and Luxembourgian Minister of Finance Pierre Gramegna signed an amendment to the France–Luxembourg Tax Treaty (1958) (the "Tax Treaty"), as amended by the 1970 exchange of letters and by the 1970, 2006, and 2009 protocols.

The amendment, in line with the current OECD Model Tax Convention on Income and Capital, reverts to the tax treatment of capital gains arising on the direct and indirect disposal of real estate assets and puts an end to the potential double-tax exemption regularly applied until now regarding sale of real estate companies' shares.

Former Tax Treatment. The former tax treaty permitted the avoidance of taxation on capital gains arising from the disposal of real estate assets located in a related country held through one or several interposed entities in the other country. Indeed, such sale did not qualify as real estate income with respect to the Tax Treaty and was therefore not taxable, neither in France nor in Luxembourg.

For instance, where a Luxco sold the equity interest held in a French real estate entity, no taxation was applied since the capital gain arising on this sale was:

• Tax exempt in Luxembourg, as the Luxembourg tax authorities treated the sale as a sale of French real estate that was taxable in France only pursuant to the former Article 3 of the Tax Treaty; and

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• Also tax exempt in France, as the Tax Treaty did not provide that an equity interest in a real estate partnership must be viewed as a real estate investment, so the gains were not taxable in France unless the selling Luxco had a permanent establishment in France.

Tax Treatment Resulting from the Amendment.
The amendment modifies this tax treatment and puts an end to the above potential double-tax exemption. Indeed, the amendment provides a new paragraph to Article 3 of the Tax Treaty (i.e., a "*Prépondérance immobilière*" clause) specifying the case of the sale of shares of a company, fiduciary, or any other institution or entity whose assets consist for more than 50 percent of their value—directly or indirectly through one or several companies, fiduciaries, institutions, or other entities—of real estate assets.

Under this new rule, capital gains arising on the sale of shares of such entities would be taxable only in the country in which the related real estate assets are located.

The amendment will enter into force on the first day of the month following the reciprocal notification of its ratification in both states.

Pursuant to Article 2.2 of the amendment, the new rule will apply:

• To capital gains taxable after the calendar year during which it enters into force, for income taxes levied as a withholding tax;

• To capital gains occurring during tax years beginning after the calendar year during which it enters into force, for income taxes not levied as a withholding tax; and

• To taxation whose action rendering the taxes assessable occurs after the calendar year during which it enters into force, for other income taxes.

Accordingly, where the amendment would be ratified by both states before December 31, 2014, only capital gains realized as from January 1, 2015, should fall under the scope of this new rule.

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What's New

China

Draft Guidance for the General Anti-Avoidance Rule

On July 3, 2014, the State Administration of Taxation (the "SAT") released a discussion draft on the Administrative Measures on the General Anti-Avoidance Rule (the "Draft Measures). The General Anti-Avoidance Rule ("GAAR") was introduced in China Corporate Income Tax Law effective on January 1, 2008. However, the provision of law and subsequent interpretation tax circulars provide only some basic principles. The Draft Measures provide comprehensive guidance on the implementation of GAAR.

According the Draft Measures, GAAR applies to a tax avoidance scheme where the sole or main purpose or one of the main purposes is to obtain a tax benefit, and the form of scheme is permitted in accordance with the tax rules, but the form is not consistent with its commercial substance. The tax authorities may make special adjustments based on the principle of substance over form.

The adjustment methods include:

• Recharacterize the whole or part of a transaction;

• Disregard a party to the transaction or treat the parties to the transaction as the same entity, for tax purposes;

• Redefine relevant income, deduction, tax incentives, foreign tax credit, etc. and reallocate them among the parties to the transaction; and

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• Other reasonable methods.

The Draft Measures also provide investigation procedures and documentation requirements.

Once the tax authority commences a GAAR investigation on an enterprise, the enterprise should provide, within 60 days of the investigation notice, the documents to prove its arrangement is not a tax-avoidance scheme, including:

• The background of arrangement;

• Explanation of reasonable commercial purpose;

• Internal decision-making and administrative documents concerning the arrangement such as board resolution, memorandum, and emails;

• The details of transaction information of the arrangement such as contracts, supplemental agreements, and the evidence of payment or receipt of consideration;

• Communications with tax advisors;

• Communications with other parties to the transaction;

• Other information evidencing that the transaction is not a tax-avoidance scheme; and

• Other information that the tax authority believes necessary.

The tax bureau at local level may initiate a GAAR investigation. However, both the formal commencement of such investigation and the conclusion of the case must be reported to and approved by the SAT.

Although the Draft Measures provide helpful guidance on the implementation of GAAR, the tax circular, if finalized and issued in current form, can give tax authorities broad authority to invoke as long as one of the main purposes is to obtain a tax benefit.

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What's New

Belgium

Recharged Costs and Expenses of Stock Option Plans Not Tax Deductible for the Belgian Employer

On June 25, 2014, the Brussels Court of Appeal confirmed an earlier ruling (dating from 2010) from the Tribunal of First Instance. The tribunal had found that costs and expenses in connection with an international stock option plan recharged by a South African parent company to its Belgian subsidiary are not tax deductible by the latter to the extent a capital loss has been suffered on the shares that had to be acquired in order to be delivered to Belgian optionees following the exercise of their stock options.

Under Belgian corporate income tax rules (Article 198, §1, 7º, Income Tax Code 1992), capital losses incurred on the sale of shares are, in principle, not tax deductible for corporations by virtue of the participation exemption regime. Although this has been disputed for some time, the Belgian tax authorities and the majority of court decisions take the position that this rule also applies when a Belgian corporate taxpayer acquires shares at a high price in order to deliver them to an optionee exercising his or her stock options at a discounted price (normally the fair market value of the shares at the time of grant or vesting).

Until recently, it was less clear what the tax treatment should be for costs and expenses incurred by a non-Belgian group company, e.g., a foreign parent company, when recharged to the Belgian subsidiary in connection with stock options granted to and exercised by employees or other optionees of

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that Belgian subsidiary. Under this scheme, the costs and expenses booked by the Belgian subsidiary are not (entirely or partially) earmarked as a capital loss on shares in the commercial books of the Belgian subsidiary, and there are good arguments to treat them as personnel (labor) costs for accounting purposes. Except if the tax law explicitly provides differently, the tax treatment of costs and expenses follows the accounting treatment. As a result, many practitioners in Belgium have taken the position that the total amount of recharged costs and expenses should in fact be tax deductible for the Belgian subsidiary.

In the case at hand, the taxpayer adhered to that position and contended that the costs and expenses that were recharged to it by its South African parent company did not (partially) constitute capital losses on shares and, therefore, should be tax deductible subject to the normal conditions, i.e., that the costs and expenses are properly documented and meet the arm's-length standard. However, both the Tribunal of First Instance and now also the Court of Appeals ruled that to the extent the recharged costs embody or include the amount of any capital loss on the shares that were sold to the Belgian employees and other optionees at a discount, they should then not be tax deductible for the Belgian subsidiary, as if the latter would have otherwise incurred the capital loss directly.

The first commentaries to the Court of Appeals ruling indicate that there is no unanimity among commentators and that there is a good chance that the taxpayer will take the case to the Court of Cassation for a definitive decision.

No Corporate Income Tax on an Undervaluation of Shares Acquired by Belgian Holding Company

Following a very long and winding road in several courts, it has finally been confirmed that Belgium cannot impose corporate tax on any undervaluation of or underpayment for shares acquired by a Belgian corporate taxpayer. Thus, when a Belgian corporation buys shares at a price below fair market and subsequently sells those same shares at the higher market value, the capital gain so booked qualifies, in principle, for the participation exemption. For more than 10 years, the Belgian tax authorities have contended that the difference between the low purchase price and the fair market sales price constitutes a so-called undervaluation of assets, which is an element of any Belgian corporate taxpayer's taxable base (Article 24, 4º, Income Tax Code 1992). Following a ruling from the European Court of Justice ("ECJ") (see below), the Belgian Court of Cassation (Supreme Court-equivalent) has now confirmed that there is no legal basis to impose tax on any undervaluation of assets. Hence the normal rules of the participation exemption will apply.

More specifically, on October 3, 2013, the ECJ ruled that there is no EU rule that forces enterprises to mark up the accounting value of shares in order to bring them in line with the higher fair market value (no mark-to-market principle). Case C-322/12, Gimle S.A. By contrast, the Belgian tax authorities had contended that any failure to mark up the substantially-below-fair-market acquisition value of a participation constitutes an infringement of the "true and fair view principle" contained in the Fourth Council Directive 78/660/EEC of July 25, 1978. As a result, such a failure should give the authorities the right to impose corporate tax on the difference between the low acquisition price and the substantially higher fair market value, in accordance with Article 24, 4º of the Belgian Income Tax Code 1992.

Since it was the Belgian Court of Cassation that submitted the issue to the ECJ in the form of a preliminary question, the court still had to render its final verdict based on the ECJ's ruling. At last, on May 16, 2014, the Court of Cassation confirmed that it would follow the view of the ECJ that no accounting rule had been breached by the taxpayer when it refrained from marking up the acquisition value of its participation in its statutory books to reflect the (higher) market value. As a result, the capital gain that was crystallized in the books of the taxpayer when it sold the participation at market value constituted a capital gain on shares, which is eligible for the participation exemption (Article 192 Income Tax Code 1992), if all other relevant conditions are satisfied.

Quite a few cases along the same lines were pending in various Belgian tribunals and courts, and most were put on hold pending the outcome of the *Gimle* case. It can be expected that those cases will now be settled in accordance with the outcome described above.

"Protectionist" French Excise Tax on Certain Types of Beer Complies with EU Law

On September 13, 2014, it was reported by the trade press that the European Commission had found that the increase by 160 percent of French excise tax on certain types of high-alcohol-content and luxury beers that was introduced on January 1, 2013 did not fall afoul of the free-market principles of the EU.

Under pressure from a coalition of domestic brewers, Belgium had complained to the Commission that the sharp increase of a very specific excise tax in France was, in reality, aimed at hindering the sale of beers that are typically brewed in Belgium and exported to France. Belgium felt that the French tax was aimed at protecting the domestic French beer and wine producers because it was so specifically tailored in terms of the types of beers it targeted in practice.

However, after a second complaint from Belgium, the Commission stuck to its initial conclusion that the additional French excise tax is not sufficiently specific to be earmarked as a protectionist measure shielding the French market from beers imported from Belgium.

The Belgian brewers have allegedly lost €58.6 million in sales since the introduction of the increased French tax on January 1, 2013. At the time of writing, it was not clear yet whether or not Belgium or (a coalition of) Belgian brewers would take the case directly to the European Court of Justice. Normally, when the Commission declines a complaint, the odds of obtaining a favorable ruling from the ECJ are against the complainants.