UPDATES AND OTHER TIDBITS

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THINK TWICE BEFORE EVADING TAXES (PART II) FOLLOW UP TO CREDIT SUISSE GUILTY PLEA

As we noted last month, Credit Suisse AG pleaded guilty to conspiracy to aid and assist U.S. taxpayers with filing false income tax returns and other documents with the I.R.S. Following Credit Suisse's guilty plea to helping American clients evade taxes, New York State's financial regulator is said to have picked Mr. Neil Barofsky as the corporate monitor for Credit Suisse Group AG. Monitors are chosen to act as the government's post-settlement proxy, shining a light on the inner workings of corporations and suggesting steps to bolster compliance procedures.

Credit Suisse agreed to two years of oversight by New York's financial regulator as part of its $2.6 billion resolution with the U.S. Credit Suisse's settlement is the first guilty plea by a global bank in more than a decade, and the penalty agreed to is the largest penalty in an offshore tax case.

For most banks, the appointment of Mr. Barofsky could be hard to swallow. Mr. Barofsky is a frequent critic of Wall Street and government bailouts, and used to serve as the Inspector General of the Troubled Assets Relief Program. Barofsky has criticized federal prosecutors for being too lenient on Wall Street and bankers whose actions fueled the 2008 financial crisis. After Credit Suisse's settlement, Barofsky was cited saying that "the Justice Department wants to be perceived as tough as nails while avoiding the collapse of a too-big-to-fail institution and other consequences." He also said that "if there are very few collateral consequences, and the criminal plea is perceived as just another cost of doing business, then the deterrent effect will be minimal." While we take Mr. Barofsky's point, we hope that criminal fines do not become generally accepted as ordinary and necessary costs of international business, banking or otherwise.

E.U. FINANCE MINISTERS MEETING SET "TAX AVOIDANCE" AND OTHER "ANTI-COMPETITION" MEASURES IN MOTION

The June 20, 2014 meeting of the E.U. Finance Ministers dealt with key issues of importance as identified by the Finance Ministers in the areas of tax loopholes and the code of contact on business taxation.

E.U. Revamp Parent – Subsidiary Provision

There was unanimous agreement to revise by legislation the E.U.'s Parent-Subsidiary directive to eliminate a double non-taxation issue. The double non-taxation at issue results from the use of hybrid instruments in conjunction with the

Parent-Subsidiary participation. Interest deductions in the country which recognizes the instrument as a debt instrument coupled with an exemption from tax under the Parent-Subsidiary Directive on the amount paid considered a dividend in the other country had resulted in billions of euros in lost tax revenue according to the Ministers.

Accordingly, to get an agreement on the E.U. legislation, a proposal was made to establish a new anti-abuse provision in the law which will address hybrid loan agreements. All E.U.-level tax laws require unanimous support from all member states. While at a previous European Council of Economic and Financial Affairs meeting in May 2014 Malta and Sweden blocked this legislation effort, the two countries lifted their objections and made this legislation possible. Malta was the last of the E.U. countries to agree with the legislation and did so in response to significant criticism by Member States of aspects of the Maltese tax law which are felt to foster tax avoidance through use of Maltese based structures.

In a statement released after the ministers' meeting, the European Taxation Commissioner Algirdas Šemeta said, "With these revisions, the Parent-Subsidiary directive will remain an important tool in creating a business-friendly environment in the E.U. without giving unintended opportunities to tax evaders."

This legislation is expected to be devised during Italy's rotating E.U. presidency, which started on July 1, 2014.

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E.U. Begins Probe of "Patent Box" Tax Schemes

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In the U.K., as an example, the patent box enables companies to apply a lower rate of tax (10%) to profits earned after April 1, 2013 from patented inventions, provided the patent was granted at a participating I.P. office such as the European Patent Office and the U.K. Intellectual Property Office. Last year, German Finance Minister Wolfgang Schaeuble complained that such schemes resulted in unfair competition. And the scheme has indeed attracted domestic investment and foreign investment, too. Pfizer Inc., a U.S.-based drug maker cited tax advantages as one of the attractions of its (failed) takeover approach to AstraZeneca PLC in May 2014.

Now, the move to have the European Commission start an overall investigation into patent box schemes begins. "Member states' tax incentives should never be used to lure profits away from where they should rightfully be taxed," European Taxation Commissioner Algirdas Šemeta said. He further said that the E.U. will begin assessment immediately and is hopeful that a full evaluation will be delivered by the end of this year.

Switzerland Agrees on Code of Conduct

The Ministers also formally closed the two year dialog with Switzerland with Switzerland agreeing to abide by rules outlined in the E.U. Code of Conduct against unfair corporate taxation.

The E.U. Code of Conduct was adopted initially in the late 1990s and has been an important tool designed to force E.U. member states to phase out more than 90 different tax schemes originally targeted in the E.U. member states.

In a June 20, 2014 statement issued by the European Commission, Šemeta said, "Switzerland has agreed to remove a number of harmful tax regimes that were of concern to member states. Our efforts to secure fair tax competition are bearing fruit, even beyond E.U. borders." According to Swiss reports, those "harmful" regimes will likely include the cantonal tax regimes, which the European Commission said in 2007 were seen to be distorting competition in Europe due to the differing treatment of domestic and foreign income.

These actions announced by the Ministers come shortly after the European Competition Commissioner Joaquin Almunia launched a formal investigation into the tax practices used by Apple Inc. in Ireland, Starbucks Corp. in the Netherlands, and Fiat Finance Trade Ltd. in Luxembourg.

Referencing B.E.P.S., the Ministers stated these actions were a major step forward in the fight against base erosion and profit shifting. In the statement issued by the European Commission following the June 20, 2014 ministers' meeting, Šemeta said, "We must verify that the principles of fair play are not being undermined."

If in fact this is the case remains to be seen, but on their face, the latest developments are focusing on tax avoidance in Europe in the wake of the region's financial crisis.

LUXEMBOURG RULING POSTURE ILLUSTRATES EFFECT OF EU COMMISSION SCRUTINY

As previously announced, the E.U. Commission is looking at the compliance with E.U. state aid rules of certain tax practices in some Member States in the context of aggressive tax planning, with a view to ensure a level playing field in a constrained economy. As part of this, the Commission announced an in-depth investigation involving, among others, Luxembourg. Under this authority, the Commission is examining whether decisions made by the Luxembourgish tax authorities comply with the E.U. rules on state aid. The Commission is focusing on the favorable ruling issued by the Luxembourg authorities for Fiat Finance and Trade.

The issue centers around Article 107(1) of the Treaty on the Functioning of the European Union, state aid. This Article addresses trade between Member States with a view towards prohibition of a Member State's distortion of competition by favoring certain undertakings. This is considered in principle incompatible with the E.U. Single Market and when tax rulings provide selective advantages to a specific company or group of companies, this may amount to state aid within the meaning of E.U. rules.

One area in which tax rulings are commonly used is confirming transfer pricing arrangements. Transfer pricing refers to the prices charged for commercial transactions between related parties, in particular prices set for goods sold or services provided. Transfer pricing influences the allocation of taxable profit between related parties located in different countries. If the tax authorities accept the calculation of the taxable basis proposed by a company, and this calculation is not based on remuneration on market terms, it could imply a more favorable

treatment of the company compared to the treatment other taxpayers would receive under the Member States' tax rules.

We are now seeing this play out. A company that applied for a ruling in Luxembourg to confirm its transfer pricing agreement with respect to goodwill transferred from U.S.-Co to LuxCo received a rejection from the Luxembourg tax authorities. The ruling request was supported by a valuation study which defined fair market value as the estimated amount for which an asset could be exchanged between knowledgeable and willing parties in an arm's length transaction. Nevertheless, the tax inspector refused to rule arguing that the transfer pricing report failed to meet increased standards of analysis with respect to the recognition and valuation of the goodwill. We believe this is indicative of future Luxembourg rulings in the transfer pricing area and perhaps other tax ruling areas as well.

THINK TWICE BEFORE EVADING TAXES (PART III) CHANGES TO GERMANY'S VOLUNTARY SELF-DISCLOSURE PROGRAM

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As a result of ongoing media coverage of prominent tax evaders in Germany, stricter requirements have been agreed to with respect to the German voluntary self-disclosure program. Under the current system, a taxpayer is able to avoid criminal prosecution by giving a full, complete, and accurate account of all avoided taxes along with payment of interest at a rate of 6% per annum on the back taxes owed. If taxes owed are in excess of €50,000, an additional penalty of 5% of the tax owed

Under the current system, the period for disclosure corresponds to the statute of limitation for which criminal prosecution is not statute-barred, five years for "minor" (€50,000 or less for each taxable year) and ten years for the more serious situations. The amounts must be paid within the deadline set by the revenue authority's agent.

Effective January 1, 2015, the period for disclosure will correspond with the ten year statute of limitations in all cases involving tax evasion. Back taxes, along with the 6% interest per year shall be due immediately, as will an additional penalty based on the amount of total taxes due. If the taxpayer owes more than €25,000 but less than €100,000, the rate of interest will be increased to 10%, 15% if less than €1 million and 20% if over €1 million.

Note that German rules provide that voluntary self-disclosure does not hinder criminal prosecution if, (i) the delinquent taxpayer or his representative has already been notified of the initiation of a tax audit or of criminal or misdemeanor proceedings, (ii) an the taxpayer is visited for the purpose of a tax audit or criminal investigations, or (iii) the taxpayer is or should be aware the offence has already been detected by the revenue authority.

RECENT I.R.S. ADMINISTRATIVE PERSONNEL RESIGNATIONS RAISE ISSUES OF AGENCY'S DIRECTION IN THE INTERNATIONAL TAX AREA

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Michael Danilack, deputy commissioner (international) and U.S. competent authority; Samuel M. Maruca, the first director of transfer pricing operations; Diana Wollman, the first director of international strategy; and Richard McAlonan, director of the Advance Pricing and Mutual Agreement (APMA) program along with Laura Prendergast, the acting deputy commissioner (domestic) have or will be leaving L.B.& I.

Any interrelationship in the departure of these individuals is not clear, however, the rumor mill is active, from a pending reorganization of L.B.&I. to fundamental disagreements with how the international BEPS initiative could affect basic tenets of international tax law as defined by Treasury and the I.R.S.

On the reorganization front, it is believed that the I.R.S. has discussed removing the international examiners from the authority of the deputy commissioner (International) and returning them to the domestic side of examinations.

One plan would be to move the international examiners back to an industry-oriented structure and convert them into general agents—a move that would reverse many aspects of the restructuring undertaken in 2010. The other alternative is to leverage the expertise of the international examiners by training domestic agents to take on some of the international workload.

As far as B.E.P.S. is concerned, recent comments by senior L.B.&I. personnel as well as Treasury officials have hinted at issues faced by the U.S. to align key B.E.P.S. action plan initiatives with internal U.S. international tax law, particularly in the transfer pricing area.

Whatever the case, the changes come at a time when the agency's international workload is immense, with F.A.T.C.A. coming online July 1 and a recent expansion of the O.V.D.P. that is intended to allow more people to qualify for streamlined procedures. And then there is the future of the transfer pricing program, which was instituted with great fanfare in 2010.

We anticipate at least a short term effect on international tax administration, both U.S.-centric and with respect to U.S. participation in and input to the B.E.P.S. process even as that process moves to its September agenda.

CANADIAN COURT DECISION AFFIRMS CRA TRANSFER PRICING ADJUSTMENT DISALLOWING MANAGEMENT FEES PAID

Document, document, document is the advice we give clients with respect to intercompany management or other service agreements. It seems the court in Canada agrees with our position in this regard. In *Marzen Artistic Aluminum Ltd. v. The Queen*, Can. Tax Ct., No. 2010-860(IT)G, 6/10/14) the Tax Court of Canada sustained nearly all of C.R.A.'s C$7.1 Million transfer pricing adjustment. The Court concluded that Marzen Artistic, the largest window manufacturer in British Columbia, was unable to prove that it received services of substantial value under a marketing and sales services agreement ("M.S.S.A.") executed in July 1999 with its wholly owned Barbados subsidiary, Starline International Inc.

The arrangement in and of itself, Canada parent/Barbados subsidiary, is subject to close scrutiny in Canada. Knowing this, Marzen should have held itself to a high standard of documentation and perhaps attempted to do so.

With respect to documentation, the Court upheld the C.R.A.'s application of transfer pricing penalties on the basis that Marzen failed to supply adequate records or documentation in response to the tax agency's request. Marzen failed to respond to a written request for documentation issued by C.R.A. in April 2003. Marzen thus failed to provide details of the data and methods it used to determine its transfer prices or allocations of profits or losses or contributions to costs of the transactions (think contemporaneous documentation under U.S. tax transfer pricing rules). The C.R.A. said the taxpayer also failed to provide any assumptions, strategies and policies that influenced its determination of transfer prices. In fact, Marzen's only discussion of the penalties issue was in oral argument, where its counsel said the taxpayer's response to the C.R.A.'s request included a statement indicating it was willing to respond to further requests to elaborate on the provided material.

On that basis, Marzen failed to meet the requirements of Section 247(4)(a) of Canada's Income Tax Act in providing adequate records or documentation, the Court said. "The appellant is deemed not to have made reasonable efforts to determine and use arm's length transfer prices and is liable to a penalty in respect of the 2001 taxation year."

Section 247(3) of the Act provides for a penalty of 10 percent of the amount by which the transfer price adjustment exceeds the lesser of the taxpayer's gross revenues for the year, or C$5 million ($4.6 million). Marzen is currently considering whether to appeal the Court's judgment.

In our view, forewarned is forearmed. Document, document, document.

I.R.S INTENDS TO FOLLOW ITS TRANSFER PRICING AUDIT ROADMAP. TAXPAYERS SHOULD PREPARE ACCORDINGLY

As we anticipated in an earlier edition of our Newsletter, the I.R.S. intends to closely follow its February 14, 2014 released "Transfer Pricing Audit Roadmap" with respect to documentation it expects during the course of a transfer pricing audit. This was confirmed by I.R.S. representatives in a recent webinar on transfer pricing documentation.

The Roadmap refers to two key orientation meetings, one on a company's financials and the other on its transfer pricing. The purpose of these meetings is to identify issues that might be consolidated which would otherwise be the subject of separate, information document requests requiring significantly more time and effort from both the taxpayer and I.R.S.

The financial orientation involves a review of the company's legal entity organizational charts and functional organizational charts as well as a review of financial statements, accounting practices, cost and profit centers and an explanation of book and tax differences, among other information.

The transfer pricing orientation is meant to give the I.R.S. an understanding of the taxpayer's intercompany transactions, its value chains and contributions to the value of any intangible, as well as an understanding of how the company's transfer pricing documentation was prepared and the key players involved in structuring the transactions.

The meetings will have to strike a balance between the opportunity for taxpayers to "tell their story" and explain their transfer pricing priorities and the I.R.S. exam team's desire to tell taxpayers where they want to focus attention. Conflicts of interest could arise where there are differences of opinion in areas that deserve attention.

The exam team's intent is to develop a "working hypothesis" early in the process, and the I.R.S. position is that cannot happen without a full disclosure of the facts. Consequently, taxpayers should be prepared for the I.R.S. to conduct significant "due diligence" of their transfer pricing affairs including understanding the taxpayer business model, strategic business goals, profit drivers, etc.

FINAL RULES ON GAIN RECOGNITION AGREEMENTS COMING SOON

The I.R.S. has indicated final rules relaxing the standard to seek relief from penalties for non-compliance with Gain Recognition Agreements are imminent.

The proposed rules (REG-140649-11), issued in January 2013, impose a more lenient "not willful failure" standard rather than the "reasonable cause" standard for relief. While no details have been given regarding the exact content of the final rules, the proliferation of transactions requiring consideration of Gain Recognition Agreements has made any regulatory change in the area something to closely monitor.

THE DEATH OF CIRCULAR 230 DISCLAIMERS

The Internal Revenue Service ("I.R.S.") recently modified its Circular 230, which sets forth the regulations to practice before the I.R.S. A major change made was to eliminate the need for the I.R.S. Circular 230 disclaimer. Karen L. Hawkins, director of the I.R.S. Office of Professional Responsibility, told practitioners at a tax conference on June 20 at New York University School of Continuing and Professional Studies that "the disclaimer is no longer necessary." Tax practitioners will no longer need to add Circular 230 at the conclusion of emails or other writings when communicating with clients. The Treasury Department stated that many tax practitioners "insert the disclaimer without any regard to whether or not the communication is necessary or appropriate." Consequently, tax practitioners have been misusing the disclaimer. While the intent was justified, many doubt the disclaimer ever served its purpose or was used effectively. The Treasury Department stated that the removal of the requirement should be effective by June 12, 2014. Where does this leave practitioners? Practitioners must make reasonable, factual, and legal assumptions and cannot hide behind the veil of a disclaimer. Practitioners are required to put reasonable efforts into discerning the facts and completing their due diligence.