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THE YEAR IN REVIEW
AN ANNUAL PUBLICATION OF THE ABA/SECTION OF INTERNATIONAL LAW

International Tax

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This article discusses the significant legal developments and actions that occurred in the area of international tax law in 2017.

I. Introduction

Observing that taxpayers around the world have various mechanisms and schemes to artificially allocate their profits to low-tax jurisdictions primarily for tax avoidance purposes—and not for sound commercial or investment purposes—thereby rapidly depleting many countries' national treasuries of much needed tax revenues, the Organisation of Economic Co-Operation and Development (OECD) published a 15-point action plan in 2013 to address the problem now commonly known as "Base Erosion and Profit Shifting" (BEPS).[1]

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1. OECD, Action Plan on Base Erosion and Profit Shifting (OECD Publishing, 2013), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en#page4 (ebook) [hereinafter Action Plan].

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BEPS generally refers to tax avoidance strategies that, among other things, exploit the gaps and mismatches in different countries' respective tax rules, resulting in the opportunity to artificially shift *profits* to low or no-tax jurisdictions, and to shift *tax losses* to high-tax jurisdictions.[2] The BEPS action plan encourages OECD Member states to coordinate their domestic laws and treaties to eliminate not only situations that result in *double juridical taxation*, but also situations that result in *double-non-taxation*—that is, transactions that are not taxed in any country, resulting in "stateless income."[3] This article explores the steps some countries took in 2017 to implement the OECD's final anti-BEPS proposals.

Action 15 of the BEPS plan advocates the development of a multilateral instrument[4] (i.e., a binding treaty) to enable countries to streamline the implementation of BEPS measures in tax treaties by updating thousands of bilateral tax treaties simultaneously through a complex matching mechanism.[5] In June 2017, sixty-eight jurisdictions signed a multilateral instrument called "The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS" (the MLI).[6]

Basically, under the MLI's matching rules, each signatory to the MLI must nominate some or all of its various double tax treaties (DTTs) that it desires to update as covered tax arrangements (CTAs) and select which provisions of the MLI it wants to opt into (or out of).[7] Some of the MLI provisions impose mandatory "minimum standards" and some are completely optional.[8] Where two MLI signatory countries nominate the DTT they have with each other, the MLI may take effect.[9] But whether a

2. *See id.* at 10.

3. OECD, OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT EXPLANATORY STATEMENT 4 (OECD Publishing, 2015) https://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf [hereinafter 2015 OECD BEPS EXPLANATORY STATEMENT].

4. OECD, DEVELOPING A MULTILATERAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES, ACTION 15 – 2015 FINAL REPORT 11 (OECD Publishing, 2015), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/developing-a-multilateral-instrument-to-modify-bilateral-tax-treaties-action-15-2015-final-report_9789264241688-en#page18 (ebook).

5. *Id.* at 9.

6. Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, June 7, 2017, OECD, http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf [hereinafter MLI]. *See also Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, OECD (Mar. 22, 2018), http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (listing 71 jurisdictions that have signed as of Dec. 1, 2017).

7. OECD, EXPLANATORY STATEMENT TO THE MULTILATERAL CONVENTION TO IMPLEMENT TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING 9 (2017) http://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf [hereinafter, MLI EXPLANATORY STATEMENT].

8. *Id.* at 4.

9. *Id.* at 9.

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specific MLI provision applies to their DTT is a function of the complex matching mechanics of the MLI itself.

II. Argentina

On December 29, 2017, Argentina enacted Law No. 27430[10] (the "Law") which introduces important amendments to the Argentine tax system. In connection with OECD BEPS Action 1 (challenges of the digital economy)[11], under this Law, Argentina imposes the value added tax (VAT) on digital services rendered by residents or persons located abroad (e.g. Spotify or Netflix) and whose use or effective operation is performed in Argentina. It is worth mentioning that the access and/or download of electronic books will be exempted from such VAT. The tax will be levied by the local provider. In the event an intermediary intervenes on the service payment (e.g. credit card), it must act as a withholding agent. This amendment is effective to taxable events occurred as from February 1, 2018. The Law also redefined CFC rules that now are fully applicable.

With regards to CFC rules, the Law provides that income tax should apply on profits of companies trusts, private interest foundations and other similar structures organized, domiciled, or located abroad, as well as any agreement made abroad or under a foreign legal system. This income should be attributed to the resident who controls such structures at the fiscal year when the end of said entities' fiscal. In addition, income earned by trusts incorporated, domiciled or located abroad must be declared by the local taxpayer who controls the trust (provided there is of course, actual "control"). Pursuant to Action 6 (Treaty Abuse), the OECD has proposed changes to international tax treaties and domestic tax rules to prevent the granting of treaty benefits in circumstances that are abusive in the OECD's view.[12] Since 2009, Argentina has denied treaty benefits to companies whose sole purpose was to enjoy the benefits of an Argentinian DTT.[13] Also, Argentina renegotiated certain DTTs where it felt that the DTTs were being improperly used.[14]

10. Law No. 27430, Dec. 29, 2017, 3733, 3 (Arg.).

11. OECD, ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY, ACTION 1–2015 FINAL REPORT 15 (OECD Publishing, 2015), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page18(ebook).

12. OECD, PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES, ACTION 6 – 2015 FINAL REPORT 9 (OECD Publishing, 2015), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report_9789264241695-en#page11 (ebook).

13. *See* Guillermo O. Teijeiro, *Argentine Treaty Network: Will the Schoppable Treaty Soon Become an Extinct Species?*, KLUWER INT'L TAX BLOG(Feb. 29, 2016), http://kluwertaxblog.com/2016/02/29/argentine-treaty-network-will-the-schoppable-treaty-soon-become-an-extinct-species/.

14. *Id.*

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Pursuant to Action 7 (Permanent Establishment Status), under Article 10 of the MLI, Argentina reserved the right for such Article not to apply to its tax treaty with Chile because this treaty already contains similar provisions.[15] Argentina will apply Action 7, pursuant to Article 10 of the MLI, to all other CTAs.[16] Argentina has also chosen to apply Article 12 of the MLI (artificial avoidance of permanent establishment (PE) status through commissionaire arrangements and similar strategies), Article 13 of the MLI (artificial avoidance of PE status through the specific activity exemptions), Article 14 of the MLI (splitting-up of contracts), Article 15 of the MLI (definition of a person closely related to an enterprise) to all its CTAs. In addition, under the Law, Argentina has completely redefined its concept of PE in line with BEPS. The Law defines the PE as a fixed place of business by which a foreign person performs his activity in whole or in part. Moreover, the Law establishes that PEs include but are not limited to the following: a) a headquarter, b) a branch, or c) a factory. In addition, the Law provides that there is no PE when an individual acts in Argentina on behalf of a foreign human or legal person and: a) has a deposit account in the country where he regularly delivers goods on behalf of the foreign person, b) takes risks on behalf of the foreign person, and c) acts following detailed instructions of or under the control of a foreign person, etc.

With regards to Actions 8, 9, and 10 (Transfer Pricing), Argentina is strengthening its transfer pricing (TP) audits and systems.[17] The Argentinian tax authority has become more aggressive and informed about TP practices. Some of the areas under more stringent scrutiny are technical services fees, intercompany debt, commission and royalty payments, intangible property fees, and management fees.

The Law establishes that the applicable rules must set a minimum limit to the taxpayers' annual income and a minimum amount of transactions in order to enforce the filing of annual affidavits related to transfer price. Bear in mind that in September 2015, Argentina enacted legislation necessary for

15. OECD, PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS, ACTION 7 – 2015 FINAL REPORT (OECD Publishing, 2015), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report_9789264241220-en#page1 (ebook).

16. *See Argentine Signs Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, ERNST & YOUNG GLOBAL LTD. (June 29, 2017), http://www.ey.com/gl/en/services/tax/international-tax/alert—argentina-signs-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.

17. OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Report* -OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris (2015), *available at* http://www.oecd.org/ctp/aligning-transfer-pricing-outcomes-with-value-creation-actions-8-10-2015-final-reports-9789264241244-en.htm (Actions 8, 9 and 10).

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the implementation of Action 13 (Transfer Pricing Documentation) and adopted the "country-by-country" reporting regime.[18]

Under its accession and signature of the MLI, Argentina has chosen to apply Articles 16 and 17 of the MLI (mutual agreement procedure) to all of its CTAs in response to Action 14 (dispute resolution). But Argentina has not opted for mandatory binding arbitration.[19]

In response to Action 15 (MLI), Argentina signed the MLI in June 2017.

III. China

China was one of the sixty-eight jurisdictions that signed the MLI on June 7, 2017. Given that China has 106 tax treaties in force and that China signed its first tax treaty as recently as 1983, the fact that China is even a signatory to the MLI is a truly momentous development.

The first round of MLI updates will affect at least forty-six of China's DTTs, beginning as early as 2019, including those with its major trading partners, other than the DTT with the United States, which did not sign the MLI. Unlike other MLI signatories with large economies (e.g., Japan), China has opted out of some key provisions, including those applicable to hybrid and transparent entities,[20] those addressing the artificial avoidance of PE status,[21] and those instituting binding arbitration for tax disputes arising under relevant tax treaties.[22]

China has opted for the highly subjective "principal purpose" test (PPT) —one of three sanctioned methods of satisfying the MLI minimum standard of preventing tax abuse.[23] China thus rejected the two ostensibly more objective methods, both of which employ a limitation-on-benefits clause (LOB).[24] Under the PPT, tax authorities may deny treaty benefits if they determine that just "one of the principal purposes" of the taxpayer's business or investment arrangement was to obtain DTT benefits (as opposed commercial business or investment objectives).[25] In accordance with the MLI's minimum standard, China has also chosen to replace language in the preambles of its nominated DTTs to clarify that the purpose of the treaty is not to create "opportunities for non-taxation or reduced taxation through

18. *See Argentina implements new Transfer Price Country by Country Report implementing Action 13 of BEPS*, Canosa Abogados (Oct. 10, 2017), http://canosa.com/argentina-implements-new-transfer-price-country-country-report-implementing-action-13-beps/.

19. MLI Explanatory Statement, *supra* note 7, at 55–65.

20. *See* MLI Explanatory Statement, *supra* note 7, at art. 3.

21. *See id.* at 39-47. Although China opted out of all MLI PE provisions, it did amend its domestic tax law in 2010 to provide similar PE rules addressing BEPS concerns. *See* Hong Ye, et al., *SAT Clarifies When a Secondment Arrangement Creates a PE*, Tax Analysis (Deloitte) May 17, 2013, at 1, https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/tax/ta-2013/deloitte-cn-tax-tap1812013-en-170513.pdf.

22. MLI Explanatory Statement, *supra* note 7, ¶¶ 39–48.

23. *See id.* ¶¶ 91–92.

24. *See, e.g., id. at 30–45.*

25. *Id.* ¶ 91.

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tax evasion or avoidance (including through treaty-shopping arrangements. . .for the indirect benefit of residents of third jurisdictions)."[26] The only MLI treaty abuse provision China has not adopted, even in part, is the provision that limits withholding tax relief on payments to third-country PEs in so-called "triangular cases."[27]

Although China decided against adopting MLI provisions on transparent entities, it did opt into the dual resident entity rules, thereby choosing to substitute the MLI's mutual-agreement approach to resolve the tax residence of dually qualified taxpayers, rather than the "place of effective management" test.[28] The latter test has been used in the model tax conventions of both the OECD and the United Nations, as well as in most of China's DTTs to date.

With respect to the MLI provisions updating the "Dividends" articles of DTTs, China has opted into a new rule requiring shareholders to satisfy a 365-day holding period to qualify for the treaty's withholding tax rate reduction on an otherwise qualified dividend.[29] Due to the MLI's matching rules, only a few of China's DTTs will be updated by this provision, including those with Armenia, Belgium, France, Germany, Ireland, Netherlands, and Russia. China has also opted to update its DTT articles governing capital gains, which govern withholding tax on dispositions of shares in land-rich entities. The selected MLI update will expand the scope of this provision to include dispositions of interests in partnerships and trusts that hold land and other immovable property.[30]

China has opted to amend its Mutual Agreement Procedure (MAP) articles with certain MLI provisions—most importantly, a provision allowing a local resident to present his (or her or its) MAP case solely to the competent authority of the contracting state where he resides (rather than to both states' competent authorities), unless his local competent authority determines that the taxpayer's objection is not justified, in which case a bilateral consultation process would be implemented.

China has chosen to update the "corresponding adjustment" rules of its Transfer Pricing articles in twenty-five of its DTTs through the MLI. Many of these, however, will be updated only to the "extent of incompatibility," meaning that further review by China and the DTT partner will often be necessary.

Finally, China has opted to include the MLI "savings clause," clarifying that DTTs do not restrict a contracting state's right to tax its own residents.[31] This clarification should affect at least twelve of China's nominated DTTs.

26. *See id.* ¶¶ 77–80.
27. *See id.* ¶¶ 142–146.
28. *See* MLI EXPLANATORY STATEMENT, *supra* note 7, ¶¶ 49–59.
29. *See id.* ¶¶ 125–126.
30. *See id.* ¶¶ 128–131.
31. *See id.* ¶¶ 147–156.

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IV. Germany

A. MLI

One of Germany's most significant BEPS-related developments in 2017 is that it signed the MLI on June 7. Germany's legislature must ratify the MLI in order for it to take effect, which will presumably occur in 2018.[32] Additionally, each DTT subject to the MLI may also require a separate ratification process. The first set of treaty changes is expected to come into force in 2019.

Germany's essential reservations and notifications to the MIL are below and should be carefully considered by other jurisdictions:[33]

- In the context of two EU directives (ATAD I and ATAD II), Germany reserved the right for Article 3 of the MLI (hybrid entities) not to apply.[34]
- Germany again reserved the right for Article 4 of the MLI (dual resident entities) not to apply. Hence, the place of effective management is decisive regarding the allocation of the right of taxation.
- The principle purpose test according to Article 7(1) of the MLI has been chosen as the measure to prevent treaty abuse; the simplified LOB provision was not picked because Germany considers the implementation of a minimum 365-day holding period for tax exemption of dividend payments.
- Germany has chosen to apply Article 9(4) of the MLI (right of taxation of capital gains arising from shares / interest of certain property holding entities).
- Germany will not implement new rules according Article 12 of the MLI (artificial avoidance of PE status through commissionaire arrangements and similar strategies).
- Germany has chosen to apply Article 13 (2) of the MLI (Option A: An activity is constituting a PE if the activity is not of a preparatory or auxiliary character).
- Anti-fragmentation-provision according to Article 14 of the MLI (splitting up of contracts) shall not apply.

32. *See* Fed. Ministry of Finance of Ger., Press release, June 7 2017 (Ger.), https://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2017/06/2017-06-06-PM17-beps.html;jsessionid=4450A66E5156120080DE15CB94105970 (last visited Apr. 17, 2018).

33. *See Fed. Republic of Ger.*, OECD, http://www.oecd.org/tax/treaties/beps-mli-position-germany.pdf (last visited Apr. 1, 2018).

34. Council Directive 2016/1164, 2016 O.J. (L 193) 1–14 (EC), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=EN; Council Directive 2017/952, 2017 O.J. (L 144) 1-11(EC), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0952&from=EN.

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B. BEPS Implementation Act

Germany's BEPS Implementation Act came into force at the end of December 2016.[35] The German Fiscal Code was amended, implementing BEPS Action 13 (Transfer Pricing Documentation). For fiscal years beginning after December 31, 2016, multinational enterprises (MNEs) generating a turnover of €100,000,000 or more per year have to prepare TP documentation considering the Master File / Local File concept. Furthermore, the corresponding regulation regarding the detailed content of TP documentation released by the Federal Ministry of Finance has been extended by adding more detailed provisions.[36] Additionally, country-by-country-reporting has to be considered for entities which are part of a multinational group generating a consolidated turnover of €750,000,000 or more. The BEPS Implementation Act also contains provisions to implement the EU council directive regarding administrative cooperation and mandatory automatic exchange of information in the field of taxation (e.g., secondary mechanism).[37]

To prevent double-dip-financing structures via the formation of a (transparent) German partnership with nonresident partners, section 4i of the German Income Tax Act was implemented. In general, tax deductions are disallowed to the extent that business expenses can also be deducted from the foreign tax base of the partner (i.e., hybrid entity).[38]

C. License Barrier

In accordance with BEPS Action 5 (Harmful Tax Practices), Germany implemented a license barrier that is effective beginning in 2018.[39]

Section 4j of the German Income Tax Act implements a limitation on the deductibility of royalties and license fees owed to a related party (licensor) that is tax resident in a non-German jurisdiction. The provision applies when royalties or license fees are paid as consideration for the use, or right to use, copyrights or industrial and/or commercial property rights; commercial, technical, scientific or similar intellectual property; or knowledge and skills, and are subject to a non-OECD compliant preferential

35. *Germany Issues Ministerial Draft Bill Reflecting BEPS Initiative, EU Directive*, Tax Incites from Transfer Pricing (PWC) July 7, 2017, at 2, https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-TP-Germany-BEPS-ministerial-draft-bill.pdf.

36. *Germany: Transfer Pricing Country Profile*, European Commission (Jan.18, 2018), https://ec.europa.eu/taxation_customs/sites/taxation/files/ttpprofile-de.pdf.

37. Council Directive 2016/881, 2016 O.J. (L 146) 8–21(EC), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0881&from=EN.

38. *See* Pia Dorfmueller & Stefan Weinberger, *Corporate Tax Law in Germany: Recent Changes and a Look Ahead*, Tax Notes Int'l 757-760.

39. *See* Pia Dorfmueller & Stefan Weinberger, *Corporate Tax Law in Germany: Recent Changes and a Look Ahead*, 85 Tax Notes Int'l 756, 757–60 (2017), https://www.pplaw.com/sites/default/files/publications/2017/02/pd-2017-corporate-tax-law-germany-recent-changes-and-look-ahead.pdf.

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tax regime with the licensor. Third-party licensors will not be affected by this new regulation.

The limitation of the deductibility will only apply if the license income is subject to an effective tax rate of less than 25 percent. However, the limitation will be determined on a pro rata base. Where there is no limitation, i.e. in case of effective taxation of 25 percent or more, a limitation of 50 percent is applicable.[40] Furthermore, the limitation regulation is not applicable in case of a preferential tax regime that is compliant with the OECD Nexus Approach.[41] In addition, the license barrier rule includes a treaty override provision: preferable provisions of applicable DTTs will be overruled by national German law.

The regulation also covers back-to-back-structures in which payments are routed through a related party whose income is not subject to a non-compliant preferential tax regime to another related party which benefits from such tax regime. According to the Authorized OECD Approach, a PE qualifies as separate and independent enterprise for tax purposes. Therefore, a PE also qualifies as licensor or licensee if it is a beneficial owner of the payments or is obligated to pay.

V. India

Google seems to be winning the popularity contest in tax litigation around the globe. On the Indian front, recently, the Income Tax Appellate Tribunal (the Tribunal), being the second appellate and last fact-finding authority, characterized payments for purchase of advertisement space on Google's AdWords program as royalty liable to withholding tax (WHT).[42]

A. Facts of the Case

AdWords is an online advertising service where advertisers pay to display brief advertising copy, product listings, and video content within the Google ad network to web users. By using the patented algorithm, Google India Private Limited (GIL) decides which advertisements are flashed to consumers visiting millions of websites and search engines.

As per the reported judgement, GIL rendered the following services to Google Ireland Limited (GIr):

40. *Germany and 67 Other Jurisdictions Sign Multilateral Convention*, German Tax & Legal Quarterly (Ernst & Young GmbH) 2017, at 4 http://www.ey.com/Publication/vwLUAssets/2017_EY_GTLQ_Q2/$FILE/EY_GTLQ_Issue_2-2017.pdf.

41. *See* OECD, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report 23-44 (OECD Publishing, 2015), https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en#page25 (ebook).

42. M/S Google India Private Ltd. v. Comm'r Income-Tax, (2017) IT(TP) A.115–1518 (India), http://itatonline.org/archives/wp-content/uploads/Google-India-Adwords-Royalty-TDS.pdf.

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- Information technology (IT) and IT enabled services (ITeS) under a services agreement (Services Agreement).
- Functioned as a non-exclusive authorized distributor of GIr's AdWords program in India under an agreement (Distribution Agreement).
- Marketing and distribution services under the Distribution Agreement including pre-sale and post-sale / customer support services to the advertisers.
- During the course of assessment, the Tax Officer noticed that in its books, GIL had accounted for approximately $ 224,000,000 payment to GIr.

GIL contended that payments for purchase of AdWords Space should be characterized as business income in GIr's hands and, in absence of a PE in India, the payments should not be liable to income tax in India. On the contrary, the tax department considered such payments to be royalty income, taxable in India, because GIL used the information and patented technology from GIr.

Aggrieved with the assessment proceedings, GIL preferred an appeal with Commissioner of Income Tax (Appeals). But with no respite being offered at the first appellate authority (the Commissioner of Income Tax), GIL preferred an appeal at Tax Tribunal.

B. Tribunal Ruling

1. *Royalties*

In addition to providing space for advertisements, GIL facilitated the display and publishing of advertisements to customers. Google had access to various data (with respect to age, gender, region, language, etc.) and used it for the purpose of selecting ad campaigns and maximizing the impression and conversion of the customers to the ads of the advertisers. By using a patented algorithm, GIL regulated the advertisements seen by millions of consumers visiting websites and search engines. IP of Google vested in the search engine technology, associated software and other features, and resultantly, use of these tools for performing various activities clearly fell within the ambit of royalty both under the Income-tax Act, 1961 (the Act) and the India-Ireland Tax Treaty.

2. *Interdependence Between Service and Distribution Agreement*

Inputs from ITeS were always required in the business model of GIL, and in its absence no targeted marketing for advertisements and promotion of sales of advertisers could have taken place. Therefore, the services rendered under the Agreements could not be divorced. Additionally, the Tribunal commented that such a structure was adopted to avoid payment of taxes.

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3. *Patent and Trademark*

GIL secured client engagement on account of the Google trademark and that in its absence it would have been difficult to have this kind of business inflow of advertisements that it witnessed.

4. *Secret Process*

For targeted marketing campaigns, promoting advertisements was only possible with the use of a secret formula and confidential customer list. This secret process of targeting the customers was not available in the public domain allowing the assessing officer to conclude that GIL had access to secret process.

5. *OECD Technical Advisory Group ("TAG") Report*

Relying on the OECD TAG report, GIL claimed that revenue earned from advertisements was taxable as business profit and in the absence of PE, it could not be taxed in India. The Tribunal distinguished the facts and set aside the reliance.

6. *WHT Proceedings*

The period of limitation for residents and non-residents is six years from the end of the financial year. Non-resident payees should be treated at par with resident payees under the Act and the tax treaty. The non-discrimination clause under the tax treaty mandates equal treatment of non-residents and residents.

C. In Summary

The instant ruling is a clear break with earlier positions taken by Tribunals on the characterization of advertisement revenue and payments under distribution arrangements as business income. Considering the use of high end technologies, the extant fine line of difference between access to IP rights and use (right to use) of IP rights is tapered. Equalization levy (EL) in India was introduced by Finance Act 2016, in line with the recommendations of BEPS Action 1 (digital economy).[43] The intention behind the same was to capture advertising fees within the Indian tax net in cases where the non-resident does not have a PE in India. Accordingly, one needs to carefully examine the services provided by foreign companies with respect to online advertising vis-à-vis applicability of EL.

The Tribunal has observed that both entities were trying to misuse the tax treaty with an intention to avoid taxes. In view of BEPS, taxpayers ought to be vigilant before taking a tax position as emphasis is placed on substance of the transaction. In recent times, a trend has been observed in which courts cross verify the facts submitted by the taxpayer within the public domain. In

43. *See* Action Plan, *supra* note 1, at 14–15.

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the instant case, the Tribunal resorted to the books available in public domain.

VI. Italy

A. Definition of PE

As per the definition of PE, the 2002 *Philip Morris* case demonstrates that Italy was an early adopter of what the OECD eventually formulated in its BEPS PE definition. In 2002, the Italian Supreme Court in the *Philip Morris* case ruled that an international group of companies could be deemed to have a PE in Italy on the basis of activities conducted by an Italy-based member of that group.[44] More specifically, according to the Court, an Italian company can be a PE of several non-resident members of the same group where all the companies (including the Italian one) act within a "unitary strategy" , provided that the activity performed by the Italian company is essential and not merely auxiliary or preparatory for achieving the group objectives.

B. Hybrid Mismatching Arrangements

According to the Income Tax Code, non-resident transparent entities are all subject to tax, having no regard to the tax or legal status in their Country of residence; this means that any foreign tax transparent entity is considered as opaque for domestic income tax purposes.[45] The effect of such a rule is that many situations, such as those depicted in the OECD Hybrids Report, should be avoided.[46]

Financial instruments will be considered similar to shares if and to the extent that their remuneration fully derives from the economic result of the Italian paying entity and is not deductible from its taxable base.[47] The effect of this rule is that the most common examples of deduction/not inclusion schemes depicted in the OECD Hybrids Report are neutralized.[48]

44. Cass., 20 dicembre 2001, n.3367, 2002 (It.); Cass., 20 dicembre 2001, n.3368, 2002 (It.).

45. Decreto Presidente del la Republica 22 dicembre 1986, n. 917, G.U. Dec. 31, 1986, n. 302 (It.), art. 73(1)(d),) http://www.altalex.com/documents/leggi/2014/07/17/tuir-titolo-ii-capo-i-soggetti-passivi-e-disposizioni-generali#61906.

46. *See* OECD, Neutralising the Effects of Hybrid Mismatch Arrangements, 20 (OECD Publishing, 2015) https://read.oecd-ilibrary.org/taxation/neutralising-the-effects-of-hybrid-mismatch-arrangements-action-2-2015-final-report_9789264241138-en#page1 (outlining the general recommendations of the Hybrid Report).

47. D.P.R., n. 917/1986 (It.), *supra* note 45, art. 44(2)(a).

48. *See* OECD, Neutralising the Effects of Hybrid Mismatch Arrangements, *supra* note 46, at 46 (According to Hybrids Report's Recommendation 2.1-Denial of dividend exemption for deductible payments, "jurisdictions that provide payees with an exemption for dividends, as a mechanism for relieving economic double taxation on corporate profits, do not extend that exemption to payments that have not borne tax at the entity level.").

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C. The Relationship between Taxpayers and Tax Administrations

Following Action 12 (Disclosure of Aggressive Tax Planning), legislation has been passed with the goal to facilitate communication and enhance cooperation between the tax administration and taxpayers thereby minimizing tax controversies.[49] This is aimed at resident and non-resident large business taxpayers with a total turnover or operating revenues exceeding €10,000,000,000[50] Once admitted to this cooperative compliance regime, taxpayers can enter into advance discussions with the tax authorities before filing the tax return, in order to prevent tax audits.[51] A further feature of this regime is the introduction of a fast track ruling procedure regarding the application of tax provisions. Also, from the tax penalties standpoint, there are advantages, like the 50 percent reduction of tax penalties and the application of tax penalties not exceeding a certain amount, together with the suspension of the tax collection until the assessment procedure has been settled.[52]

D. Country-by-Country Reporting

Since 2016, an Italian subsidiary belonging to a multinational group has been required, under certain conditions, to report to the tax authorities the information concerning the country-by-country reporting recommended by Action 13 (Transfer Pricing Documentation).[53] In brief, this reporting standard requires that a multinational group with consolidated financial statements exceeding €750,000,000 of revenue shall report separately for each jurisdiction the following data: identification data of the entities (so called constituent entities) as well as the nature of their activity; revenues; profit or loss before income tax; income tax accrued and paid; share capital; accumulated earnings; number of employees; tangible assets.

Practitioners should note that data gathered by the Italian Tax Authorities should not be used directly during tax audits at the Italian subsidiary level. But they may be useful for risk assessment on transfer pricing or, more generally, tax base erosion issues.

49. Decreto Legislativo 5 agosto 2015, n.128, G.U. Nov. 2, 2015, n.190 (It.), http://www.gazzettaufficiale.it/eli/id/2015/08/18/15G00146/sg.

50. Provvedimento Direttoriale, 14 aprible 2016, Agenzia delle Entrate para. 2 (It.).

51. Decreto Legislativo 5 agosto 2015, n.128, G.U. Aug.18, 2015, n. 190 (It.), art. 6(1).

52. *Id.* at art. 6(3).

53. Legge 28 dicembre 2015, n.208, G.U. Dec. 30, 2015, n.70 (It.) http://www.gazzettaufficiale.it/eli/id/2015/12/30/15G00222/sg. *See* OECD, Transfer Pricing Documentation, *supra* note 17.

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VII. Japan

Japan also signed the MLI. At the time of signing, Japan submitted a list of thirty-five DTTs it wanted treated as CTAs, and thus amended through the MLI.

With respect to the MLI's provisions aimed at Article 7 (preventing treaty abuse), Japan has opted to apply the Principal Purpose Test (PPT) alone.[54] But, Japan's election to apply the PPT does not preclude existing LOB provisions in Japan's DTTs from operating. Japan has reserved the right not to apply MLI Article 6(1) (which adds language to CTAs' preambles) in its DTTs that already contain preamble language describing the intent of both contracting states to eliminate double taxation without creating opportunities for double non-taxation and treaty shopping. However, because only Japan's CTA with Germany contains such language, most of Japan's CTAs will be amended by the MLI's recommended language, limiting the scope of the treaty.

Japan will apply most of the MLI provisions targeting the artificial avoidance of PE status through commissionaire arrangements and similar strategies,[55] as well as through expansive activity exemptions.[56] Article 12(1) broadens the concept of "dependent agent PE," and Article 12(2) narrows the concept of "independent agent," making the finding of a taxable PE more likely. The only PE provision Japan has completely opted out of is Article 14, which prevents taxpayers from splitting-up contracts as a way of avoiding PE status. However, as noted in the final BEPS reports, the PPT may operate to prevent the abusive splitting of contracts in these types of cases.

Although Japan has completely opted out of the MLI Article 8, which contains anti-abuse rules for obtaining a treaty-reduced dividend withholding tax rate (e.g., a 365-day holding period), Japan will apply Article 9, which incorporates anti-abuse rules for qualifying for treaty benefits on capital gains from dispositions of shares in entities that derive their value principally from holding land and immovable property.

Japan has also chosen to apply Part V of the MLI, containing Articles 16 and 17. Article 16 sets forth minimum standards for improving dispute resolution, as well as complementary best practices. Article 17 applies in the absence of provisions in a CTA requiring corresponding adjustments where the other treaty party makes a transfer pricing adjustment.

Finally, Japan is one of approximately twenty-five countries that have committed to adopting and implementing mandatory binding treaty arbitration (MBTA) in accordance with Articles 18 through 26 of the MLI. The MBTA provisions will apply to all tax issues contrary to the relevant CTA unless a country has made a reservation specifying a more limited scope. Japan has opted to apply the MBTA provisions to all of its CTAs that

54. *See* MLI Explanatory Statement, *supra* note 7, ¶¶ 88–117.
55. *See id.* ¶¶ 157–167.
56. *See id.* ¶¶ 168–181.

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do not already provide for mandatory arbitration arising from MAP cases—namely its treaties with Germany, Netherlands, and the United Kingdom.

VIII. Luxembourg

As illustrated by its position as Early Adopter with regards the automatic exchange of information in 2014, Luxembourg has always been strongly committed to comply with various European and international initiatives in the field of taxation. The government closely follows the new developments as it seeks to preserve the attractiveness of its internationally recognised financial centre.

A. New Transfer Pricing Rules

The 2017 budget law of December 23, 2016 has introduced a new article 56bis in the Luxembourg Income Tax Law (ITL) clarifying the concept of the arm's length principle in compliance with Actions 8-10 of the OECD BEPS plan.[57]

In addition, on December 27, 2016, the Luxembourg tax authorities issued a new transfer pricing circular letter (New Circular)[58] regarding the tax treatment of Luxembourg companies engaged in intra-group financing activities which replaced the 2011 circular letters,[59] in order to align it with the revised OECD guidelines.[60]

Similar to the 2011 Circulars, the New Circular applies to entities engaged in intra-group financing transactions, meaning any activity involving the granting of loans or advances to associated enterprises. According to the revised OECD guidelines, a "comparability analysis" lies at the heart of the application of the arm's length principle. The arm's length principle is based on a comparison of the conditions of a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.

57. *See* Rapport De La Commission Des Finances Et Du Budget, du 15 décembre 2016 de la Chambre des Députés 65 (Lux.), http://www.chd.lu/wps/PA_RoleDesAffaires/FTSByteServingServletImpl?path=F39B18F2562DC9E11C109B5DA7059C5864C87317A9A89E4137BC0576F38B31220DCCBA95B9FAAE143756C6C278CDD33A$E97FFFB47A98CA158BB3229EA55B3ABD.

58. L.I.R. n. 56/1–56bis/1 du 27 décembre 2016 (Lux.), http://www.impotsdirects.public.lu/content/dam/acd/fr/legislation/legi16/circulairelir561-56bis1-27122016.pdf.

59. L.I.R. n. 164/2 du 28 janvier 2011 (Lux.), http://www.impotsdirects.public.lu/content/dam/acd/fr/legislation/legi11/Circulaire_L_I_R__n___164-2_du_28_janvier_2011.pdf; Circular of the Director of Contributions L.I.R. n. 164/2bis du 8 avril 2011 (Lux.), http://www.impotsdirects.public.lu/content/dam/acd/fr/legislation/legi11/Circulaire_L_I_R__no_164-2bis_du_8_avril_2011.pdf.

60. OECD, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 43–96 (OECD Publishing, 2017), https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page8 (ebook).

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B. New Intellectual Property Tax Scheme

The Luxembourg government revealed a new tax framework for intellectual property in its bill of law 7163[61] dated August 4, 2017.[62] The long awaited new Luxembourg IP box results from the need to comply with the Action 5 of BEPS, but also from the government's wishes to address the increasing direct and indirect impact of intellectual property on the country's economy. In order to strictly comply with the OECD prerequisites, the bill takes into account the "substantial activity" requirement reflected by the new nexus approach which ensures that IP income derived by a taxpayer will only benefit from the tax regime to the extent that the taxpayer itself incurred the Research and Development (R&D) expenditures that contributed to the IP. The new provisions thereby establish a link between expenditures, IP assets, and IP income. The effective date of the new provisions is set as of January 1, 2018.

C. Signing of the MLI

Luxembourg signed the MLI on June 7, 2017 in order to swiftly implement the tax treaty measures contained in Actions 2, 6, 7 and 14 of the OECD's BEPS project.[63] The Luxembourg government has adopted a restrictive approach and has opted for introduction of a principal purposes test clause and the improved dispute resolution mechanisms. The principal purposes test clause aims at denying the benefit of a tax treaty where there is evidence that an arrangement or a transaction was set up for the principal purpose of obtaining that benefit.[64] Luxembourg has also opted to include the reformed dispute resolution mechanisms under the MLI (Arbitration and Mutual Agreement Procedure) to its existing treaty network. These minimum standard measures will apply to the eighty tax treaties signed by Luxembourg, currently in force. At the very earliest, it is expected that the MLI provisions will enter into force in 2019. It is possible that certain measures, in particular those regarding withholding taxes, already apply in 2018.

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61. The Bill of law was slightly amended and adopted by Luxembourg parliament on March 22, 2018. *See* Projet de loi n. 7163 du 22 mars 2018 sur la fiscalité de la propriété intellectuelle (Lux.), http://www.chd.lu/wps/PA_RoleDesAffaires/FTSByteServingServletImpl?path=9D612A046BA1F487E78B2897D5E0B0FAB4313B66949354E30252D2E5EEF35DB9789AAC20412DE523D1E39FA7EB145A1C$4716403954929880B36B99FD6E204FD1.

62. Projet de loi n. 7163 du 4 avril 2017 sur la fiscalité de la propriété intellectuelle [Bill n. 7163 of 4 April 2017 on the taxation of intellectual property] (Lux.), http://www.chd.lu/wps/PA_RoleDesAffaires/FTSByteServingServletImpl?path=/Export/exped/sexpdata/Mag/0004/091/8910.pdf.

63. Signatories and Parties to the Multilateral Convention, *supra* note 6.

64. Signatories and Parties to the Multilateral Convention, *supra* note 6.

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D. Outlook – ATAD I & II

The EU anti-tax avoidance directive package falls within the current context of increased transparency and prevention of tax evasion and aggressive tax planning. Adopted on July 12, 2016, the first anti-tax avoidance directive (ATAD I) contains interest limitation rules, a general anti-abuse rule, controlled foreign company rules, and hybrid mismatch provisions which have to be implemented by December 31, 2018, with an exception for exit taxation rules which should be implemented by December 31, 2019.[65] Some of the measures already apply under Luxembourg law, but their application would be revisited or extended with the implementation of the ATAD package.

On May 29, 2017, the Council of the EU adopted amended directive (ATAD II) which broadens the scope of ATAD I by covering different types of hybrid mismatch arrangements with third countries.[66] Therefore, EU taxpayers engaged in cross-border structures involving third countries, like the United States, may be impacted by the future application of ATAD II. Luxembourg, as the rest of the EU Member States, has until December 31, 2019, to transpose ATAD II into its national law for the measures to become applicable as of 1 January 1, 2020 (31 December 31, 2021, and January 1, 2022, respectively for provisions regarding reverse hybrids).[67]

VII. Mexico

A. Scope and Interpretation of Terms

Mexico considers as CTAs all of its Double Tax Conventions (DTCs) and amending protocols in force on the date of the MLI's signing, for a total of sixty-one countries. DTCs not in force yet and protocols will constitute CTAs to the extent that the counterparties express their intentions to consider them as such.

B. Hybrid Mismatches

1. *Article 3 – Transparent Entities*

According to the Mexican position, only the CTAs with Australia, Austria, Barbados, Brazil, Czech Republic, Denmark, Iceland, Indonesia, Israel, Kuwait, Malta, Poland, Russia, Singapore, South Africa, Sweden, the United States of America, and Uruguay provide provisions to regulate the tax treatment of income derived by transparent entities.

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65. Council Directive 2016/1164, *supra* note 34.
66. Council Directive 2017/952, 2017 O.J. (L 144) 1–11(EC), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0952&from=EN (amending Council Directive 2016/1164).
67. *See id.* at Article 2.

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2. *Article 4 – Dual Residency*

The Mexican position to the MLI is that several CTAs in force already contain mechanisms to solve dual residence conflicts. Therefore, Mexico reserves its right with respect to Article 4, as follows:

- For the CTAs with Indonesia and the United States of America, in cases of dual residence conflicts, the subject entities will not have access to the benefits or exemptions of the Agreement.[68]
- For the CTAs with Argentina, Austria, Barbados, Brazil, Canada, Chile, Czech Republic, Denmark, Germany, Hong Kong, Hungary, Iceland, Latvia, Lithuania, Malta, the Netherlands, Panamá, Peru, Qatar, Russia, Slovakia, South Africa, Switzerland, Turkey, and Uruguay, in cases of dual residence conflicts, the conflict should be solved through a Mutual Procedure Agreement between the Contracting jurisdictions.[69]

Additionally, Mexico's CTAs with Australia, Bahrein, Belgium, China, Costa Rica, Ecuador, Estonia, Finland, France, Greece, Guatemala, India, Ireland, Israel, Italy, Jamaica, Japan, Korea, Kuwait, Luxembourg, New Zealand, Norway, the Philippines, Poland, Portugal, Romania, Saudi Arabia, Singapore, Spain, Sweden, Ukraine, United Arab Emirates, and the United Kingdom, will be subject to Article 4 of the MLI.

C. Tax Abuse

1. *Article 6 – Purpose of a CTA*

As part its position to the MLI, Mexico reserved its right to apply Article 6(1) in the case of the CTAs with Argentina, Guatemala, the Philippines, and Spain, because those agreements already contain a similar preamble.

Additionally, Mexico notifies that the rest of its CTAs shall modify respective preamble, to the extent that the other Contracting jurisdictions have made the same notification.

2. *Article 7 – Prevention of Treaty Abuse*

Mexico reserved its right not to apply the PPT clause contained in Article 7(1) for its CTAs that already consider that the benefits of a tax treaty will be denied when the principal purpose or one of the principal purposes for a transaction to be conducted is to obtain a benefit from the respective treaty (Argentina, the Philippines, and Spain).

Likewise, Mexico stated its decision to incorporate the simplified LOB clause and reserved its right not to apply the clause contained in Article 7(8) to (13) of the MLI, for the CTAs that already contain a similar clause (Argentina, Barbados, China, Colombia, Costa Rica, Guatemala, India,

68. *United Mexican States: Status of List of Reservations and Notifications at the Time of Signature*, OECD, 1, 11 (2015), http://www.oecd.org/tax/treaties/beps-mli-position-mexico.pdf
69. *Id.* at 12.

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Israel, Jamaica, Kuwait, Panamá, South Africa, Ukraine, United Arab Emirates, and the United States of America).[70]

With respect to CTAs for which Mexico made no reservations, Mexico takes the position to apply a simplified LOB clause.

3. *Article 8 – Dividend Transfer Transactions*

Mexico's CTAs with Argentina, Australia, Austria, Barbados, Belgium, Brazil, Canada, Chile, Costa Rica, Denmark, France, Germany, Guatemala, Hungary, Island, Ireland, Israel, Jamaica, Japan, Korea, Latvia, Lithuania, Luxemburg, the Netherlands, New Zealand, Norway, Panamá, Peru, the Philippines, Poland, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, and the United States already contain clauses similar to Article 8.

4. *Article 9 – Capital Gains from Alienation of Shares or Interests of Entities Deriving Their Value Principally from Immovable Property*

Mexico's position stated that fifty-six of the sixty-one CTAs (except Brazil, Chile, Greece, Luxemburg, and Russia) have provisions similar to Article 9 of the MLI. Therefore, to the extent that the other contracting jurisdictions conduct the same notification, Article 9(1) of the MLI will become applicable.

5. *Article 10 – Anti-Abuse Rule for PEs Situated in Third Jurisdictions*

Mexico has not submitted a position to the MLI related with this Article, which is consistent with its domestic law and DTCs where a tax credit is used as mechanism to alleviate double taxation, creating a situation as the one described where the country of residence exempts the attributable profits to a foreign PE.[71]

D. Dispute Resolution and Arbitration

Mexico adopted the minimum standard rules relative to Mutual Agreement Procedures (MAP), whereby countries are obligated to implement rules that allow efficient resolutions of treaty related disputes. Taxpayers may request a MAP in either country. Mexico, however, did not accept the mandatory arbitration procedures under the MIL.

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70. *Id.*, at 20–22.
71. Código Fiscal de la Federación [CFF], Ley Del Impuesto Sobre La Renta, título 1, art. 5, Diario Oficial de la Federación [DOF], 11-12-2013 (Mex.), http://www.ordenjuridico.gob.mx/Documentos/Federal/html/wo88917.html.

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