ADIT

ADIT VOICE

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Contents

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CHAIR'S VIEW

Joy Svasti-Salee
Chair, International Taxes sub-committee. Professor and International Tax Specialist, Centre of Commerical Law Studies, Queen Mary, University of London

Significant international tax change in 2017?

2017 will bring with it significant change in the field of international taxation with the anticipated signing of a Multilateral Instrument designed to amend Bilateral Double Taxation Treaties for minimum standards and recommendations made by the G20/OECD following their Base Erosion and Profit Shifting Project ('BEPS'). Treaty changes will essentially come into effect, at prescribed times, where two countries both agree to the same changes.

In December 2016, the UK helpfully, indicated its current position. This involves the adoption of simply the agreed minimum standards and other provisions where they are in line with existing policy. It means that some recommendations, such as the lowering of the permanent establishment threshold are not being adopted, and comments are being sought on this approach. The impact of the Multilateral Instrument on the UK's Double Taxation Treaties will only be known when we know which changes other countries wish to sign up to. There has apparently been some form of 'country speed dating' to enable pairs of countries to decide which changes they can both agree to, and a signing ceremony is planned to take place in June 2017 in Paris. The UK approach seems a sensible one in what is a period of significant other change.

For UK parented multinationals the broader implications of the Multilateral Instrument, namely the position in relation to double taxation treaties between third countries in which they do business, which is also important, should also become clearer in the summer.

For the first time outside of double tax relief provisions, limited asymmetry is possible, in the area of Treaty Abuse. If, for instance, one county opts for the Principal Purpose Test and the other for the limited Limitation on Benefits Test, both countries would apply different tests in determining whether the treaty applies. The UK policy is to adopt the Principal Purpose Test and not to accept the limited Limitation on Benefits Test. However, the position of other countries remains to be seen. Where two countries do adopt different tests, taxpayers will need to be doubly careful before assuming that a Treaty applies to them.

In circumstances where countries do not adopt the agreed minimum standards via the Multilateral Instrument the expectation is that they will adopt them in negotiations to revise bilateral treaties. We will get a clearer idea in the summer how many treaties will need to be updated in this 'old fashioned slower way'. In any event taxpayers will need to monitor changes to Treaties closely, identifying those changes that impact them, and precisely when such changes come into effect.

The Multilateral Instrument itself has no termination clause and is drafted in a manner that enables future changes to be made, so treaty interpretation is likely to increase in complexity going forwards. This is likely to be especially important where 'most favoured nation' clauses are involved, and in the area of withholding taxes.

For taxpayers, withholding taxes on income such as interest, dividends and royalties, are likely to again become a significant issue. Over the years, despite significant reductions in the rates of corporate taxes, the rates of withholding taxes have remained high (the US for example applies a 30% rate under domestic law). However, this rate is reduced, often to 0%, under tax treaties, essentially giving the resident state the sole or main right to tax. The renewed focus on treaty abuse means that taxpayers will need to consider even more carefully whether the country of the payer has such a tax, whether the reduced rate is available to the payment they are making, and whether the Treaty applies to them. This in addition to keeping an eye out for taxes, which in recent years some countries have introduced (for example 'digital taxes'), which are specifically designed to be outside the scope of treaties altogether.

Disputes in relation to withholding tax, and disputes more generally, are likely to increase going forward. To end on a high, the good news is that the Multilateral Instrument brings with it the possibility that more countries may agree to arbitration, a recommendation rather than a minimum standard, to help resolve tax disputes going forward.

This is particularly welcome given the prospect of increasing numbers of transfer pricing disputes resulting partly from Country by Country Reporting. Such disputes are inevitable, given that transfer pricing is a relatively recent phenomenon (many countries did not introduce such rules until years after the publication of the 1995 Transfer Pricing Guidelines) and is not an exact science. The Guidelines have changed significantly over the years, for instance, moving from:

- a focus on an 'arm's length price' to determining a price within an 'arm's length range'
- a focus on traditional methods (comparable uncontrolled price, cost plus, and resale minus) to accepting that other methods focused on profitability may be more appropriate; and
- an approach based on identifying who actually owns intangible assets to the new BEPS focus on where value is created (which could conceivably be in a number of places at different times)

So it is important to understand what the guidelines said at the time of the transaction, and easy to see that increasing numbers of disputes are likely to arise.

The bottom line is that in 2017 we are likely to see much change in the international tax world. Where countries agree to and implement treaty changes via the Multilateral Instrument, the changes will come into effect quickly and are likely to start impacting taxpayers in 2018. As most of the minimum standards are anti-avoidance measures the eyes will be on countries or pairs of countries that do not agree to make the minimum agreed changes in this way, and in their progress in renegotiating treaties.

With so much change on the horizon, a career in international tax law remains a good choice!

Joy Svasti-Salee

TRENDS IN MANAGING INTERNATIONAL ASSIGNMENTS – IT'S ALL ABOUT VALUE

Phil Renshaw digs deep into the world of international assignments

As the world of Brexit and Donald Trump continues to dominate the airwaves, it is not surprising that businesses organising international assignments are asking what to expect. In an increasingly VUCA environment (volatile, uncertain, complex and ambiguous), these questions are understandable. However, in many respects, this is not helpful. There have been new and often unpredictable events around the world for many years affecting the day-to-day implementation and support of international assignments. This can range from a specific new visa requirement to changes in global shipping methodologies affecting transportation costs.

The uncertainty triggered by the Brexit and Trump phenomena risks moving our focus from the strategic to the purely tactical. In many respects the basics remain the same and there is a need to get these right first. Most people involved in the organisation and implementation of international assignments struggle to demonstrate the value that is generated by these assignments. Without clarity regarding the strategic impact of international assignments and a clear alignment with the overall business, the Global Mobility (GM) function cannot enable assignees to deliver to maximum effect. Nor indeed, are they able to demonstrate that GM is anything but a manager of cost. Departments supporting GM, including tax specialists, will likely have to be reactive through no choice of their own.

Acting strategically

Consultancies continue to produce surveys informing us about the challenges in Global Mobility. These continue to show that whilst the majority of organisations would like to demonstrate the value that is generated through international assignments, an incredibly tiny number actually claim to do so. The solution to this is relatively straightforward and will be no surprise to those involved in the management of tax.

Unless activities are organised on a strategic basis aligned with the business such that interventions are managed with clear business cases and effective planning, it is incredibly difficult both to evaluate the effect and be perceived to be adding long-term value. The risk which otherwise arises is a reactive focus on task and hence cost. As a result, questions as to the latest issues affecting international assignments (IAs) quickly turn to a discussion of cost management instead of value achievement. This is highlighted by the continuingly high rate of assignments which are described in surveys as being used to plug skills-gaps. Such a justification has the hallmarks of short-term, reactive business practices rather than strategic long-term ones.

A 2016 survey by the RES Forum found that almost 2/3 of respondents said that the objectives of international assignments were achieved. This appears to be positive yet 35% said they did not know whether the achievements were met and nobody stated that they were not met. This failure to identify failure seems extraordinary and draws into question the validity of such responses. Furthermore, it supports the underlying problem that business cases are not undertaken, long-term planning does not follow and hence the true value

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generated is unknown.

Latest trends

The current uncertainty in world trade is undoubtedly affecting the organisation of international assignments. Individuals being asked to move between the UK and EU locations, for example, are nervous about the impact on their rights to work and stay especially when partners and families are involved. From an organisational perspective however, this should simply affect the business case analysis. For example, noting an increase in the cost of persuading people to go and the potential future cost of organising visas or returning individuals home early. Whilst such an EU-based calculation may therefore be more complicated than it otherwise was, an expert should see parallels with organising assignments to other historically more complex countries where such issues have existed for many years.

It would seem undeniable that the amount of political unrest, armed conflict and terrorism is increasing throughout the world and affecting where and how assignees are sent. These factors create an increased need for detailed risk assessments and, for example, the creation of emergency response plans. However, such risk assessments should already have been taking place as part of the business case analysis process. Similarly, the need for assessing such issues should not be surprising if GM is acting strategically, aligned with the business and involved in operational discussions.

Technology continues to offer both new opportunities and challenges for GM. On the one hand it increases the ability to track costs and value. On the other hand, it gives governments the ability to track individuals to question their work status and hence both visa and tax obligations. Strategically technology is more important than the specific organisational requirements of individual countries when considering a single assignment.

The complexity of assignment reward packages continues to grow. This is, perhaps, a function of the VUCA world. Larger organisations no longer have a single approach for all circumstances and this flows through into reward packages. Again, however, this supports the absolute need to have clear business case propositions for every

IA and to understand how they fit with the wider strategic business plan. Otherwise it simply becomes an administrative cost-based activity the value of which cannot be determined.

As the growth of emerging economies continues so this has a knock-on effect on to the number of assignees sent to work there or from there. This trend may of course be affected by both Brexit and Trump to the extent they affect global trade. The ability to predict the outcome of this is extremely difficult. Hence when considering business cases for sending assignees to emerging economies one needs to identify unique or specific risks and adjust the assessment accordingly. Whilst this will be challenging it emphasises the importance of including a section in any business case evaluation template to draw attention to the known-unknowns. Assessing these risks is crucial to demonstrate value.

One final trend to draw attention to is the impact of the increasing diversity in the workforce. These demographic shifts create additional challenges for those involved in Global Mobility. For example, the ability for unmarried partners and their children to travel with an assignee can be a challenge in several countries. Such issues may impact upon the relationship between an organisation's overall Talent Management agenda and its ability to implement it for those individuals affected.

Conclusion

Whilst there is always a desire to understand the latest changes affecting the use of international assignments, organisations with clear processes in place ought to be able to manage these. Unfortunately, the data shows that such processes tend to focus on cost management issues and do not drive or work alongside an organisation's strategic agenda demonstrating value creation. This is where the focus is needed. Tax specialists can have a role in enabling this change simply by continuously challenging those that seek their input on a reactive basis and bringing into play their experience of the benefits generated by working strategically as partners within the overall business.

PROFILE

Phil Renshaw

With a background in international banking, treasury and corporate finance, Phil Renshaw is now an executive coach and an expert in the value of international assignments. He is currently researching this as a Henry Grunfeld Research Fellow and in a PhD at Cranfield University. He can be contacted at phil.renshaw@cranfield.ac.uk.

THE NEW AGE OF TAX TRANSPARENCY

Conrad Law sets out the key features of the new age of tax transparency and looks at the impact on tax audit risk management for multinational enterprises.

Multinationals enterprises (MNEs) have always faced a multitude of different transparency and data disclosure requirements as the international tax environment evolved to deal with the new globalized way of business. Over the last few years, the pace of change of the transparency debate and requirement has significantly quickened. This has a direct impact to the global tax audit and controversy landscape, with the volume of tax audits and disputes expected to continue to rise as a result.

Tax administrations around the world have continued to demand for more, and more readily accessible, information from MNEs. Whereas the tax administrations already have the power to request taxpayers to produce all records, more information than ever before are now available in the hands of the tax administrations that can be used in data analysis and subsequently as part of tax audit challenge material against the taxpayers.

This article provides an overview of some key recent changes in the world of tax transparency and suggests how MNEs should act in light of the increase in tax audits and controversies.

Tax Transparency Initiatives

Global Tax Transparency Initiatives

The early initiatives for "transparency disclosure" was largely industry-focused and voluntary, with the key forerunner being the Extractive Industries Transparency Initiative (EITI) that dealt with transparency over payments made by participating oil, gas and mining companies to governments and government-linked entities, as well as transparency over revenues by those host country governments. Such voluntary initiatives were then followed up by various mandatory regimes, such as the European Union's disclosure rules for large extractive enterprises and logging industry enterprises in the Accounting Directive and Transparency Directive.

At the heart of the new transparency developments is Action 13 of Base Erosion and Profit Shifting (BEPS) project of the G20 and OECD. In this respect, the Final Report on Action 13 recommends that MNEs should prepare transfer pricing documents comprising of three documents: a master file, jurisdiction-specific local files and a country-by-country report (CbCR). Countries are required to implement CbCR requirements as one of the BEPS minimum standards.

Standing alone, the disclosure of the global revenue and profit allocation of the Action 13 initiative including the CbCR reporting may be intended to serve as a "risk assessment tool for the tax administrations". Practically, tax administrations will now be in an unprecedented position to obtain a global picture of where the MNE's profits, tax and economic activities are reported. This information will enable tax administrations to assess transfer pricing and other BEPS risk better than ever before, to use the reported information to perform data analytics and therefore to initiate tax audits.

Regional Tax Transparency Initiatives

The drive for tax transparency has also attracted significant interest from regional organisations such as the EU An example of a recent transparency measure implemented by the EU was the directive adopted by the Council of Europe in December 2015 requiring all the 27 Member States to exchange information automatically on advance cross-border tax rulings and Advanced Pricing Agreements (APAs) from 1st January 2017.

During the first half of 2016, the Council of Europe further adopted the rules for an EU-wide version of the CbCR that will be consistently applied to all Member States, with countries expected to implement the rules into their domestic legislation no later than 4th June 2017. Shortly thereafter, the European Commission issued draft directive on public CbCR that provides for certain information to be publicly disclosed (e.g. available on the company website) in addition to sharing information with the concerned tax administration. Whether such public CbCR may be implemented (requiring qualified majority approval in the Council of Europe) will remain to be seen.

Jurisdictional Transparency Initiatives

Countries have individually begun taking action to enhance tax transparency too in anticipation of the OECD's BEPS recommendations. Examples of this include the UK Finance Bill 2016 that introduced the requirement for qualifying large businesses to disclose their tax strategy as it relates to UK taxation. UK even became the first country to approve the public CbCR in its statute books. On the other hand, half-way around the world, the Australian Tax Office (ATO) developed and implemented Reportable Tax Positions schedules in 2015 – to be completed by certain taxpayers – with regards to their detailed tax positions.

Tax Administrations' Cooperation Initiatives

Once the information becomes available due to enhanced transparency, an effective exchange of information program and cooperation programme will enable the concerned tax administrations to trace and, where necessary, assess cross-border transactions, and these additional information can help support tax administrations to more effectively assess taxpayer in tax audits. While some of these cooperation initiatives may have started a number of years ago, the last few years have seen solid development of membership and activities in conjunction with the advancement in transparency initiatives.

Global Tax Administrations' Cooperation

In a global context, international standards on the exchange of information among tax administrations have been promoted by the OECD, in particular through its framework of the Global Forum on Transparency and Exchange of Information for Tax Purpose (The Global Forum). The Global Forum is instrumental in drafting a new model treaty, the OECD Model Tax Information Exchange Agreement (TIEA), aimed at ensuring that an agreement concerning information exchange can be reached between OECD economies and the other members of the Global Forum as well as other jurisdictions normally cut from mainstream tax treaty networks. The most visible outcome of this has been the significant increase in number of TIEA inspired by the OECD Model in recent years.

On the other hand, the Convention on Mutual Administrative Assistance in Tax Matters, jointly developed by the OECD and Council of Europe in 1998 to provide all possible forms of administrative cooperation between tax administrations in the assessment and collection of taxes, received a significant boost in the recent years because of renewed interest in cooperation by the tax administrations. As of the beginning of November 2016, the latest version of the Convention has been signed by some 106 countries. This Convention provides the legal framework to implement automatic exchange of information between the tax administrations, as well as the legal framework to implement the automatic exchange of CbCR.

Regional Tax Information Exchange and Cooperation Initiatives

Besides the activities of international organisations such as the OECD, tax administrations tend to form networks on a regional basis. These regional frameworks aim to enhance cooperation among tax administrations more directly, and the building up of effective exchange of

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information experience between tax administrations will no doubt have positive impact to their further collaboration. Examples of such regional network include the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC) comprising of 36 tax administrations to deal with anti-avoidance, Study Group on Asian Tax Administration and Research (SGATAR) comprising of 17 Asian tax administrations that cooperate on joint training and experience sharing and the African Tax Administration Forum (ATAF) comprising 36 member countries aiming to develop, share and implement best practices.

Forces in action to further drive tax transparency

In the context of tax transparency, it is worthwhile to note some of the significant forces that are driving its continued development in the last few years.

Public pressure

Whereas, in the past, campaigners against corporate income tax avoidance were either ignored or drowned out, the tide had changed whereby they now find a much more sympathetic ear with the public. The group of external stakeholders has widened too and now also include politicians, the media and social justice activist groups/NGOs whose influence in the development of relevant law and regulation can be significant. They often see direct link between tax and corporate social responsibility, and hence exerting pressure to push for an effective monitoring mechanism through transparency and disclosure.

Public Sector Revenue pressure

The financial crisis has seen tax issues climb much higher on the political agenda, and coincided with increased demand for tax administrations to collect against government budget pressure. Tax administrations can be expected to establish more measures to drive tax transparency in order to facilitate efforts to initiate tax audit challenges, while taxpayer will often be worn down by the ensuing appeal process / uncertainty and come to a settlement.

Transparency facilitated by technological advancement

The advancement of technology has enabled the tax administrations to amass a significant amount of information concerning the taxpayer either at real time or shortly after key milestones e.g. financial year-end. Such aggregation of data sources, together with a new generation of data analytics platforms, are allowing the tax administrations to better identify compliance issues and reap the benefits of transparency when initiating tax audits.

How MNEs should react to new world of tax transparency and manage tax audit risks

The world of tax is therefore very different compared to a few years back. The implementation of new transparency measures globally, regionally as well as nationally, in combination with new tax disclosure requirements will enable tax administrations to scrutinize the taxpayer in a new enhanced way. This will be complemented by increased tax authority resources and new tools intended to leverage on the new data availability. In addition, the drive for transparency through automatic exchange of information will undoubtedly lead to more questions from tax administrations as they gain access to new sources of information such as CbCRs. More tax audits and controversies will arise especially in a transition period where countries may implement the new rules at a different pace. Within this new complex world, the MNE tax function will need to adapt in order to effectively manage the increase of tax audit risks and disputes.

Develop a strong and robust tax risk control framework

Tax audit risks are best tackled at source via the effective control of tax risks in the first place. In this respect, the development of a risk control framework that can identify and manage potential tax issues and risks at an early stage, as well as ensuring compliance with applicable law and be free of material errors, will be of critical importance. A robust tracking mechanism should also be in place to monitor the implementation of tax risk mitigation measures.

Tap into the new environment of cooperative measures

Many tax administrations have propagated cooperative measures e.g. horizontal monitoring, tax ruling, advance pricing arrangement programmes (APA), etc. in order to seek to modernize the relationship with corporate income taxpayers, with a view to more effectively resolve any uncertainty around tax issues. When managed effectively, these measures can provide upside for taxpayers to reduce controversy and tax audit pressure.

Even without formally entering into such a programme, part of the tax audit risk management process should involve pro-active relationship building with the key tax administrations through regular lobbying and engagement, especially in light of increased global enforcement and information exchange across geographies.

Embrace the need to change the tax function

The MNE tax function is forced to deal with a rapidly increasing workload resulting not only from a deluge of new and increasingly complex tax law and other regulation, but also increases in tax audit challenges from tax administrations. Consequently, the MNE tax function must:

- Assess the additional resource (internal and external) that will be required to cope with the increased workload of managing compliance and handling tax audits, and equip itself accordingly.

- Enhance internal processes to manage news ways of cooperation between central and local teams in terms of managing local regulatory developments as well as handling tax issues, tax dispute support and resolution.

- Build linkages to other parts of the organization, not only with respect to tax risk management, but also in securing the proper data support and understanding when handling tax audit responses

Be prepared to deal with the uncertainty

The unprecedented availability of data and information available to the tax administrations and the exchange of information mechanism will give rise to concerns over the inappropriate utilization of such information against the taxpayer:

- Data may be susceptible to misunderstanding and misinterpretation by the tax administrations and initiate tax audits and bring inconvenience to the taxpayers as a result.
- In the context of exchange of information, there may be a risk that countries will fail to reach consensus on the provisions of the multilateral instrument or abuse the provisions of bilateral TIEA.
- There is also a risk that any exchange of information may result in a leak to the press or third parties of business and personal data.

Consequently, the MNE tax function should have a contingency plan in place to deal with the undesirable effects of a more volatile audit and dispute environment.

PROFILE

Conrad Law

Conrad is Tax Director, Tax Risk Management, Huawei Technologies

US TAX UNDER TRUMP – REDUCE, REPEAL AND SIMPLIFY?

David Treitel provides a view on the future and a recommendation to act sooner rather than later

US tax reform in 2017? Yes or No? Aside from nudging clients to get ready for significant change; the tough thing speaking to anyone about US tax reform today is that all the issues mentioned to date seem to be broadly outlined, light in detail and seemingly based on no more than plentiful tweets. The over-arching *theme* of the Trump administration has nonetheless emerged clearly. *Reduce, repeal and simplify*. Based on this limited set of policy objectives, this article highlights the safest individual US tax planning tools available today; *accelerate or defer*.

Reduce?

Trump has kindly promised that we should soon be seeing "phenomenal" tax reform throughout the US tax system. On the individual tax front, Trump talked throughout the campaign last year of simplifying the current seven US tax brackets to just three rates set at 12%, 25% and 33%; the lowest of which is higher than the current lowest rate of 10% and the highest lower than the current highest of 39.6%. Trump has also talked of raising the standard deduction to $15,000 per person.

Repeal?

Trump has also spoken frequently of dismantling the Affordable Care Act (commonly known as Obamacare). To this end, he issued an Executive Order in January permitting the IRS to process individual tax returns even if the return does not indicate whether a taxpayer had health insurance. It seems, therefore, a likely outcome that the 3.8% Net Investment Income Tax (NIIT) surcharge on wealthier taxpayers, designed in 2010 to pay for Obamacare, will be eliminated by the end of 2017. Trump has also proposed to repeal personal exemptions and eliminate the Alternative Minimum Tax (AMT).

There are also strong indications that Trump continues to intend to repeal the estate tax, although its replacement might include a capital gains tax for estates over certain thresholds.

Simplify?

While detailed tax policy proposals are not expected until the full budget, expected to be released around May, the President released a preliminary spending budget for 2018 in March 2017 called "*America First: A Budget Blueprint to Make America Great Again*". This budget mainly made the headlines by arguing for a $52 billion increase in defence spending; but contained no detailed tax proposals at all (unless one includes a commitment to reduce the IRS spending budget by $239 million).

Although a reduction in the number of tax rates and an increase in the standard deduction could reduce tax for many individuals; it seems inevitable with any major change that some groups of taxpayers might be worse off.

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No News? Good News?

Although there is no draft legislation confirming future tax rates or indicating when any tax reform might be implemented, clients will naturally still want to know how they can best plan their finances for unknown and unpredictable tax changes. With few details yet available, the best tax planning today relies on the traditional techniques of *accelerate or defer*. Based on the decently strong assumption that tax rates overall will reduce, especially at the higher levels, it could make sense for many clients to delay income or gains until rates are lower. Equally clients may want to arrange to pay and claim expenses currently while tax rates are higher.

Accelerate or defer?

While US tax rates are seemingly higher now than they are likely to be in the future, a US person might as mentioned above think of accelerating revenue and capital expenses to get tax relief at today's higher tax rates. Equally, it could be helpful to realise capital losses currently so that these can be offset against gains taxed at today's capital gains tax rates. Some clients may want to pay foreign (e.g. UK) tax earlier, in case foreign tax credits are of lower value or use in the future.

Within these broad themes, some clients will have specific opportunities today. For example, because of the sharp fall in the Pound over the past year, US individuals who have UK investment portfolios which show capital gains when expressed in Sterling might want to review their investment portfolios to see if any of the same valuations might result in dollar losses that could be realised at today's US tax rates. The fall in the Pound also presents an opportunity for many Americans in the UK to sell a broad range of investments that might not be considered "US tax friendly"; such as most UK unit trusts, investment trusts and OEICs (these are generally unsuitable for US persons from a tax perspective, because of the anti-avoidance "Passive Foreign Investment Company" rules). While exploiting the fall in the Pound to save tax might appear unconventional tax advice, many Americans in the UK have historically held investments directly and within ISAs and Junior ISAs without adequate consideration of US tax consequences.

For anyone in the UK who wants to avoid all US tax changes by renouncing US citizenship, the fall in the Pound over the past year has reduced the Sterling equivalent of the expatriation tax threshold of $2 million, making it easier for some individuals to expatriate free of a possible US tax charge.

Deciding to defer income or gains is a seemingly obvious choice if tax rates are likely to be lower in the future. At the most extreme end; some people may choose to delay the date of a relative's death by extending life-support until after the estate tax has been abolished. (While keeping grandad on life-support may not be something typically discussed in ADIT Voice, changes in mortality rates based on expected reductions in the rate of tax on death have been observed in the past; economists even have a fancy phrase for the effect, calling it "death tax elasticity".)

More practically, aiming to delay anything that triggers the AMT, such as exercising US qualified incentive stock options, could be prudent as might delaying anything that is likely to be subject to the NIIT; which includes delaying realising capital gains as rates might be lower in the future. For taxpayers with non-US dollar mortgages, delaying paying off capital could also save money; as the US tax rate on foreign currency gains seems likely to be lower in future.

Change? Yes! Now

In a world where no-one can predict future tax policy, using rules that exist today seems to be the best and most pro-active client advice available. Plan for change, but starting changing your client's plans sooner than later.

PROFILE

David Treitel

Frequently quoted as one of the UK's leading experts on American tax, David Treitel is a widely known authority, writer and speaker on US tax. David is Managing Director at American Tax Returns Ltd, a boutique US specialist tax practice in London; dually US and UK qualified and an active member of the Membership & Branches committee of the Chartered Institute of Taxation and the Private Client committee of the Tax Faculty of the ICAEW Tax Faculty. David is also an IRS Certifying Acceptance Agent and represents the ICAEW on the HMRC Expat Forum.

He can be contacted via email at:
david.treitel@americantaxreturns.co.uk.

US COMPREHENSIVE TAX REFORM AND THE DESTINATION-BASED CASH FLOW TAX

William L. Inchoco, provides an insight into these proposals

Efforts to overhaul the US tax system have been the subject of many discussions and countless white papers over the years. From 1949 and to 1986, attempts by both sides of the aisle to simplify the tax code through bipartisan legislation fall short of expectation. The medley of amendments only add to the already complex and intricate web of existing tax provisions that fail to address the myriad of issues made worse by the explosion of digital commerce. Fundamentally, this is the natural consequence of patchwork legislation introduced outside the realm of comprehensive reform.

The GOP (the Grand Old Party – the Republicans) has been touting tax reform recently and has actually produced a 35-page blueprint as a starting point. While the blueprint carries with it some serious and radical ideas, the GOP never really thought that their plan would be seriously considered until the new incumbent President was elected to the White House. Piggy-backing on the GOP idea, the new administration is now looking to restart the discussion.

The GOP Tax Reform and Destination Based Cash Flow Taxation

The GOP plans sweeping changes in the tax code specifically in the area of corporate income tax. Chief among its ideas is the introduction of the so-called "destination based cash flow taxation" (DBCFT). The key feature of this DBCFT concept as it applies to business tax is the application of the "border adjusted" tax that would significantly change the way the tax code works for corporate entities.

What is DBCFT?

Currently, the US Tax Code taxes corporations on domestic income on a net basis under a source-based principle. This means that costs, to the extent allowed, are deductible from gross income and the net taxable income is subject to the 35% marginal tax rate. Capital expenditures are depreciated, amortized or written off over a number of years. US companies with operations outside the country are not taxed on their profits earned until repatriated to the US via dividend (unless exception applies).

The DBCFT has a different idea.

Key features of DBCFT are as follows:

- Corporate tax rate of 20%
- Profits earned outside the US are not subject to tax
- No depreciation for capital investment (but allows full expensing at year of purchase)
- No deduction on interest expense
- Corporate tax is "border adjusted"

What is Border Adjustment?

DBCFT is achieved through border adjustment tax where exported goods and services are not taxed and imported goods are subject to tax. As implied by its name, DBCFT is anchored on the destination principle where taxation happens only in the place where goods are consumed. In other words, tax is levied based on where the goods and services end up and not where the goods are produced and services originated. This in fact is the very principle that governs the Value-Added Tax (VAT) system – a system of taxation that imposes tax on the consumer; hence, called a consumption tax. Under

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VAT, tax is imposed in the place of consumption of goods and services rather than the source of income or the residence of the taxpayer.

It is worth noting that the border adjustment tax is primarily the fundamental concept of the VAT system, which has been adopted by more than 150 countries in the world including most of the OECD member countries. This tax system is the main source of revenue for most countries alongside corporate income tax. While the US has hitherto been most adamant in adopting the VAT system, it is now considering applying this principle to business taxes in a modified form.

The Border Adjusted Business Tax

The marriage between the principles of VAT and the border adjustment tax as it applies to corporate tax calls for the non-taxation of goods and services that cross the border and the taxation of goods and services that are imported into the US. Pure cash-flow taxes are commonly viewed as consumption rather than income taxes. Nevertheless, the GOP refuses to call DBCFT a VAT despite its clear semblance to the mechanism that makes up the VAT.

The question therefore arises as to whether DBCFT is a form of tariff as it taxes imports and not exports. In addition, there is also ambiguity as to whether the DBCFT is an instrument aimed at advancing protectionism that subsidizes exports (by exempting them from tax) and discourages imports since the latter is subject to tax.

How DBCFT Will Be Implemented

It appears that the 35-page GOP blueprint is short on implementation details and will have to answer questions on how this radical shift in tax concepts will be implemented and administered, as well as the costs it entails to the IRS and its compliance burden on the taxpayers.

The Economists' Arguments

While there seems to be an impression that exports are favored and imports are discouraged in the DBCFT model, some economists and academics believe that this notion will be quickly corrected as exchange rates and prices are adjusted. It is believed that the level of exports and imports should be at the level they were once before the DBCFT is implemented bringing market equilibrium.

Others argue that there may be an issue of perception to the common taxpayer as MNCs exporting goods and services may not have to pay any US tax despite billions of earnings each year, while small business owners who import goods and sell locally may be liable to US tax.

There is also a question as to whether DBCFT will preserve the principles of capital export neutrality in which business decisions are not supposed to be affected by tax rules. Consider the impact of a traditional IP planning, as an example. On the one hand, if a US MNC has IP sitting offshore, DBCFT may increase the US tax of the MNC if it will import the IP by way of rights to use and exploit the same from its offshore location. On the other hand, exporting IP offshore may result in non-taxable royalty income to the US MNC, which enables the foreign affiliate to deduct expenses related to the acquisition of the IP. Whether this is sound policy is yet to be tested.

The WTO

Many tax experts have sounded the alarm that an income tax with the border adjustment feature will not pass the WTO's scrutiny. Recall that in the late 90's, the WTO struck down a US tax provision that purportedly subsidised exports in now defunct FSC rules.

The Unknown

With this new-look corporate taxation, questions are beginning to surface. What will happen to the 68 bilateral income tax treaties the US signed with other countries? Will they be rewritten? What about the Section 482 rules? Since there will be no incentive to park profits abroad, will transfer pricing go away? What about Foreign Tax Credit? Will FTC still work? Are US corporations paying taxes abroad going to be able to continue to reduce US taxes through the credit mechanism? These are just a few of the questions surrounding the DBCFT.

With the many questions surrounding the concept coupled with the seemingly gargantuan task of rewriting existing tax principles, it appears that there is more harm than benefit with DBCFT. DBCFT carries with it a prima facie sense of welcome change, but it is presumable that the negative effects will immediately outweigh its suggested benefit.

PROFILE

William Inchoco

William Inchoco, J.D., ITP/MPA, is an International Tax Director with BlumShapiro. BlumShapiro is the largest regional business advisory firm based in New England, with offices in Connecticut, Massachusetts and Rhode Island. The firm, with over 450 professionals and staff, offers a diversity of services which includes auditing, accounting, tax and business advisory services. In addition, BlumShapiro provides a variety of specialised consulting services such as succession and estate planning, business technology services, employee benefit plan audits and litigation support and valuation. The firm serves a wide range of privately held companies, government and non-profit organisations and provides non-audit services for publicly traded companies.

UNION BUDGET – SENSIBLE YET OPPORTUNITY MISSED

Parthasarathi Shome provides a view of the recent Indian Budget

A nation's Budget should ideally inspire. This one was, instead, workman like, perspicacious in policy aspects while lacking in administrative ones. Reflecting limitation of space, I shall take up only fiscal policy followed by tax policy and administration. To begin, while the Fiscal Responsibility and Budget Management (FRBM) Review committee recommended that fiscal deficit should be 3 percent of GDP, government has fixed it at 3.2 percent for 2017-18. This may seem amiss; however, it reflects capital expenditure rather than revenue (consumption) expenditure of government. Indeed, revenue deficit is projected to decline to 1.9 percent (though FRBM would allow 2 percent), from 2.1 percent in 2016-17. This is fine in an environment of lacklustre private investment.

Concerning the business sector, the prominent salutary measure is reduction of the corporate income tax (CIT) rate to 25 percent for 96 percent of return filing companies. This was direly needed for investment from the (Micro Small and Medium Enterprises) MSME sector. The other 4 percent larger companies enjoy lower effective tax rates but bringing down their headline rate should not be long postponed from an international competitiveness perspective. Interestingly, the annual revenue loss due to this measure is only Rs 72 billion (approx. £865m) – a miniscule percent of total tax or expenditure. Thus the intelligent follow-up policy would be to make this sector pay their legitimate tax share through expanded taxpayer base which FM assured.

Corporations have to pay the higher of CIT and Minimum Alternate Tax (MAT). MAT's unanticipated extensions to new productive activities have exacerbated uncertainty in business decisions but, if left alone, it is a good tax that enhances equity among taxpayers. The extension of MAT loss carryover from 10 to 15 years is a rational measure for evening out tax payments and improving MAT's acceptability. On the other hand, the change in long term capital gains definition from three to two years is arbitrary for, indeed, it differentiates income and capital gains even more starkly while ideally they should not be separated.

In international taxation, removing taxation of indirect transfers that take place abroad of foreign portfolio investors on India-based assets is welcome. It was long overdue and reflected a flaw in the tax structure. Also, the Indian tax administration's excessive transfer pricing (TP) audit practices is internationally well known. Thus, limiting transfer pricing audit of domestic companies to only those with profit-linked deductions should contain an explosion of domestic TP audit cases. However, a gross omission was any mention of ongoing training for GAAR application from April 1 given the adverse experience with TP application.

Moving to individual income tax, it is not clear why the tax rate was reduced from 10 percent to 5 percent for the Rs 0.25-0.5 million bracket. Just an inflation adjustment would have corrected for fiscal drag. FM read out a long calculation of beneficial tax saving within this group reflecting routine such calculations of the income tax department. It appeared more as an election preparatory item than being based on economic rationale. On the other hand, the 10 percent surcharge introduced for the Rs 5-10 million bracket is justifiable. It is to be conceded that the composite package comprises a direct income transfer from the top to the lower tax brackets.

Now to tax administration. The World Bank ranks India at 172 in the ease of paying taxes among 190 countries. The Budget proposals will not improve this since they contain little fundamental tax administration reform despite the Tax Administration Reform Commission's

(TARC) deep recommendations. The group that invented the term ‘tax terrorism” is sinking rapidly into it. FM’s single sentence, “I would like to assure everyone that honest, tax-compliant person would be treated with dignity and courtesy” fails to reassure. The one-page Form proposed for individuals with taxable income less than Rs 0.5 million (other than business income) is good on paper. By international standards, however, Individual Tax Return Forms continue to be complex, often not comprehensible, and sometimes perhaps not above the law—for example where asking for information on financial and real assets in a Form for income tax when there is no tax on wealth. This is where lack of conviction or understanding of fundamental tax administration reform reveals itself.

On a salient note, the Finance Minister (FM) frankly reported on GST preparations—albeit a poorly designed tax that does not stand up to international scrutiny—thus indicating what the remaining tasks comprise. When exactly those tasks would be successfully completed was not clear though the indication that GST taxpayers would be informed and consulted from April 1 was welcome—though, if GST is to be implemented from September-October, the stakeholder consultation period is utterly short by international standards.

To conclude, the tax policy announcements and the overall fiscal framework cannot be heavily faulted; indeed, many aspects should be praised. However, tax policy is only one palm. For a namaste, the other palm – tax administration – has to be offered. This part is missing for FM did not delineate it convincingly. Successful demonitisation—other than, as implemented, its deeply harmful effects on the poor—is certainly good for reducing tax evasion. But, again, the quid pro quo has to be ensuring and elaborating on the design of tax administrator behaviour. It is not just putting a distance between taxpayer and tax administrator through policy for, ultimately, that would merely skirt the crux of the problem. FM expressed preoccupation with lagging private investment. It will not improve much without fundamental administration reform.

Profile

Parashati Shome

Parashati Shome is Chairman, International Tax Research and Analysis Foundation, www.itraf.org. This article was first published in Hindustan Times, New Delhi, 3 February, 2017.

CIOT CONSULTATIONS AND SUBMISSIONS

The CIOT aims to include input from its members in its responses to consultations, including those issued by HMRC, HM Treasury and the European Commission. This is done via our sub-committees and each sub-committee considers and makes representations to Government on consultations, legislation (existing or proposed) or other material within their remit. The responses below have been taken from the International Tax sub-committee and the EU&HR sub-committee.

International Tax and EU&HR submissions: November 2016 – present

21 January 2017: Economy, Jobs and Fair Work Committee of the Scottish Parliament – Call for Evidence on the Economic Impact of Leaving the European Union
The CIOT's response focused on tax implications for Scotland's exporters, non-UK companies investing in Scotland and on potential labour market issues. Due to space constraints, we merely highlighted key issues. The response took as its baseline the position if no agreement is reached between the UK and the EU under Article 50 of the Treaty on European Union (TEU).
www.tax.org.uk/ref218

1 February 2017: Draft FB17 Clause 20 Schedule 6: Carried-forward losses
The proposed new rules reforming the treatment of corporation tax losses go beyond the stated policy aim and place unnecessary burdens on taxpayers.

The Finance Bill clauses on carried-forward losses and the corporate interest restriction were dropped from the Finance Bill due to the general election, but are expected to be re-introduced into a post-election Finance Bill.
www.tax.org.uk/ref253

4 February 2017: Draft FB17 Clause 21 Schedule 7: Corporate interest restriction
In addition to raising concerns around some aspects of the detail of the proposed new rules, the CIOT tackled the implementation of the new rules for a corporate interest restriction, saying that the legislation has been rushed through without sufficient time for full consideration.
www.tax.org.uk/ref254

10 March 2017: Hybrid and other mismatches – draft guidance
www.tax.org.uk/ref286

YOUR ADIT VOICE

ADIT Voice is also published on the Tax Adviser website

Students, members and international tax affliates will be able to access ADIT Voice, together with its related articles at taxadvisermagazine.com. Initially the site will not require a password but in due course you will need login details to access it.

Publishing on the web will allow us to provide more information to members as well as reaching a wider audience but we would really like to hear your feedback. What do you find useful? What do you want more (or less) of? – please email us at technical@ciot.org.uk

The taxadvisermagazine website has undergone a revamp recently and now has an easy to search function for Personal Tax content under the 'Feature' and 'Technical' tabs. You can also access Tax Adviser magazine via the NewsStand app on a variety of smart devices. The app can be found on the Apple Store (under Tax Adviser (CIOT)) and the App Store via Google Play.

THE LATEST NEWS FROM THE ADIT TEAM

With awareness of ADIT continuing to grow around the world, it is fair to say that been a busy few months for the ADIT team as we look to further build upon the qualification's reputation as a global benchmark in international tax learning.

Our promotional activities have taken members of the ADIT team to international tax events in four countries, while the number of tax professionals pursuing the ADIT qualification and sitting exams around the world continues to climb.

We will be introducing some exciting new ADIT developments over the course of 2017, so for the latest news please continue to visit the ADIT Noticeboard at www.adit.org.uk/noticeboard or keep up-to-date with ADIT news on the go via our LinkedIn group (www.linkedin.com/groups/2314603) and Twitter feed (@CIOTADITStudent).

Making an event of it…

Since the last edition of ADIT Voice, ADIT has been exhibited at the IFA Annual Congress in Madrid in October, the Norwegian Petroleum Society's 27th International Petroleum Tax Conference in Oslo in November, and the Tax Executives Institute's Tax School in Houston in February. The latter two of these events were attended by a large number of international tax professionals from major corporate firms, and enabled us to promote ADIT exam options that are of particular interest to in-house tax professionals, such as the Upstream Oil and Gas and Transfer Pricing options.

In March, ADIT was promoted at two major international tax events in London. The TP Minds International summit took place on 7 and 8 March, and showcased a number

CIOT Education Officer Rhiannon Pardoe and ADIT Committee member Conrad Law at TP Minds International 2017 of prominent international tax thinkers, including ADIT Academic Board members John Avery Jones, Philip Baker and Jefferson VanderWolk, on a variety of transfer pricing topics. The Kings College London and CIOT London Branch held an International Tax Conference on 14 March with an agenda that included an ADIT presentation alongside a range of European tax features delivered by leading experts.

…with help from the ADIT community

We were supported in our activities at the London events by ADIT Committee members Conrad Law ADIT, Tax Director at Huawei, and Jonathan Schwarz FTII, Barrister at Temple Tax Chambers and Visiting Professor at King's College London. We offer our thanks to Conrad and Jonathan for their assistance in promoting ADIT!

We are always grateful for the opportunity to collaborate with members of the ADIT community in promoting international tax learning and the ADIT qualification to audiences around the world, so if you would like to be involved in promoting ADIT at a forthcoming event – or if you know of an opportunity for us to engage with potential ADIT students and employers – please get in touch with us via email at info@adit.org.uk.

Records tumble again

We're delighted to report that the June 2017 exam session will be the biggest in ADIT's history, with over 1,000 entries received from students at approximately 50 exam centres around the world. ADIT exams will take place for the first time in Austria, Cameroon and Papua New Guinea, as the global network of international tax practitioners pursing ADIT continues to expand.

2016 saw more than 700 new ADIT students registered onto the qualification, and the ADIT population currently includes approximately 2,500 students in addition to nearly 600 graduates and International Tax Affiliates who have completed the qualification.

And finally…

We will be exhibiting ADIT again at this year's IFA Annual Congress, in Rio de Janeiro, between 27 August and 1 September. As usual, we look forward to meeting with members of the ADIT community in attendance as well as international tax leaders from organisations around the world. To reserve your place, visit www.ifa2017rio.com.br.

Rory Clarke
CIOT ADIT Examinations Manager

CONTACT US

Suggestions?

If you have any suggestions for further articles, please let us know: technical@ciot.org.uk

To contact Sacha Dalton, CIOT technical officer, International Taxes and EU&HR Sub-Committees, please email: sdalton@ciot.org.uk

To contact Will Silsby, ATT technical officer, please email: wsilsby@att.org.uk

To contact Rory Clarke, CIOT ADIT Examinations Manager, please email: rclarke@ciot.org.uk

Editorial Team

Editor-in-chief	Chris Mattos CTA ATT	cmattos@ciot.org.uk
Editor	Lakshmi Narain CTA	lnarain@ciot.org.uk
Designer	Sophia Bell	sbell@tax.org.uk