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IN

International News

FOCUS ON

Tax

Cross Border Planning for Trusts

International Tax Disputes: A Ray of Hope

The UK as a Tax-Efficient Holding Company Jurisdiction

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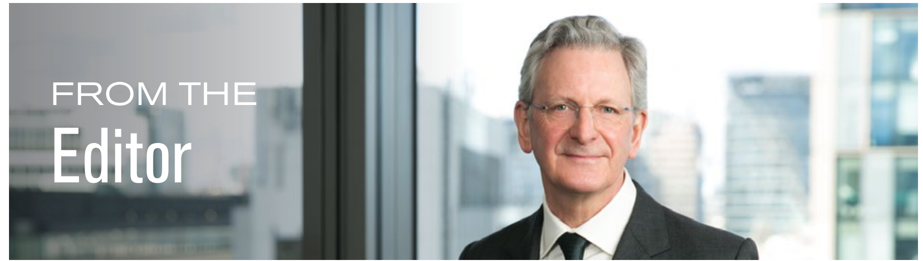

The breadth of the articles contained in our Focus on Tax this issue demonstrates the perennial importance of this topic to global businesses and international high net worth individuals. We examine topics ranging from cross-border planning for trusts, to the potential resolution of the problems generated by the lack of an international tax dispute resolution process.

China continues to present both inbound and outbound opportunities for sensibly prepared investors. The scheme for overseas investment by qualified domestic individual investors, known as QDII2, will provide the increasing numbers of high net worth Chinese individuals with new options for investing overseas. The burgeoning private health care market presents a number of potentially profitable avenues for investment.

Finally, the forthcoming EU General Data Protection Regulation is likely to have considerable impact on all businesses that move data around, or in and out of, the European Union. EU and non-EU businesses alike will need to thoroughly review the way they collect, process and store personal data.

Please contact me if you have any comments on our articles or would like to discuss any of the issues raised.

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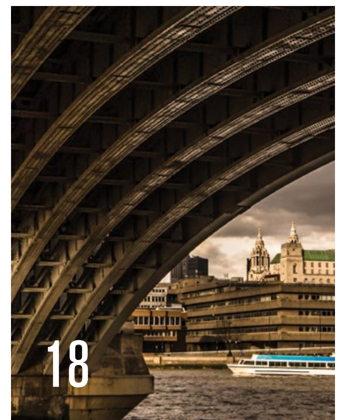

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QDII2 – A New Channel for Overseas Investment by Chinese Individuals

JACQUELINE CAI AND CHARLENE ZHANG

Despite the existence of a number of schemes intended to facilitate investment by Chinese individuals in overseas opportunities, this type of investment has remained complex, particularly with regards to regulatory approval. The eagerly-awaited QDII2 scheme is set to finally make overseas investment a reality for high net worth individuals.

CONTINUED >

In May 2015, the State Council of the People's Republic of China issued the Opinions on the Key Tasks for Deepening the Reform of the Economic System in 2015, which stated that efforts will be made to launch a pilot scheme for overseas investment by qualified domestic individual investors, known as QDII2. The Renminbi Internationalisation Report published in June 2015 by the People's Bank confirmed this intention.

The QDII2 scheme is now ready to be launched once the preparations made by the relevant authorities have been completed.

CURRENT INVESTMENT CHANNELS

There are currently three major channels for Chinese individuals to make overseas investments: through Qualified Domestic Institutional Investors (QDII), as a Qualified Domestic Limited Partner (QDLP), and through Overseas Direct Investments (ODI).

QDII

The QDII scheme was launched in 2007. It is divided into QDII funds supervised by the China Securities Regulatory Commission (CSRC) and QDII funds supervised by the China Banking Regulatory Commission (CBRC).

According to the Trial Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institutional Investors issued by the CSRC on 18 June 2007, China's qualifying fund management companies and securities companies may raise funds or asset management plans in China (QDII Products) to invest in overseas securities. Chinese individuals may invest in QDII Products and, through these, indirectly in overseas securities markets. The individual investors are generally unable to control the QDII Products' investments.

According to the Interim Measures for Entrusted Overseas Financial Management Business of Trust Companies issued by the CBRC and the State Administration of Foreign Exchange (SAFE) on 12 March 2007, Chinese individuals may entrust trust funds to invest in certain overseas financial products.

Although the standards provided by the CSRC and the CBRC are different, they both place clear limits on, amongst other things, the targets to be invested in under the QDII scheme, the investment activities and proportions of investments.

QDLP

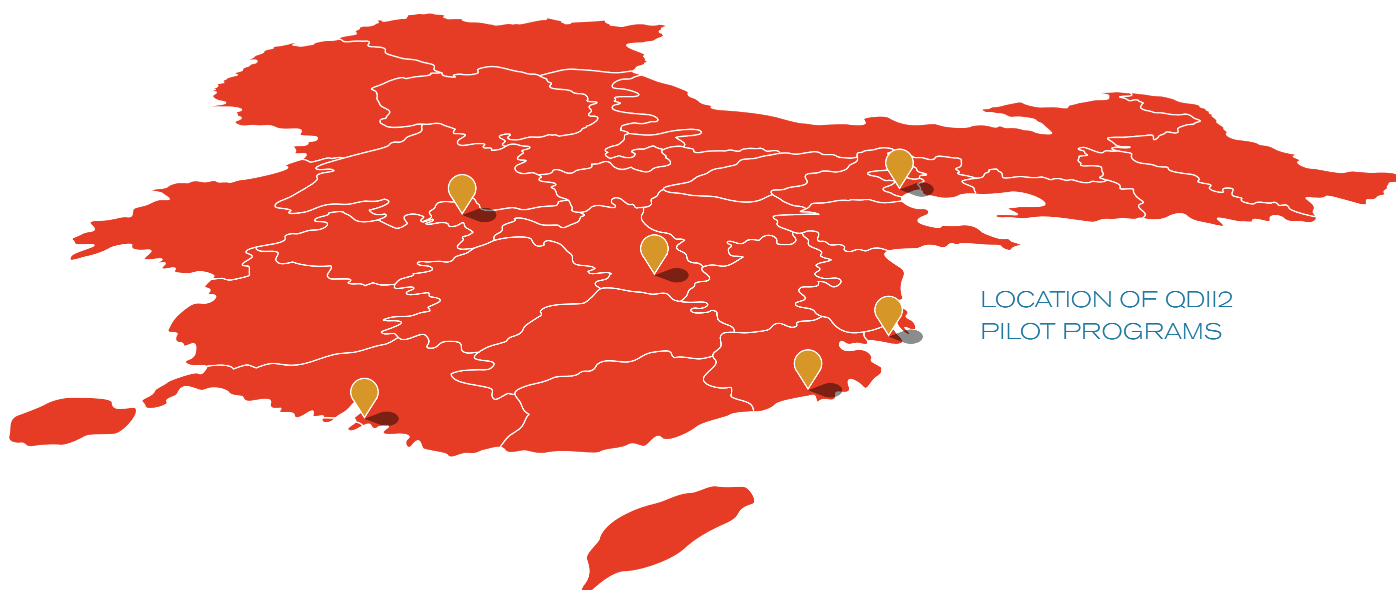
The legal basis for the QDLP scheme is mainly the Implementation Measures for the Launching of a Pilot Program for the Qualified Domestic Limited Partners System in Shanghai Municipality (the implementation measures) issued jointly by the Shanghai Financial Services Office, the Shanghai Municipal Commission of Commerce and the Shanghai Administration for Industry and Commerce in April 2012.

According to the implementation measures, foreign-invested fund management companies, and Chinese individuals and/or institutional investors may jointly raise a fund in the form of a limited partnership, with the fund management companies as general partners, and the second group as limited partners, *i.e.*, qualified domestic limited partners. In practice, limited partners are most likely to be major institutional investors rather than individuals. The limited partnership may invest in overseas secondary markets within the approved foreign exchange quota.

A QDLP must meet certain conditions. For example, the capital contribution committed by a single QDLP in an overseas investment fund must not be less than RMB 5 million. In addition, the total of the contributions made by each QDLP and the general partners in the limited partnership must be no less than RMB100 million. As under the QDII scheme, a QDLP cannot make overseas investment directly.

Overseas Direct Investment

On 14 July 2014, SAFE issued the Notice on the Administration of Foreign Exchange Involved in Overseas Investment, Financing and Return Investment Conducted by Residents in China via Special-Purpose Vehicles (the notice), according to which, Chinese



LOCATION OF QDII2 PILOT PROGRAMS

individuals must apply to SAFE for foreign exchange registration of overseas investments prior to making capital contributions to an overseas special purpose vehicle.

The notice was once considered a revolutionary step in enabling Chinese individuals to lawfully make overseas investments. For many reasons, however, such as the lack of any implementation rules, in practice it is still difficult for SAFE to accept applications for direct overseas investments by Chinese individuals.

Chinese individuals may still, of course, establish a company or partnership in China and then invest overseas in the name of that company or partnership. In this situation, the company or partnership applies to the relevant development and reform commission, commerce authority and SAFE for approval and filing. The review procedures are, however, complex. Furthermore, in practice, the approval/filing authorities will usually examine the "final destination" of the investment and the entire business plan. It may be difficult to obtain approval/filing for those investment projects that have no substantive business activities such as manufacturing or trade. In addition, if cash then flows from the company or partnership to an overseas investment fund, the regulatory compliance involved in obtaining approval and filing becomes even more onerous, and the result would still be uncertain.

QDII2

As the number of high net worth individuals gradually increases in China, the number of individuals hoping to invest in overseas markets has also increased. Neither the annual quota of US$50,000 per capita per year (as specified in the Implementing Rules of the Administrative Measures for Personal Foreign Exchange promulgated on 5 January 2007) nor QDII, QDLP and ODI can meet the demands of this developing market.

QDII2 is expected to enable the free, cross-border flow of personal funds more smoothly. It is predicted that the pilot programs for QDII2 will be launched in six cities: Chongqing, Shanghai, Shenzhen, Tianjin, Wenzhou and Wuhan. To qualify, individual investors must

- Be aged 18 or above
- Currently reside in one of the pilot cities
- Have an average daily balance of personal financial net assets over the last three months of no less than RNB 1 million
- Pass overseas investment and risk assessment tests
- Have no major convictions or outstanding debts that have been ruled on by the judicial bodies, or any record of financial misconduct or wrongdoing.

> "QDII2 is expected to enable the free, cross-border flow of personal funds."

QDII2 schemes are likely to be able to invest in the following areas:

- Overseas financial investments, such as stocks, bonds, funds, insurance, foreign exchanges and derivatives
- Overseas industrial investments, including greenfield projects, and mergers, acquisitions and joint ventures, subject to filing or approval according to the provisions of the relevant competent authorities
- Overseas real property investment, including purchasing houses and other real estate, subject to a review of certification documents.

In the near future, in the six pilot cities, a qualified Chinese individual will be able to open foreign direct investment accounts, including a Renminbi account and a foreign exchange account, for receipt and payment of funds for overseas investment and foreign exchange settlement and sales, by presenting the bank with certain documents. These include a valid ID card or residence permit, a verification document stating that his or her average daily balance of financial net asset over the last three months has been not less than RMB 1 million, a signed application for the account, a letter of commitment regarding the legality of the funds being used for overseas investment, and a letter of commitment regarding the investor's bearing of investment risks, amongst other documents.

The document requirements and reviewing procedures appear to be reasonably uncomplicated compared with banks' routine know-your-customer requirements.

Although the relevant policy has not yet been officially published, a number of parties are already eagerly looking forward to the reform promised by QDII2. It is likely that QDII2 will facilitate considerably more overseas investment by Chinese individuals, as the threshold for overseas investment is much lower under QDII2 than before, and individual investors may purchase overseas financial products directly, rather than through QDII, QDLP or other intermediate channels.

It is likely that, in the future, the difficulties inherent in Chinese individuals making direct investments in industrial projects will also be changed.

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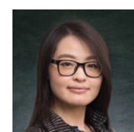

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CHINA > HEALTH CARE

Entering the Private Health Care Market in China

JOHN HUANG, JOHN KOCORAS AND LEON LIU

There are huge opportunities for health care companies to open private facilities in China. But they need to be aware of, and prepared for, the myriad compliance issues involved.

Private hospitals are new to China and not common; in 2010, private facilities housed just 5 per cent of China's hospital beds. Hospitals with foreign ownership are even more rare.

Private hospitals compete in an environment where patients, who rely on government services for many aspects of their lives, are not predisposed to consider or appreciate the advantages offered by private health care. China's many government officials tend to share their scepticism.

Nevertheless, China has a genuine need to increase the availability, and improve the quality, of health care services for its large, diverse population, and there is tremendous potential for organisations willing to invest resources into this market. If private hospitals can contribute to China's health care resources without competing unfairly with public hospitals, and without dramatic increases in costs, they will become a very welcome addition.

With a bourgeoning middle and upper class, China is ripe for investment in private health care services. Other opportunities include meeting the needs of China's rapidly aging population. According to the China National Committee on Aging, the elderly population is likely to reach 221 million by the end of this year, and that number will continue to increase. Many wealthier families are looking for alternative means of care for seniors rather than keeping them within the family. Other niche medical needs include facilities to provide effective post-partum care, which is increasingly in demand in China.

"There is limited enforcement history to provide meaningful guidance."

In tandem with these opportunities, there are a number of key challenges that must be met. China has a patchwork of laws and regulations that apply to the operation of hospitals, but there is limited enforcement history to provide meaningful guidance for understanding and complying with these laws and regulations.

ANTI-BRIBERY LAWS

China's anti-bribery laws prohibit bribes to public officials and improper payments to private-sector employees. Historically, China did not aggressively enforce these laws against foreign companies, but this approach has changed in recent years. For example, China has begun enforcing its anti-bribery laws aggressively in the pharmaceutical industry in response to reports of widespread corruption and a perception that corruption has contributed to pharmaceutical prices that are significantly higher than in other countries. As China attempts to get health care costs under control, it is likely that authorities will demonstrate the same level of concern with regard to private hospitals.

Commercial Bribery

Article 164 of China's Criminal Law provides that anyone who, for the purpose of receiving unjustified benefits, gives money or property in a relatively large amount (the exact amount isn't specified) to any employee of a company or enterprise, shall be subject to imprisonment for a maximum of three years and concurrently fined. If the amount involved is particularly large, the individuals will be sentenced to a term of imprisonment of not less than three years, but not more than ten years, and shall be concurrently fined.

Bribery of a Public Official

Article 393 of China's Criminal Law provides that a "unit" that offers bribes for the purpose of securing illegitimate benefits, or gives rebates to a State functionary in violation of State regulations, shall be fined if the circumstances are "serious".

The individuals directly in charge of the unit, and other individuals directly responsible for the offence, will also be

sentenced to imprisonment for no more than five years, or sentenced to criminal detention and concurrently fined. Anyone who personally and privately gains illegal benefits from the act of the unit offering the bribe will be sentenced under the crime of an individual offering a bribe, rather than as a unit.

Bribery of a State-Owned Unit

Article 391 of China's Criminal Law provides that anyone who, for the purpose of securing illegitimate benefits, gives money or property to a State agency or State-owned company, enterprise, institution or people's organisation, or violates State regulations by giving certain rebates, shall be sentenced to imprisonment for not more than three years, or criminal detention, and concurrently fined.

> "China is ripe for investment in private health care services."

Where a unit commits the offence, the unit will be fined. The persons who are directly in charge of the unit and others directly responsible for the offence are also subject to punishment.

ADMINISTRATIVE LIABILITIES

In addition to the criminal laws, China has administrative laws that address compliance concerns such as bribery and unfair competition. These include Article 9 of the Interim Rules on the Prohibition of Commercial Bribery, which imposes a fine of between RMB 10,000 and RMB 200,000 for commercial bribery and requires disgorgement of unlawful profits.

China's Anti-Unfair Competition Law similarly provides financial penalties for bribery "in selling or purchasing commodities."

COMPLIANCE RISKS FOR PRIVATE HOSPITALS

The most significant risks for compliance violations by hospitals and their employees in China involve potentially corrupt payments related to obtaining licenses and passing government inspections; enrolling in social insurance programs; and pursuing patient referrals; potentially by improperly giving cash, gifts or entertainment, or entering into improper consulting relationships or other financial relationships with referral sources that purport to be legitimate.

Likewise, as in the United States and other countries with social insurance programmes, providers face significant risks of being accused of overbilling.

The following are examples of some of the most common types of wrongdoing perpetrated by private hospitals and their employees.

Shenzhen Longcheng Hospital

In February 2014, Jiang Hanping, the former director of the Shenzhen Ministry of Health, was sentenced to 11 years imprisonment for allegedly receiving RMB 3 million in bribes from the privately-owned Shenzhen Longcheng Hospital. According to published reports, between 2006 and 2012, in exchange for improper payments, Mr Hanping strongly recommended the Shenzhen Longcheng Hospital to the Shenzhen Social Insurance Bureau, and assisted the hospital's efforts to join the local social insurance programme.

Qingdao Hospital

From January 2005 to March 2006, Qingdao Hospital allegedly spent RMB 40,000 in cash and gifts to doctors at other local hospitals in exchange for patient referrals. The local Administration of Industry and Commerce imposed a penalty of RMB 50,000 on the Hospital for commercial bribery.

Chongqing Private Hospital

Chongqing Private Hospital reportedly engaged in a scheme to defraud a social insurance programme in the amount of RMB 100,000. According to reports, the hospital misstated quantities and types of medications it provided to patients, and falsified records regarding in-patient treatment. In August 2013, a local People's Court imposed a penalty of RMB 100,000 on the Hospital. The court also sentenced Chongqing Private Hospital officials to terms of imprisonment ranging from 10 months to one year.

CONFRONTING COMPLIANCE RISKS

The most successful foreign participants in China's health care market will be the ones who understand the pitfalls and address compliance risks well in advance of pursuing operations. Opportunities for misconduct will almost certainly be presented as organisations begin the complicated and time-consuming procedures for obtaining the required Establishment Licence of Medical Institution or Practice Licence of Medical Institution.

By investing in compliance resources at the front end, and being prepared to identify and confront anticorruption risks, private organisations will be poised to seize the great opportunities rapidly unfolding in China.

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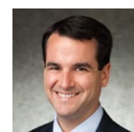

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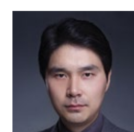

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EU Data Protection Reform and its Impact on EU and Non-EU Businesses

MÉLANIE BRUNEAU AND ANTOINE DE ROHAN CHABOT

The European Commission's proposed changes to the current legal framework on data protection will soon be adopted and will impact on EU and non-EU businesses alike.

THE CURRENT EU DATA PROTECTION FRAMEWORK

Every day within the European Union, businesses, public authorities and individuals transfer vast amounts of personal data across borders. Conflicting data protection rules in different countries disrupt international exchanges and individuals are unwilling to transfer personal data abroad if the level of protection in other countries is uncertain. To address these concerns, in 1995 the European Union enacted Directive n° 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data (the Data Protection Directive).

The Data Protection Directive was implemented in the national laws of all 28 Member States with the intention of ensuring that personal data enjoys a high standard of protection, and individuals have the same rights, everywhere in the European Union.

Under the Data Protection Directive, personal data can only be gathered legally under strict conditions and for a legitimate purpose. Organisations that collect and manage personal information must protect it from misuse and respect certain rights of the data owners. These rules also foresee specific criteria for the transfer of personal data outside the European Union to ensure adequate protection when it is exported abroad.

AN OUTDATED LEGISLATION IN NEED OF REFORM

Because the Data Protection Directive came into effect in 1995, before the internet came into widespread use, it is woefully out of date, despite being amended several times. In addition, its implementation by 28 fragmented (and sometimes conflicting) legislations has proved to be an obstacle to effective reform.

The Commission proposed its comprehensive proposal for the reform of EU data protection rules in January 2012, with the aim of strengthening online privacy rights, boosting Europe's digital economy and simplifying the regulatory environment for businesses.

The Commission expects that substituting a directive implemented differently in 28 Member States with a single, directly applicable General Data Protection Regulation (GDPR) will do away with the current fragmentation and costly administrative burdens, leading to significant savings for businesses. As a regulation and not a directive, the GDPR will have direct and immediate effect on all 28 EU Member States and will not require any enabling legislation to become effective.

The GDPR was approved by the European Council on 15 June 2015, and is currently under discussion by the Commission, the European Parliament and the European Council to reach a consensus on the final text, which is expected by the end of 2015. The GDPR will come into force two years after its final approval, which will also cause the repeal of the Data Protection Directive. In the meantime, national legislations implementing the Directive will stay in place.

KEY ELEMENTS OF THE GDPR

The main changes that will be brought in by the GDPR include the following:

- A single, unified set of rules on data protection, valid across the European Union.
- The removal of unnecessary administrative requirements, such as notification requirements for companies.

- > Instead of the current obligation for all companies to notify all data protection activities to data protection supervisors, the GDPR demands increased responsibility and accountability for those processing personal data. For example, companies and organisations must notify the national supervisory authority of serious data breaches as soon as possible, within 24 hours if feasible.
- > Companies will only have to deal with a single national data protection authority (DPA) in the EU country where they have their main establishment. Likewise, data subjects can contact the DPA in their country, even when their data is processed by a company based outside the European Union.
- > Wherever consent is required for data to be processed, it has to be given explicitly, rather than assumed.
- > Data subjects will have easier access to their own data and will be able to transfer personal data from one service provider to another more easily (right to data portability).
- > Data subjects have a right to be "forgotten". They will be able to delete their data if there are no legitimate grounds for retaining it.
- > EU rules must apply if personal data is handled abroad by companies that are active in the EU market and offer their services to EU citizens.
- > Independent national data protection authorities will be strengthened so they can better enforce EU rules in the Member States. They will be empowered to fine companies that violate EU data protection rules, with penalties of up to €1 million or up to 2 per cent of the global annual turnover of a company.

A new directive will also be adopted to cover police and judicial cooperation in criminal matters, regarding both domestic and cross-border transfers of data.

Although the final text of the GDPR has not yet been finalised, its contents have been controversial from the outset and, as more details became known, specific criticisms have appeared. For example, the requirement to have a data protection officer (DPO) will be new for many EU countries and is likely to present an administrative burden. Moreover, the GDPR seems to have been developed with a focus on social networks and cloud providers, but did not sufficiently consider requirements for handling employee data.

Under the GDPR, European businesses will save up to **€2.3 billion** per year.

The GDPR's implementation will require comprehensive changes in business practices for companies that did not implement a comparable level of privacy under the Data Protection Directive, especially non-EU companies doing business in the and handling EU personal data.

WHAT THE GDPR MEANS FOR EU COMPANIES

Currently, EU businesses have to deal with 28 different national data protection laws. This fragmentation represents a costly administrative burden that makes it harder for many companies, particularly small and medium-sized enterprises, to access new markets. Under the GDPR, EU companies can expect

- > One single law applicable to any business across the European Union, which, according to the Commission, will save businesses up to €2.3 billion per year.
- > A drastic reduction in red tape and bureaucratic requirements that impose unnecessary costs on businesses.
- > To be answerable to just one DPA, no matter how many EU countries they do business in.
- > Enhanced cooperation between DPAs to ensure the consistent application of rules across the European Union.

Big companies, *i.e.*, those with more than 250 employees, will need to be more proactive and take measures to ensure compliance with data protection law by appointing a DPO.

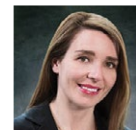
WHAT THE GDPR MEANS FOR NON-EU COMPANIES

The GDPR will also significantly impact non-EU companies, providing

- > Clear rules defining when EU law is applicable to non-EU companies. Whenever the company offers goods or services to EU individuals or to the monitoring of their behaviour, EU rules will apply.
- > Streamlined "adequacy decisions" taken at EU level, *i.e.*, the acknowledgement that a non-EU country provides adequate protection, on the basis of explicit criteria, allowing a free flow of information between EU and non-EU countries.
- > Easier and less burdensome transfers, by reinforcing and simplifying other rules on international transfers, in particular by streamlining and extending the use of binding corporate rules to groups of companies.

OUTLOOK

With the final adoption of the GDPR looming and in the wake of the European Court of Justice's recent judgment invalidating the US-EU Safe Harbor Program, EU and non-EU businesses alike will need to thoroughly review the way they collect, process and store personal data, and start anticipating what steps they will need to take to deal with the GDPR's new requirements.



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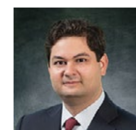

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The UK Consumer Rights Act 2015: New Advance in Private Antitrust Enforcement

ANDREA HAMILTON, WILKO VAN WEERT AND DAVID HENRY

On 1 October 2015, the UK Consumer Rights Act 2015 (CRA 2015) entered into force, bringing with it a raft of changes pertaining to consumer protection law and competition law litigation.

The CRA 2015 sets the scene for the future proliferation of competition damages actions in the United Kingdom and consolidates the country's reputation as one of the most advanced competition regimes in Europe.

The new rules introduce a series of significant changes to facilitate claims, including the establishment of a fast-track procedure for simple claims, the introduction of a collective settlement regime, and an extension of the limitation period for actions before the Competition Appeal Tribunal (CAT), the United Kingdom's specialist competition law tribunal.

Arguably the most controversial and high-profile measure is the introduction of collective proceedings before the CAT which, subject to the CAT's discretion, can be brought on an opt-in or opt-out basis for both follow-on and stand-alone claims.

The CAT will certify claims that are eligible for inclusion in collective proceedings. In this regard the following three conditions must be met. There must be an identifiable class; the claim must raise common issues; and it must be suitable for collective proceedings, taking into account, *inter alia*, whether or not collective proceedings are an appropriate means for the fair and efficient resolution of the common issues, the costs and benefits of the collective proceedings, and the size and nature of the class.

If the CAT decides that collective proceedings are appropriate, it will then determine whether the proceedings should be "opt-in" or "opt-out". The CAT will take into account all the circumstances, including the estimated amount of damages that individual class members may recover, the strength of the claims, and whether it is practical for the proceedings to be brought on an opt-in or opt-out basis.

If appropriate, the CAT will also authorise an applicant to act as class representative. The representative must not have, in relation to the common issues for the class members, a material interest that is in conflict with the interests of the class members, and must be someone who would act fairly and adequately in the interests of all class members.

In order to prevent the rise of a "litigation culture", certain safeguards are included. For instance, the CAT may not award exemplary damages in collective actions, and contingency fees, *i.e.,* damages-based agreements whereby the lawyers are paid a proportion of the damages obtained, are not permitted in opt-out collective actions.

There will no doubt be considerable up-front litigation surrounding the issue of class certification before the first cases get off the ground. It is likely, however, that the mere threat of class actions before the CAT will represent a powerful weapon in the hands of the claimant when negotiating a settlement.

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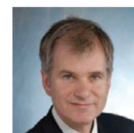

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Cross Border Planning for Trusts

ELLEN HARRISON, CLAIRE MURRAY AND JEAN-MARC TIRARD

As trusts become increasingly globalised in their reach, effective cross-border tax planning becomes more vital to avoid double taxation.

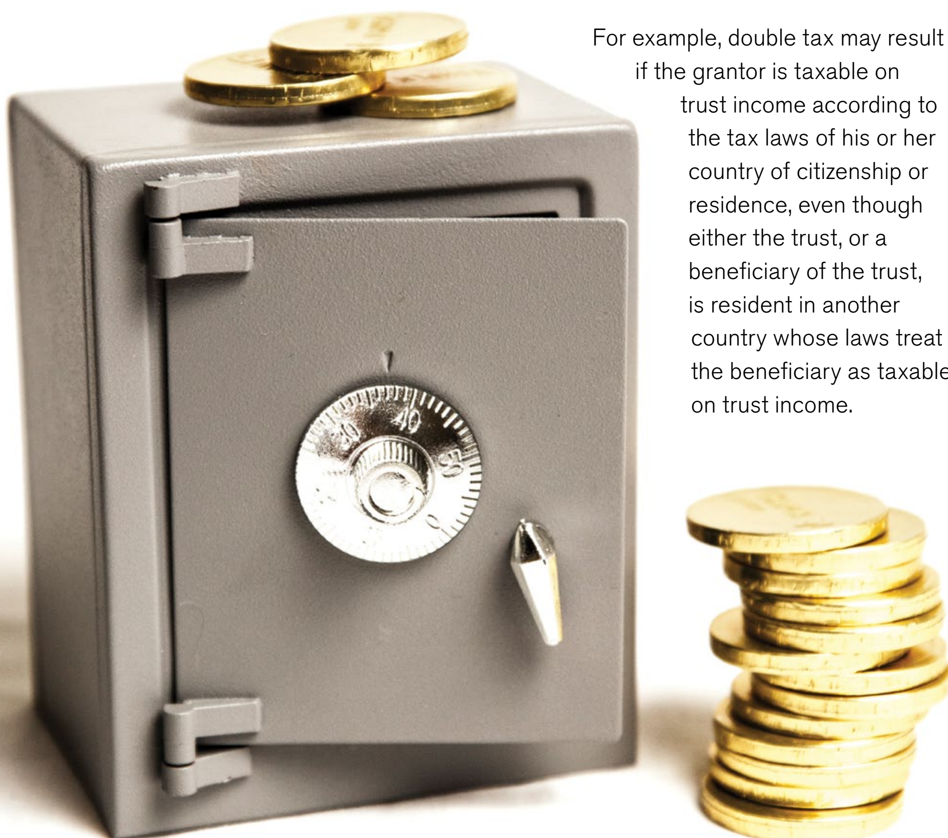
CONTINUED >

When the laws of more than one country apply to a trust, each country may apply different rules depending on the answers to the following questions:

- What is a trust?
- Is the trust (or trustee as a fiduciary and not individually) the owner of the trust for tax and/or property law purposes, or will the grantor/settlor, beneficiary or another person be treated as the owner?
- Are contributions and distributions taxable events?
- Is the trust considered a "resident" for tax purposes in more than one country?
- What happens when the residence of a trust changes?

WHAT IS A TRUST?

A common law trust is an arrangement whereby trustees hold and administer assets for the benefit of the trust beneficiaries. Income accruing to the trust is generally taxed to the trust (or to the trustees), to the grantor of the trust or to the beneficiaries of the trust, depending upon the circumstances and governing law.



Some countries have statutory trusts or other entities, such as foundations, that differ in some respects from common law trusts. Whether or not these entities or arrangements are classified as trusts under the tax laws of other countries varies.

Several civil law countries refuse to recognise a trust as a legal relationship. In such cases, a trust cannot take title to assets. A foreign trust must therefore hold title through an entity, trust assets may be subject to claims by creditors of the fiduciary and transfers of beneficial interests may incur inheritance tax. For example, in France, inheritance tax may apply when residents acquire beneficial interests in a trust upon the grantor's death.

WHO IS TAXABLE ON TRUST INCOME?

Generally, trust income is taxed to the trust, with the exception that income is taxable to beneficiaries to the extent it is actually distributed (or required to be distributed). Sometimes, however, the income is treated as belonging to the grantor (or another person) rather than to the trust, and sometimes beneficiaries are taxed even if they do not receive a distribution. Double tax may result if inconsistent tax laws apply.

For example, double tax may result if the grantor is taxable on trust income according to the tax laws of his or her country of citizenship or residence, even though either the trust, or a beneficiary of the trust, is resident in another country whose laws treat the beneficiary as taxable on trust income.

Suppose that a trust is resident in the United Kingdom and the trust's US grantor is treated as the owner of the trust under US grantor trust rules, but not for UK purposes. This means that the grantor pays tax in the United States and the trust (or its beneficiaries) pays tax in the United Kingdom. If the UK tax is paid by UK beneficiaries, there may be no credit available to prevent double tax.

Similarly, if the trust is a US non-grantor trust for US tax purposes, but France taxes the French beneficiaries on the same income, the trust may not credit the taxes paid by the beneficiaries. France may also not allow a credit to the beneficiaries for the tax paid in the United States.

> "Double tax may result if inconsistent tax laws apply."

Occasionally, the mismatch results in situations favourable to the taxpayer. For example, if a UK domiciled taxpayer creates a foreign trust that requires that income be paid to his US spouse during his lifetime, the trust is a grantor trust for US tax purposes, but not for UK tax purposes. Under UK law, the spouse's interest is taxable to her. If the spouse is not UK domiciled, and her income is not remitted to the United Kingdom, her income is not taxable in the United Kingdom. Because the grantor is not a US taxpayer, the income is also not taxed in the United States. In this situation, the income is not taxed either in the United States or the United Kingdom (other than on the basis of source), unless remitted to the United Kingdom.

TAX CONSEQUENCES OF CONTRIBUTIONS AND DISTRIBUTIONS

If a gain is recognised by the grantor on her contribution of assets to a trust, but is not a gain recognition event where the trust is resident, there may be no basis adjustment for the notional gain. This

will cause a double tax when the asset contributed to the trust is sold later.

Distributions from trusts are usually taxable only to the extent that they are treated as income distributions. In some civil law countries, however, the receipt of a distribution from a trust is subject to inheritance tax. For example, if a US person created a US trust for beneficiaries in civil law countries, the distribution of principal would not be taxable in the United States, but many civil law countries will impose inheritance tax on the receipt of those distributions.

The UK Government is currently considering changing its tax regime for non-UK resident trusts so that, in certain cases, all distributions would be taxable, regardless of whether they constitute as income, capital gains or original trust capital.

DUAL RESIDENT TRUST

A trust may be considered a "resident trust" in more than one country. If this is the case for an individual, treaties apply "tie-breaker" rules to avoid double tax, but there is no similar "tie-breaker" rule for trusts.

A trust is considered resident in the United States for federal tax purposes if the trust is subject to the primary jurisdiction of a US court and all substantial trust decisions are controlled by US persons. If the trust is a US resident, it is taxed on worldwide income.

Under UK law, a trust is resident in the United Kingdom if all the trustees are UK residents or the trust has at least one UK resident trustee, one non-UK resident trustee, and the settlor of the trust was either UK resident or UK domiciled at the time the assets were settled on trust. If the trust is a UK resident trust, it is likely, depending on the terms of the trust, to be taxable on its worldwide income and gains, and may also be subject to periodic inheritance tax charges.

Under the laws of Canada, a trust is a Canadian trust if central management and control are located in Canada. Usually this is determined by where the trustees reside and where the trust is managed. Certain foreign trusts are, however, deemed to be resident in Canada if the trust has a Canadian resident contributor or beneficiary.

> "Several civil law countries refuse to recognise a trust as a legal relationship."

It is not difficult to envision a trust having a dual residency. A trust with a UK grantor, one UK trustee and two US trustees, governed by the laws of a US state, would be resident in both countries. A US trust with a Canadian contributor could be dual resident in Canada and the United States.

TRUST MIGRATION

When a trust changes its residence, tax consequences can result for both the trust and the grantor and beneficiaries. A change of residence may be treated differently in the relevant jurisdictions. For example, if a US trust ceases to be resident in the United States, the trust may become a "grantor trust" if, *inter alia*, it has any US beneficiaries. If it is not a grantor trust, the trust will be treated as recognising gain on its assets, but not its losses.

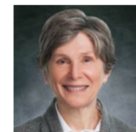
If a UK trust ceases to be resident in the United Kingdom, the trustees are deemed to have disposed of all trust assets and reacquired them at market value on the date their residency ceases. If the deemed disposal results in a capital gain, this is chargeable on the trustees.

Generally, there are no tax consequences to migration into the United States or the United Kingdom. There is, however, no adjustment to the gain deemed to be realised on a migration out of one country and into the other.

HOW TO AVOID DOUBLE TAX

Careful planning is necessary to avoid double tax by, for example, making sure that the same person is treated as the owner of income in all relevant jurisdictions (or that tax credits will be available) and that the trust will not be considered resident in more than one country. In addition, it is critical that trust instruments allow the flexibility to modify or terminate trusts when necessary and avoid inadvertent migration of trusts. For example, if the intent is to retain residence in the United States, the trust instrument could require that at all times a majority of the trustees must be US persons and the trust must be administered in the United States.

Trust arrangements should be structured to avoid "deemed" gains and deemed distributions that create inconsistent tax treatment in relevant jurisdictions.



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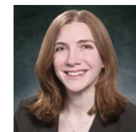

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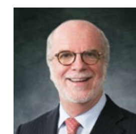

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International Tax Disputes: A Ray of Hope

TODD WELTY AND CYM LOWELL

Despite the anticipated tsunami of tax disputes generated by underlying tensions in international taxation, there is reason for hope that appropriate means are being developed to address them efficiently and effectively.

All multinational enterprises (MNEs) are, should, or will be addressing their existing international taxation planning structures with respect to dramatic changes in the tax world. This process is likely to be supervised at Board of Directors level, reflecting the seriousness of events on the horizon.

There exists today an unfortunate deluge of aging inventories of treaty-based mutual agreement procedures (MAP) and domestic resolution processes being overwhelmed with international tax disputes, of a volume and complexity for which they are ill-equipped to achieve efficient resolution. The underlying tensions include

- Disputes over historic residence versus source country treaty and transfer pricing models
- Revenue collection from international businesses for all countries
- Base erosion and profit shifting (BEPS) measures
- Competition between countries for MNE tax bases
- The desire of developing/source countries to address their own perceived needs
- The United Nations (UN) Secretariat's focus on dispute resolution
- The needs of international financing organisations
- The perspectives of civil societies
- MNEs' need to: i) adapt global effective tax rate planning to existing and evolving tax regimes of countries (alternative regimes) and ii) anticipate means of handling disputes to minimise incidences of double taxation.

As a result, countries are likely to devote additional resources to tax base protection. Each country needs the ability to efficiently challenge tax planning that it believes provides insufficient tax revenue, including situations involving so-called double non-taxation. Inefficient dispute resolution processes slow down the ability to resolve such challenges.

In addition, MNEs are likely to focus on effective tax rate planning to take maximum advantage of alternative regimes to minimise taxation and dangers of double taxation. The unpredictable nature of the BEPS process provides stark encouragement for MNEs to take the most aggressive approaches possible, using the alternative regimes then seeing what happens in other countries and dispute resolution processes.

Predictability of tax base results is a serious issue to countries and MNEs alike. The only realistic antidote would be to create a dependable and independent treaty-based international tax dispute resolution process (ITDRP) designed to accommodate the needs of all stakeholders. While there may be broad dissatisfaction with the *status quo*, there is ample guidance in related areas of dispute resolution to provide light at the end of this tunnel.

WIRTSCHAFTS UNIVERSITY, VIENNA, JANUARY 2015

In a January 2015 meeting at Wirtschafts University, the attendees, as a group, began a process of developing a consensus on a way forward for dispute resolution in the international tax world. For an ITDRP to be meaningful for MNEs and countries alike, it will need to be embraced by as large a body as possible. Acceptance by a unanimous action of, for example, the UN membership, would provide a solid foundation for predictability.

The following elements will be key to developing a successful ITDRP:

- A thorough understanding of the obstacles to be overcome (including observations about sovereignty, cost, independence of arbitrators, control of process, scope creep, confidentiality, transparency, *etc.*
- The identification of the parties' common objectives
- A study of the experience of successful alternative dispute resolution (ADR) mechanisms in other areas
- An approach that deals with the obstacles to the use of arbitration in tax disputes, *e.g.*, transparency versus confidentiality
- A broad consensus for the proposed approach
- Implementation of the approach by an institution that has broad experience

in administering cases through dispute resolution mechanisms in other contexts.

STEPS FORWARD

On 5 October, the OECD released its final deliverables with respect to BEPS, including Action 14. The following is an extract from the report (authors' emphasis):

Through the adoption of this Report, countries have agreed to important changes in their approach to dispute resolution, in particular by having developed ***a minimum standard*** *with respect to the resolution of treaty-related disputes, committed to its rapid implementation and agreed to ensure its effective implementation through the establishment of a* ***robust peer-based monitoring mechanism*** *that will report regularly through the Committee on Fiscal Affairs to the G20. The minimum standard will:*

> *Ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner;*

> *Ensure the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and*

> *Ensure that taxpayers can access the MAP when eligible.*

The minimum standard is complemented by a set of ***best practices****. The monitoring of the implementation of the minimum standard will be carried out pursuant to detailed* ***terms of reference and an assessment methodology*** *to be developed in the context of the OECD/G20 BEPS Project in 2016. In addition . . . the following countries have declared their commitment to provide for mandatory binding MAP arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified timeframe: . . .3 This represents a major step forward as together these countries were involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD.*

An initial review of Action 14 suggests that it is intended to outline a normal OECD approach of model treaty guidelines and monitoring. Of course, this is the only option the OECD has in the absence of a capacity to actually administer a process on a global basis. Whether or not an OECD-led process will be acceptable to a broad range of developing countries is an issue yet to be addressed.

A paper on ITDRP was then released on 8 October 2015 by the Secretariat of the UN Commission of Experts in International Taxation (the UN Committee). It broadly reviewed all issues pertinent to the evolution of an effective tax dispute resolution process.

> "To be meaningful for MNEs and countries alike, it will need to be embraced by as large a body as possible."

When the OECD final Action 14 comments are read in conjunction with the UN Secretariat paper, it appears there is a natural link. The OECD paper establishes a framework for ITDRP within the treaty MAP process, including eventual guidelines and monitoring.

The UN paper seems to take over at this point by framing the need for a neutral administrator. What remains is the need for the development of an organisation with broad experience in non-tax areas of dispute resolution to actually facilitate and administer a process.

ICC DISPUTE RESOLUTION

The Taxation Commission of the International Chamber of Commerce (ICC), which has almost 100 years of experience in all types of state-to-state, commercial, investment and other forms of dispute resolution, has made enhanced taxation dispute resolution mechanisms a priority for the global business community, working in cooperation with the OECD and UN.

A variety of concerns have, however, been raised for any type of ADR for international tax purposes, including

> How to control the costs

> Transparency, confidentiality and secrecy

> Enforceability

> Sovereignty

> Inexperience of developing countries, independence of arbitrators and their selection within an arbitral institution

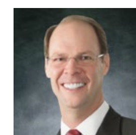
> Procedural models for tax treaty arbitration

> Parallelism in domestic remedies and due process

> Arbitrability of taxes

UN COMMITTEE

At the October 2015 meeting of the UN Committee in Geneva, there was broad, near unanimous support for the formation of a subcommittee to address ways of achieving ITDRP within the framework of the MAP provisions of global treaty networks. This is, frankly, a rather amazing evolution, as it reflects the coordinated efforts of developed and developing, OECD and non-OECD member, countries to focus on this critical issue for all stakeholders in the international taxation world.



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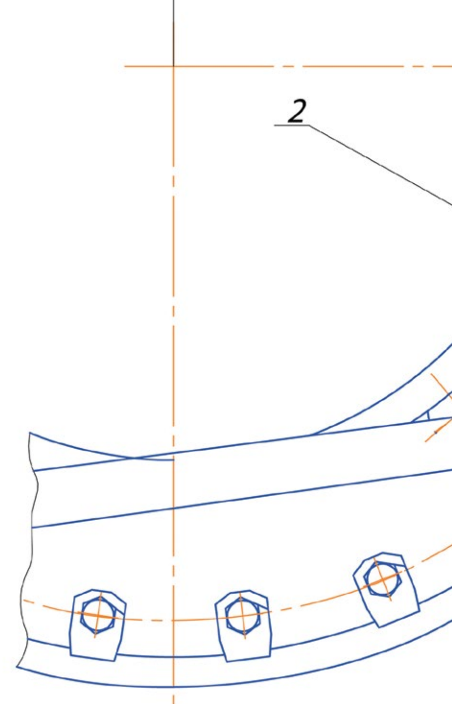


The Italian Patent Box and Its (Non-) Compliance With OECD Recommendations

CARLO MARIA PAOLELLA AND FEDERICO BORTOLAMEAZZI

The Italian Patent Box regime largely complies with the OECD recommendations to prevent base erosion and profit shifting. Its non-compliant features offer a brief window of opportunity for companies able to take swift advantage of its wide range of qualifying intangible assets.

Many countries have implemented in their domestic tax legislation specific IP regimes that provide a tax benefit on the income derived from certain intangible assets, such as patents, designs and other types of intellectual property. Although these regimes are generally regarded positively as tools to create incentives to research and innovation, they have also been exploited improperly by many countries, generating harmful tax competition between tax jurisdictions.

As a result, the Organisation for Economic Co-operation and Development (OECD) has explicitly addressed these regimes in the context of the implementation of the Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Plan has been developed with the support of the G20 in order to tackle international tax avoidance by enterprises with a broad international consensus.

The “Report on Action 5, Countering harmful tax practices more effectively, taking into account transparency and substance”, delivered on 5 October 2015, defined the features of IP regimes that can be regarded as non-harmful.

At the end of 2014, the Italian Parliament approved the Budget Law for 2015 which, *inter alia*, introduced for the first time in Italy a Patent Box tax regime, similar to those already in place in many other EU countries. The Italian regime is relevant for both Corporate Income Tax (IRES, at 27.5 per cent) and the Regional Tax on Productive Activities (IRAP, ordinary rate at 3.9 per cent).

The enactment of this regime took place while the OECD was developing the Report on Action 5 and delivering interim discussion drafts. As a result, the Italian Patent Box is already widely aligned with the principles defined by the OECD.

The Italian Patent Box is a very attractive regime. It provides a 50 per cent exemption (30 per cent in 2015, 40 per cent in 2016) on income derived from the exploitation of a wide range of qualifying intangible assets, after the application of a specific ratio based on the costs borne for the development, acquisition, enhancement and maintenance of those intangibles. The incentive is determined according to a proscribed formula.

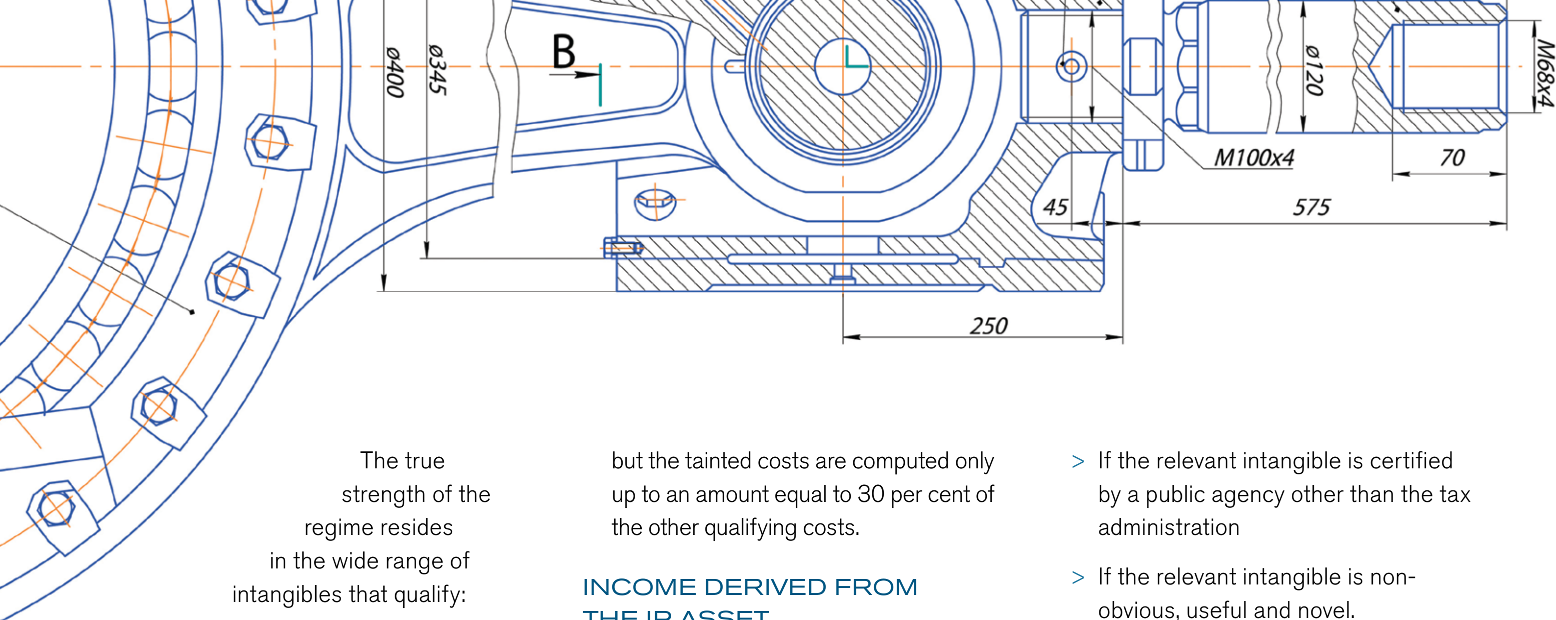
$$\frac{\text{Qualifying expenditures incurred to develop the IP asset}}{\text{Overall expenditures incurred to develop the IP asset}} \times \text{Qualifying expenditures incurred to develop the IP asset} = \text{Income qualifying for tax benefits (50 per cent on an ongoing basis)}$$

Furthermore, the Patent Box grants a full exemption from taxation over the capital gains arising from the sale of the same qualifying intangible assets. The sole condition is that 90 per cent of the consideration obtained from the sale is re-invested in the maintenance, enhancement or development of other qualifying intangible assets.

The Patent Box regime is optional and requires a five year irrevocable opt-in.

SCOPE OF APPLICATION

In theory, any taxpayer carrying out a business activity in Italy, either as a tax resident or through a permanent establishment located in the country, is eligible for the regime. The sole requirement is, however, a substantial one: the taxpayer must be undertaking a qualifying research activity that leads to the creation of a qualifying IP asset. If only non-qualifying research is carried out, or no qualifying IP is obtained, no benefit is granted.



The true strength of the regime resides in the wide range of intangibles that qualify:

- Industrial patents, biotech inventions, utility models, patents for plant varieties and designs for semiconductors
- Business, commercial, industrial, and scientific information and know-how that can be held as secret and the protection of which can be legally enforced
- Formulas and processes
- Legally protected designs and models
- Software protected by copyright
- Trade marks, including collective trade marks, either registered or in the process of registration.

CALCULATING THE COSTS

In compliance with the guidelines developed by the OECD, it is necessary to apply a formula to the identified IP income. The formula considers all the costs borne in order to acquire, develop or maintain the IP in order to reduce (or rule out) the tax incentive when the taxpayer bears the following non-qualifying costs (tainted costs) related to the intangible asset:

- Research and development costs outsourced to companies or other entities belonging to the same group of the taxpayer.
- Costs of acquiring the intangible from related or unrelated third parties.

The formula is as follows:

- The denominator includes all the costs incurred by the taxpayer for the purpose of acquiring, developing and maintaining the relevant IP.
- The numerator includes the same kind of costs included within the denominator, but the tainted costs are computed only up to an amount equal to 30 per cent of the other qualifying costs.

INCOME DERIVED FROM THE IP ASSET

The calculation of the income that can be imputed to the IP can be relatively simple when the intangible is licensed to third parties, since the royalty paid to the IP holder by the licensee constitutes the primary item to be considered.

More complex calculations are required when the IP is exploited internally. The use of transfer pricing methods is required to provide a reliable calculation of the portion of income internally generated that can be attributed to the IP. In these circumstances, the determination of the eligible income has to be granted through an advance ruling by the Revenue Agency, which can be fairly time consuming. It is likely that the Agency will see an increase in requests for rulings under the new regime, which will undoubtedly slow the process further. For this reason, while the tax benefit can only be taken after the ruling is granted, the benefit will be retroactive to the fiscal year in which the ruling request is filed. This is why filing during 2015 is recommended for companies that want to fully exploit the benefits of the Patent Box.

NON-COMPLIANT FEATURES

It is the broad scope of the eligible intangibles that makes the Italian Patent Box non-compliant with the OECD principles. The OECD has explicitly stated that marketing intangibles cannot qualify for IP regimes, but the Italian Patent Box includes trade marks. Furthermore, the OECD Report has stated that intangibles, other than patents and copyrighted software, can be eligible only

- To smaller taxpayers (basically, small- and medium-sized enterprises, with €50 million overall turnover and €7.5 million of turnover attributable to the intangible)
- If the relevant intangible is certified by a public agency other than the tax administration
- If the relevant intangible is non-obvious, useful and novel.

The last requirement also gives rise to the question of whether or not even designs and models, other than utility models, can be included in a fully compliant regime.

The OECD has, however, also defined some transitional rules (and some anti-avoidance rules) in order to allow EU Member States to amend their domestic legislation in accordance with these principles.

The OECD has stated that non-compliant regimes must be repealed by 30 June 2021. It has also declared a ban on "new entrants" to existing non-compliant regimes, stating that no new opt-ins are allowed after 30 June 2016. As a consequence, taxpayers currently have a one-off, brief opportunity to benefit from the Italian Patent Box in relation to their trade marks, know-how (for large enterprises) and possibly even models. If they are willing to take this opportunity, they must opt-in by 30 June 2016.

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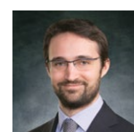

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FOCUS ON > TAX

The UK as a Tax-Efficient Holding Company Jurisdiction

Matthew Herrington

The UK is an attractive holding company jurisdiction for multi-national groups looking to establish both interim UK holding companies within their existing groups, and holding companies for the group as a whole.

Whilst there is no specific UK tax code for holding companies, the attractiveness of the United Kingdom as a holding company regime is largely attributable to the recent overhaul of the country's approach to the taxation of foreign profits and a low headline rate of corporate income tax.

The specific aspects of the UK tax code that make the United Kingdom an attractive regime for a holding company include

- A low headline rate of corporate income tax (20 per cent) that is projected to fall to 19 per cent in 2017 and to 18 per cent in 2020
- A territorial system of corporate taxation that involves an exemption for profits of foreign permanent establishments. In addition, a disposal of shares in a UK holding company by an offshore shareholder will not generally be subject to UK tax
- A common system for the taxation of domestic and foreign-source dividends. Most dividends received by a UK holding company will not be subject to corporation tax, regardless of their source
- A domestic participation exemption for capital gains realised on the disposal of substantial shareholdings in trading companies (or holding companies of trading groups) that have been held for at least 12 months
- The absence of UK withholding tax on outbound dividends, which applies regardless of the jurisdiction of residence of the recipient. There is no requirement for the recipient to be the beneficial owner in order for the withholding tax exemption to apply
- The availability of an extensive network of double taxation treaties to reduce UK withholding tax on interest and royalties
- A generous regime for tax relief on interest payments. In general, the United Kingdom gives relief for tax purposes in line with the accounting treatment of the interest, for example, on an accruals basis over the life of the loan.
- Membership of the European Union, which brings the benefit of access

to legislation such as the Parent-Subsidiary Directive and the Interest and Royalties Directive

> A new controlled foreign company code that supports the general approach to territoriality (by focusing only on profits that have been artificially diverted from the United Kingdom) and enables a UK holding company to locate a group finance subsidiary offshore and be taxed at an effective rate of only 5 per cent on interest income notionally attributed to the United Kingdom

> A relatively extensive system for obtaining non-statutory and statutory clearances, as well as the facility to negotiate advance pricing agreements and advance thin capitalisation agreements for transfer pricing purposes

> The existence of a wide range of targeted incentives aimed at encouraging and supporting growth in certain sectors, including the UK patent box regime and regimes that support research and development.

The UK tax authorities are also generally geared-up to be helpful, with customer relationship managers for large businesses, a generally good understanding of multinational business and support for inward investment into the United Kingdom.

The potential downsides of locating a holding company in the United Kingdom include

> The potential for exit charges on certain assets and shares leaving the UK tax net. In practice, however, this can often be addressed by relying on a relief, such as the domestic participation exemption for share sales

> The sale of shares in a UK company still attracts a charge to transfer taxes (stamp duty and stamp duty reserve tax) at the rate of 0.5 per cent of the consideration given by the purchaser of the shares

> The United Kingdom is currently consulting on the implementation of the Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS) recommendations on restricting interest deductibility in line with a fixed earnings before interest, taxes, depreciation, and amortisation ratio (or a fixed group ratio). There are also several existing domestic rules that can restrict interest deductibility such as transfer pricing, "purpose" rules, the worldwide debt cap, the anti-arbitrage rules and the distributions regime.

> UK tax legislation is long and complex, and contains a number of anti-avoidance rules (including a domestic General Anti-Abuse Rule) that always have to be considered even in relation to entirely commercial arrangements.

> The United Kingdom has recently introduced a new "diverted profits tax" under Action 7 of the OECD's BEPS Project, which is intended to counter diversion of profits from the United Kingdom through aggressive tax planning techniques.

Overall however, the United Kingdom is a very attractive holding company jurisdiction and has a highly competitive tax package to offer as an "onshore" prospect.

"Most dividends received by a UK holding company will not be subject to corporation tax."

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