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Briefing

International review for July

Speed read

Despite Covid-19 still dominating government agendas, July saw a number of developments, including: a high profile win for Ireland in the Apple state aid case; the announcement that the US would impose tariffs on France in retaliation to France's digital services tax; and publication of an ambitious new package for fairer and simpler taxation by the EU. For the first time, the OECD has published anonymised and aggregated country by country reporting statistics, which highlight the importance of investment hubs for intercompany transaction flows within multinational enterprises. Finally, the anticipated six-month deferral of the DAC 6 reporting deadline has been adopted by most EU member states, although Germany, Finland and Austria are pressing ahead with the original timelines

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Ireland wins state aid case

The General Court of the European Union has found that two Irish tax rulings issued in favour of the multinational corporate group, Apple, did not constitute illegal state aid given by Ireland (Cases T-778/16 and T-892/16). The two contested tax rulings issued in 1991 and 2007 by the Irish tax authorities endorsed the transfer pricing methods used by group companies in determining the chargeable profits attributable to their Irish trading branches. The European Commission had previously found that the tax rulings in question constituted state aid, unlawfully put into effect by Ireland and demanded the recovery of the aid in question (determined to be €13bn). The General Court's judgment annulled the Commission's decision on the basis that it did not 'succeed in showing to the requisite legal standard' that there was a selective advantage for the purposes of article 107(1) of the Treaty on the Functioning of the EU'.

The Commission had contended that the Irish rulings in question resulted in an unfair advantage. The Commission had argued that, insofar as the head offices of the Irish entities were unable to control or manage the group's intellectual property licences, those head offices should not have been allocated the profits derived from the use of those licences and that instead these profits should have been allocated to the Irish branches. This argument was dismissed as the court found the intellectual property not being managed by the headquarters did not automatically mean it was managed by the branches. The licences in this case were actually managed by US-based executives. In addition, the Commission claimed that the Irish rulings relied on benchmarking studies with methodological errors. The court dismissed this on the basis that the methodology did not prove 'an advantage has actually been granted, in as much as such an error has actually led to a reduction in the tax burden of the companies in question'.

The court also noted that discretion applied by a member state in giving a ruling does not itself mean it engenders a selective advantage. To prove selectiveness, discretion needs to be broader, for example involving considerations not related to the tax system, such as maintaining employment.

One of the underpinnings of the defence's case was that aspects of the group value chain were controlled by US based executives. This is a common backstop defence for a number of similar models, and the judgment suggests that what matters is what happens outside the country in question, rather than specifically within the country with which it transacts. The judgment reinforces that transfer pricing, rather than being one or two sided, is actually multi-sided, and that it was not the job of the Irish tax authorities to police profit allocations elsewhere in the world.

It will be interesting to see if this proves to be a watershed moment for state aid challenges on transfer pricing. The Commission has two months and ten days from the date of the court's decision to appeal the judgment. If it does, the case will be heard by the CJEU, which will issue a final ruling on the case.

OECD corporate tax statistics

The OECD recently published the second edition of its *Corporate tax statistics* database which included, for the first time, anonymised and aggregated country by country reporting (CBCR) statistics.

The statistics highlight the importance of corporate tax revenues for developing countries and commodity exporters and reinforce the growing dominance of China in terms of volume and scale. It is difficult to draw any meaningful conclusions on BEPS activity from the initial CBCR dataset, but it does highlight the importance of investment hubs like Ireland and Singapore as magnets for intercompany transaction flows within multinational enterprises (MNEs).

The CBCR data relates to 2016 (the first year of reporting) and covers 26 reporting jurisdictions and 4,000 MNEs. Whilst this might sound like a lot, it is important to note that only 46 of 137 members of the BEPS Inclusive Framework had introduced mandatory CBCR reporting requirements which applied for 2016 and only 26 of the 46 are included in the statistics. Notable absentees include the UK, Germany, Switzerland and the Cayman Islands.

Approximately, 45% of all the CBCR reports included in the anonymised dataset came from the US and Japanese MNEs reflecting the significance of these two countries as a headquarter location for MNEs. The aggregated data for China highlights the country's importance from a supply and demand perspective. The level of unrelated party revenues, tangible fixed assets and headcount reported across 88 CBCR reports from Chinese MNEs dwarfs the totals reported in any other country including the US.

The OECD compared countries' 2016 total income tax accrued data per the aggregated CBCR with their total 2016 corporate tax yield data to show the level of corporate tax revenue attributable to CBCR-sized domestic and foreign headquartered MNEs. It wasn't a surprise to see Ireland topping this list with 65% of its CIT revenues estimated to come from local affiliates of foreign headquartered CBCR sized MNEs. The US, Norway, Luxembourg and Switzerland all had CBCR MNE shares in excess of 50% of the CIT revenues with the US and Norway shares largely driven by domestic MNEs and Singapore and Luxembourg having larger contributions from foreign headquartered MNEs.

The aggregated data indicates revenue per employee is higher for territories where there is zero CIT compared with countries where CIT is above 20% and those where it is 20% or below. The difference in median values is significant and it is interesting that the data for the 20%+ rate countries and sub 20% rate countries are quite closely aligned.

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The CBCR data is segmented into jurisdiction groups: (i) high income (e.g. US, Japan, Canada, UK, France and Germany); (ii) middle income (e.g. Brazil, India, Malaysia, Russia, South Africa and Turkey); and (iii) low income (largely African countries), based on World Bank classification; and (iv) investment hubs, which are defined as jurisdictions with a total inward foreign direct investment position of more than 150% of GDP. The investment hub category contains an interesting mix of countries, including China, various zero tax jurisdictions and a group of countries that have traditionally been favoured as locations for MNEs to establish operational hubs (Switzerland, Ireland, Singapore and Netherlands). Data shows each jurisdiction groupings percentage share of foreign MNE's activities measured by reference to tax, profit, revenue, employees and tangible fixed assets.

The investment hub category exhibits:

- higher revenue per employee (median $1.1m) as compared to the high, middle and low income groups ($150k–$380k); and
- a greater proportion of revenues from related parties (median 40%) as compared to the high, middle and low income groups (5%-20%). The inclusion of China within the investment hubs category may be preventing this differential from being even greater.

For the high income group, the foreign MNE share of employees, tangible fixed assets and revenues is broadly consistent but the percentage share of profits is much lower. The reverse is true for investment hubs where the profit share is significantly higher relative to employees, tangible fixed assets and revenues; however, it is unclear as to the extent to which dividend income could be driving the higher profit figure for the investment hubs. It would be interesting to see what the picture would look like if China was removed, as the data for China and the rest of the investment hubs group may look very different.

The data for the middle income group is striking as the employees percentage is substantially higher (more than 10%) than any other group but the tangible fixed assets, revenue and profit shares are broadly consistent but over 15% lower compared to the employee share. The World Bank estimates that approximately 75% of the world's population live in middle income countries (note: China is included in the World Bank middle income data but has been allocated to the investment hub category by the OECD for these purposes).

Looking ahead, the impact of the BEPS measures should become more visible as the dataset expands. However, if we are able to better understand the trends and draw reliable conclusions from the data, it is likely that the OECD will need to refine some of the methodology for its collection and analysis. The inclusion of China within the 'investment hubs' category and the treatment of dividend income within the datasets are two areas that should be looked at.

Taxation of the digital economy

As previously reported, the United States Trade Representative (USTR) is running a s 301 investigation into various digital service taxes (DSTs), including the UK's. The USTR noted that it would undertake further work to determine appropriate action. On 10 July, the US announced it will impose extra 25% tariffs on certain French goods, commencing January 2021, in retaliation for France's DST. The January 2021 commencement date gives the US and France additional time to resolve their dispute, and it is also accommodates the OECD's timetable to reach a multilateral solution to taxing the digital economy.

Despite this development, there is no indication that the UK will postpone the introduction of its DST, which has now been enacted and is effective from 1 April 2020.

EU package for fair and simple taxation

July also saw the EU reveal a new package of measures for 'fair and simple taxation'. At the heart of the package is a 25 point action plan the European Commission intends to implement between now and 2024 to make taxation fairer, simpler and more adapted to modern technologies. The actions include:

- establishment of an EU cooperative compliance framework;
- updates to VAT rules on financial services to take into account the rise of the digital economy;
- legislation to clarify where taxpayers active cross-border in the EU are to be considered resident for tax purposes;
- establishment of an EU capability against VAT fraud in cross-border transactions;
- publication of a charter on EU rights; and
- establishment of an expert group on transfer pricing.

Following the publication of model rules for reporting by platform operators with respect to sellers in the sharing and gig economy (MRDP) by the OECD, the second element of the European Commission's tax package is a proposal to amend the Directive on Administrative Cooperation, to extend the EU tax transparency rules to digital platforms. Once implemented, member states will automatically exchange information on income generated by sellers on digital platforms.

The third and final element of the package is the publication of a communication on tax good governance which the Commission describes as 'the foundation on which fair taxation is built'.

The timing of this announcement was no doubt triggered by the EU turning its focus to the recovery of the single market following the economic fallout of Covid-19 which continues to dominate the tax agendas of governments around the world. Indeed, alongside the launch of the package Paolo Gentiloni, Commissioner for Economy, commented that: 'Fair taxation is the springboard that will help our economy bounce back from the crisis.' The content of the package, meanwhile, is consistent with the EU's involvement to date with the BEPS project and its ongoing efforts to find a solution to the challenges presented in taxing the digital economy. With this backdrop in mind it does not contain any radical surprises.

Delay to DAC 6 reporting deadlines

As I reported last month, the European Parliament has voted in favour of a proposed deferral of six months to the initial reporting deadlines under the EU mandatory disclosure rules (DAC 6). The optional deferral was agreed by the Council of the European Union on 24 June and it was then up to each member state to opt for and communicate the deferral. At the time of writing, most member states have opted for the full six-month deferral. Poland is implementing differing deferrals for each type of discloser. Bulgaria, Cyprus, Italy and Portugal have yet to confirm a decision. Austria, Germany and Finland are, so far, the only countries that have opted not to defer. The Austrian government has indicated that it will not charge late filing penalties for reports filed by 31 October 2020. ■

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