Taxes

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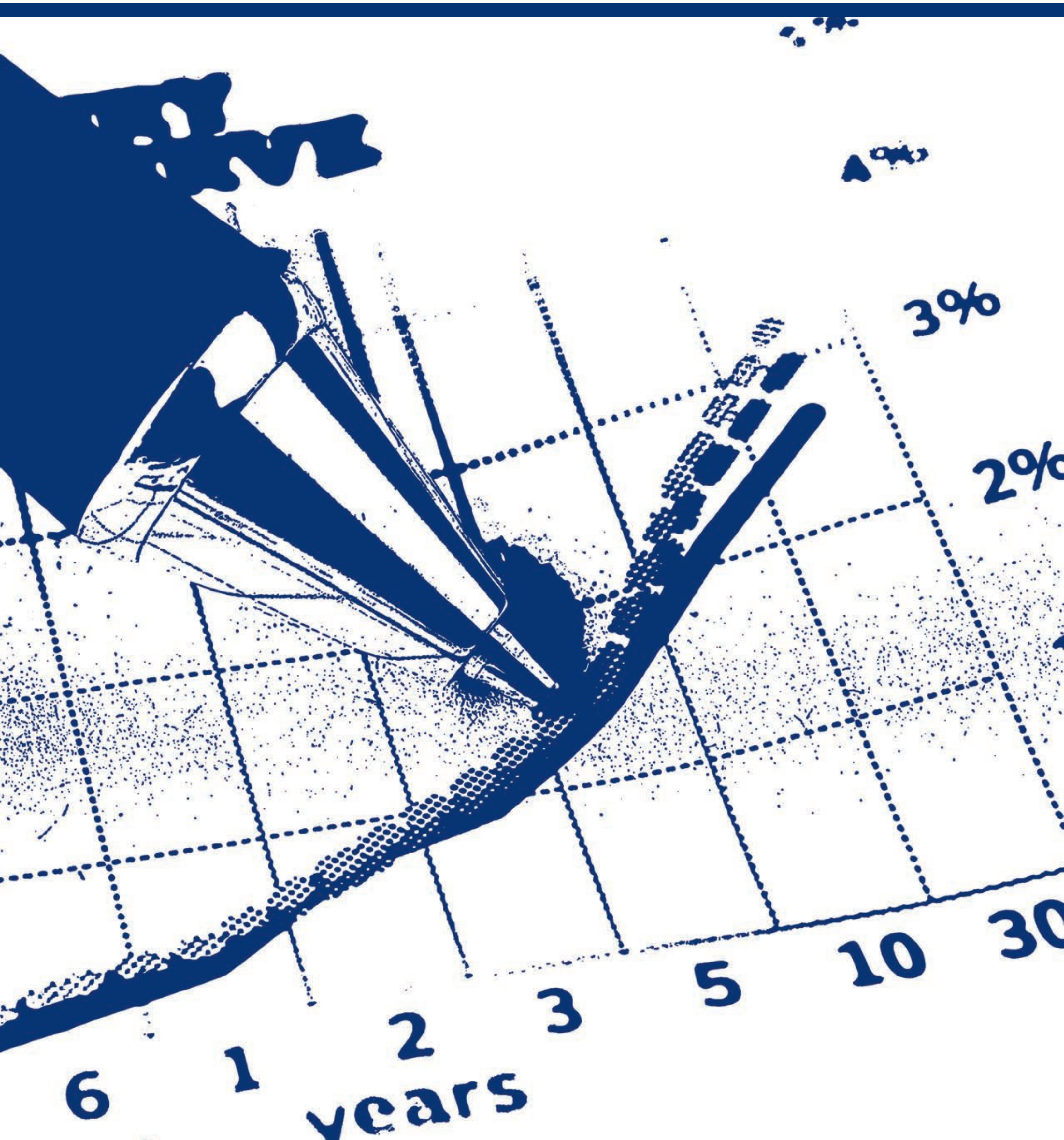

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would simply be warranted if there was a resident (paying agent in Japan) and the income is paid to that resident. As this was the case, it was held that the lower rate of withholding tax should be applied. Therefore, beneficial ownership provisions should not be retrospectively read into the treaty.

Panel discussion

The judges then set themselves and the Co-Chairs a number of questions.

If there is no beneficial ownership clause incorporated into the relevant tax treaty should the concept of beneficial ownership still apply?

As stated, the opinion of the Brazilian judge was that if a beneficial ownership clause was not incorporated within a tax treaty, then it should not be impliedly or retrospectively added. The remainder of the panel echoed this opinion. At the time both parties sign a tax treaty, each is aware of the others' tax regime and this knowledge is brought to the table when the treaty is being agreed. If the treaty does not include a beneficial ownership clause, the view was that the parties had either not agreed to it or considered it.

Is OECD Commentary binding or is it a tool for guidance?

The panel was in agreement that the OECD Commentary could only be seen as 'commentary and nothing more'. The Commentary is not legally binding and, therefore, is only to be used as an interpretive tool when considering the application of a tax treaty.

Should the definition of beneficial ownership include an anti-avoidance test?

In summary, it was felt that a clear definition of beneficial ownership was required and that it may not be appropriate to include an anti-avoidance test. Whilst it was noted that many countries are adopting GAARs, it was considered that treaties are international by their nature and, therefore, international interpretative tools and concepts should be applied. It was not deemed appropriate to unilaterally 'amend' or circumvent a two party agreement by introducing local tax legislation or rules.

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Base erosion and profit shifting: views from Peru, Brazil and Mexico

Friday 14 June 2013

Co-Chairs
Sam Kaywood *Alston and Bird, Atlanta*
Raquel Novais *Machado, Meyer, Sendacz and Opice Advogados, São Paulo*
Elinore J Richardson *R and Co Consulting, Toronto*

Speakers
Monica Calijuri *Peer Review Group (PRG) of the Global Forum on Transparency and Exchange of Information for Tax Purposes, São Paulo*
Oscar Molina Chie *Tax Revenue Service, Mexico City*
Enrique Vejarano Velásquez *National Customs and Tax Administrative Agency, Lima*
Gustavo Lazo *Estudio Olaechea, Lima*

Introduction

It is no secret that governments worldwide view protecting their tax bases from erosion to be an issue of the highest importance.

The differences in countries' domestic corporate income tax laws facilitate the use of international tax-planning structures and transactions that can, within the constraints of these laws, substantially reduce or even eliminate the tax liability of a multinational enterprise (MNE). For their part, governments are seeking ways to limit the extent to which such international tax planning provides insulation from tax liability. This is generally easier said than done. From the point of view of the governments, it is a constant struggle to obtain information as to the planning which is being done and to adapt their laws to keep pace with the ever changing and increasingly complex international business environment.

The governments of Peru, Brazil and Mexico are no exception. Emerging economies have generally been eager to attract investment, slower in developing their tax rules and less effective at collecting and exchanging information concerning their own taxpayers and those making investments within their borders, making them attractive to foreign MNE investors. At the Government Roundtable discussion during the US-Latin American Tax Planning Strategies Conference in June of 2013 in Miami, Florida, representatives from each of these countries commented on tax policy and recent legislation, transparency and related issues such as the exchange of information, treaty negotiations, tax avoidance and transfer pricing as they offered insights into the unique problems, techniques and developments in each of their respective jurisdictions.

Peru

Enrique Vejerano Velasquez from the National Customs and Tax Administrative Agency in Lima, Peru discussed recent changes in the Peruvian tax regime with Elinore Richardson and Gustavo Lazo.

Mr Velasquez explained that Peru's economy is growing and that Peru is now playing a greater role in the international economy. Peru's GDP and foreign exchange reserves have been steadily increasing over the past ten years, and foreign direct investment, imports and exports are also on the rise. Additionally, Peru is a party to 16 trade agreements, including agreements with the European Union, the United States, Canada, Mexico and China. Overall tax revenues are climbing, and Peru seeks to continue this trend. The Peruvian tax administration is the Superintendencia Nacional de Aduanas y de Administración Tributaria (SUNAT) and has the goals of gaining proficiency in international taxation and being a model in South America.

Similar to governments in so many countries, the SUNAT views transfer pricing as a very important issue. In 2010, transactions subject to transfer pricing regulation represented 25 per cent of Peru's GDP and 60 per cent of its total trade commerce operations. Transfer pricing rules were first introduced in Peru's income tax regulations from 2001–2003, and over the years, they have been developed to better suit the government's objectives. For example, under prior law, when related parties engaging in a transaction agreed to a certain value that did not reflect the market value, both negative and positive pricing adjustments were made to make the agreed value commensurate with market value. However, sometimes this adjustment would actually reduce the tax the parties owed. Therefore, the law has been amended to restrict adjustments to those which are made only to increase the tax liability.

Two other transfer pricing related developments include changes to advance pricing agreements (APA) and to regulations which add a 'sixth method' of valuation. Previously, APAs were only available for resident taxpayers solely regarding international operations. However, this proved to be unnecessarily limiting and for this reason, the SUNAT will now consider APAs in cases where transactions occur either between residents (ie, not an international transaction) or where the transaction includes a foreign resident of a jurisdiction with which Peru has entered into a double taxation convention. Prior to the 'sixth method' regulation, commodities could be valued according to any of the five enumerated OECD transfer pricing methods. However, the Peruvian government concluded that taxpayers were manipulating values through the use of timing and tax havens. Therefore, a sixth method of valuation has been introduced into the regulations which permits the Peruvian government to set the price of commodities by reference to an international price. This set price considers the quoted price at the time of shipment (seeking to eliminate the use of timing strategies).

Peru also has concerns that its tax residents are deferring passive income through the use of intermediary companies located in tax havens. Peru taxes its residents on worldwide income and tax on passive income is due when the income is actually received. Peruvian tax residents were consequently able to defer income using a foreign nominee company. To combat this, Peru introduced a special anti-avoidance rule that disallows income deferral and attributes income of a non-resident company to its related Peruvian resident shareholder when certain conditions are met:

(i) the Peruvian resident owns at least 50 per cent of the foreign nominee company; and

(ii) the foreign nominee company is located in a tax haven or any other jurisdiction in which the tax burden is less than 75 per cent of the Peruvian rate of tax. This rule allows Peru to tax its residents on passive income earned abroad in low-taxed intermediaries in the period in which it is earned.

Peru is also concerned about increasing international fiscal transparency. It is strengthening its existing double tax treaty network and currently has in effect double tax conventions with several jurisdictions (Chile, Canada, Brazil and the countries of the Andean Community) that include information exchange provisions. Peru has signed, but is not yet enforcing, additional agreements with several other countries, including Mexico and Switzerland.

A key focus of the Peruvian government has been the ability of foreign investors to avoid Peruvian tax on the indirect sale of Peruvian companies. Gains from the sale of shares of a Peruvian company are considered Peruvian-sourced income; however, gains from the sale of a foreign company that owns those shares were not. To counter the use of intermediary companies created with no other purpose than to hold shares of Peruvian companies to avoid Peruvian tax, Peru has introduced a system of upstream taxation which deems the gains on sale of such companies to be Peruvian-sourced income.

Peru has also adopted a general anti-avoidance rule to fight 'fraud of the law'. The phrase 'fraud of the law' refers to tax planning that does not expressly violate the law, but accomplishes goals that the Peruvian tax legislation did not intend. Prior to this general anti-avoidance rule, the government could only pursue cases where contracts were drafted to distort the reality of the deal. Proving fraud of the law looks a lot like an economic substance approach – the Peruvian tax administration must prove that the challenged transaction creates the same economic consequences as another, but that it creates tax advantages that would be unavailable if the transaction were structured differently. Anti-avoidance rules also apply to prevent deductions from wash-sales and losses between related parties.

The discussion concluded as Mr Velasquez noted that international tax and transfer pricing are new topics in Peruvian tax legislation. However, the Peruvian government has been developing its laws with the goal of fighting tax avoidance and, to that end, is working with international organisations, government-related sectors and representative entrepreneurial organisations.

Brazil

Raquel Novais introduced Monica Calijuri from the Peer Review Group of the Global Forum on Transparency and Exchange of Information for Tax Purposes based in Sao Paulo, Brazil and, together, they discussed current tax issues in Brazil.

Ms Calijuri mentioned that Brazil has had several recent developments in the area of international tax law, and further legislation is currently being evaluated.

In particular, Ms Calijuri noted that Brazil's Supreme Court recently issued two rulings affecting the ambit of legislation that established Brazil's controlled foreign corporation (CFC) regime (Article 74 of Provisional Measure 2,158-35/2001, 'Article 74'). In one decision, ADI 2588, the Court held that while the controlled foreign company rules apply to make available to a Brazilian taxpayer the income of its foreign corporations in tax haven jurisdictions, these rules will not apply to income earned by foreign corporations of a Brazilian taxpayer not located in tax haven jurisdictions. That decision is binding on all taxpayers and the Brazilian tax administration. In another decision, RE 541090, the Court ruled that the CFC rules applied to income derived by all CFCs (in that case located in Italy and China) of a Brazilian taxpayer. This latter decision is binding only on the subject parties.[1] While the Court's holdings are known, as of the time of this writing the full publications of the decisions have not been issued. It is expected that the Supreme Court will issue guidelines given the wide-ranging effect of the Brazilian CFC rules and the absence, at this stage, of consistency by the Brazilian courts.

Ms Calijuri also discussed the role of information exchange agreements from a Brazilian perspective. While double taxation agreements are in place, Brazil has experienced difficulty in identifying ultimate investors into Brazil and in monitoring their activities so as to properly assess the resulting tax consequences. This has a significant impact on tax collection. To that end, the Brazilian government is moving forward on information exchange agreements. For example, Brazil has now authorised the enforcement of the tax information exchange agreement previously signed with the US in March of 2007. Ms Calijuri stated the government is not sure how this agreement will play out, but that it is related to the most relevant tax topic in Brazil at the moment: base erosion and profit shifting (BEPS).

Recent changes in transfer pricing were also discussed. Ms Calijuri highlighted two important changes in Brazil's transfer pricing rules. For context, Brazil has not adopted the OECD arm's length principle in its transfer pricing legislation. Brazil's resale price method (PRL) included in the tax regulations provide for fixed profit margins based on the type of commodity and industry. The prior rule required a 60 per cent profit margin for inbound products to be used in production and a 20 per cent margin on imported products for direct resale. The first key change is that required profit margins are now 20 per cent, 30 per cent or 40 per cent, depending on the economic sector. The taxpayer may, however, take the position that the margin is not adequate to the business and can request a change of margin. The second key change is that for intercompany transactions involving commodities, the average trading price on the date of the transaction will now be the applicable transfer price.[2]

On the general anti-avoidance front, Ms Calijuri emphasised the need to fight abusive transactions. She noted that there have been a number of studies relating to general anti-avoidance rules in Brazil over the past few years. While there is nothing new to report on the legislative front, the government has carved out specific issues, such as limits on deductions for interest paid to a related party.

Mexico

Oscar Molina Chie from the Tax Revenue Service in Mexico City, Mexico and Sam Kaywood reviewed various issues relating to Mexico's tax regime.

Mr Chie began by emphasising that the Mexican tax administration is very technical and not heavily influenced by the political climate. However, he pointed out that President Enrique Peña Nieto is a strong president who may be able to achieve tax reform in Mexico, reform that the treasury department has been unable to accomplish in the last several years.

Mr Chie mentioned, in particular, the success Mexico has had with its most recent amnesty programme, which began on 1 January 2013. Taxes collected under this programme have resulted in four times the revenue collected under the 2005 programme.

Mr Chie also discussed Mexico's tax agenda, which has two components. The first is domestic, focusing on very aggressive local tax planning which facilitates employees reporting diminished income and social security tax for Mexican tax purposes. The second has an international focus, as Mexico is very sensitive to the international climate, and is aimed at preventing BEPS. In this regard, over the next few years the Mexican government will be focusing on how to challenge and collapse complex structures in order to identify and tax Mexican-sourced income. Often, the Mexican tax administration knows taxpayers are not honestly reporting company operations. For example, a taxpayer may present its company structure showing entities as operating abroad. However, in reality, there is substantial direction and activity occurring in Mexico with many calls being made to the US (and no US connection is revealed).

In the transfer pricing area, the Mexican tax administration is also currently raising transfer pricing issues related to the sale of goods and services made into the Mexican market.

Mr Chie commented on the tax exemption that applies to the sale of stock through the Mexican Stock Exchange (Bolsa). He stated that this rule was originally intended to provide an exemption to the general public, but that the exemption is being used beyond that original purpose. For example, in 2004, a Mexican bank sold stock to Citibank through the Bolsa and took the position that they were entitled to the exemption. The tax administration conceded. In 2008, the legislators introduced reform seeking to limit the extent to which the exemption could be used.

Mr Chie also noted that the Mexican government is seeking to fight against aggressive tax planning through changes to the manner by which the tax regime is administered. This represents another area of change in Mexican tax policy. To illustrate, several years ago taxpayers could apply for a ruling with respect to a particular tax-planning issue. If the ruling was not issued in its favour, the taxpayer could challenge the ruling in the tax court. As one might expect, rulings were constantly being challenged, undermining the effectiveness of the Mexican tax administration. By contrast, currently taxpayers may apply for a ruling in relation to their planning, but the sole way to challenge the ruling is through an audit.

The Mexican tax administration previously proposed a general anti-avoidance rule, but it was not approved by the congress.

Conclusion

The Government Roundtable illustrated clearly that Peru, Brazil and Mexico are each in their own ways facing international and domestic tax issues common to governments worldwide. Each is continuing to develop its domestic tax regime, international treaty and other relationships to more effectively respond to those issues.

Notes

1 For further information on this topic, see the conference materials of Marcos Neder, Trench, Rossi e Watanabe Advogados, São Paulo, Brazil from the panel entitled 'Outbound Investment from Latin America'.

2 For further information on this topic, see conference materials of Ana Cláudia Akie Utumi, TozziniFreire Advogados, São Paulo, Brazil from the panel entitled 'Transfer Pricing: Audit and Litigation Developments'.

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You can run, but you can't hide: the current state of play in relation to Australia's Commissioner of Taxation obtaining taxpayer information

Introduction

The expansion in the number and size of foreign operations of Australian taxpayers, Australian operations of foreign taxpayers and the growing pressure on the Commissioner of Taxation[1] (Commissioner) to collect the appropriate level of revenue have emphasised the importance of enforcing taxation obligations associated with both domestic and international operations of Australian taxpayers. A prerequisite to the Australian Tax Office (ATO)'s tax enforcement efforts, domestically and internationally, is the collection of relevant information on taxpayers activities. Therefore, an effective and efficient process of collecting adequate amounts of usable information is crucial to the success of the Commissioner and ATO in their tax enforcement task.

In this context, the purpose of this article is to discuss the Commissioner's information gathering tools and his use of those tools, both domestically and internationally. In discussing the state of play in Australia, this article will also draw on a couple of recent cases to illustrate the scope of the Commissioner's more commonly used information gathering tools and powers and concludes that perhaps, the theme going forward will be 'you can run, but you can't hide'.