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EDITORS' NOTE

In our final edition of the year, this month's *Insights* features contributions from several tax professionals across the globe. Our articles address the following:

- **Canadian Immigration Trust Exemption Withdrawn.** Guest author Michael Cadesky, C.A./C.P.A., of Cadesky & Associates LLP, Toronto, addresses the discontinuation of decades-old legislation that provided a 60-month exemption to Canadian taxation of foreign assets. What plans remain available?

- **Voluntary Tax Regularization: A U.S. and French Comparison.** Nicolas Melot, A. Fanny Karaman, and Sheryl Shah provide a comprehensive review of voluntary programs for rectifying tax noncompliance in the U.S. and France.

- **Expansion of Non-Willful Standard for Relief from Non-Filing of Gain Recognition Agreement Reduces Compliance Burdens.** Robert G. Rinninsland and Philip R. Hirschfeld discuss reporting requirements for outbound reorganizations under Code §367.

- **New I.R.S. Procedures for Canadian Retirement Plans.** Kenneth Lobo examines new revenue procedures which eliminate the need to file Form 8891 to defer the accrued R.R.S.P./R.R.I.F income for U.S. tax purposes in the case of eligible individuals.

- **Corporate Matters: Don't Be Late – Time is of the Essence.** Guest authors Alexander Seligson and Alyne Diamond of Seligson Rothman & Rothman, L.L.P., address terms of art that are surprisingly powerful when specifying the closing date in a contract of sale and counterpart phrases that have no legal meaning.

- **F.A.T.C.A. 24/7.** Galia Antebi and Philip R. Hirschfeld provide a monthly update on F.A.T.C.A. compliance, including bitcoin and pre-existing account reporting, and the signing of five additional U.S. I.G.A.'s.

- **Foreign Correspondence: Notes from Abroad.** A team of international guest authors, Thierry Boitelle and Aliasghar Kanani of Switzerland, John Chown of the U.K., and Michael Peggs of Canada, provide commentary on lump-sum taxation in Switzerland, the proposed diverted profits tax in the U.K., and Canadian transfer pricing proposals to reduce the Canadian retail price premium in comparison to prices in the U.S.

- **A Bad Month for Luxembourg.** Galia Antebi and Rusudan Shervashidze address recent revelations concerning preferential tax treatment for global companies active in Luxembourg.

- **Updates and Other Tidbits.** Cheryl Magat, Kenneth Lobo, and Rusudan Shervashidze review current events in international taxation.

We hope you enjoy this issue.

-The Editors

CANADIAN IMMIGRATION TRUST EXEMPTION WITHDRAWN

Author
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Tags
Bump-up
Canada
Cost Basis
Immigration Trust

INTRODUCTION

For over 40 years, Canada offered a unique tax benefit to individuals not previously Canadian resident or who had been resident in Canada for less than 60 months. Such persons were allowed to establish a nonresident trust, which would not be taxable by Canada and from which a Canadian resident beneficiary could receive tax-free capital distributions. In addition, and in comparison to U.S. tax rules, income accumulated in the trust at the end of the calendar year automatically became capital, following typical provisions in discretionary trusts. Once converted into capital, the rules for tax-free distributions of capital became applicable.

This made Canada an attractive jurisdiction for global elite. Wealthy immigrants to Canada could shelter foreign investment income and capital gains from Canadian tax for a period of up to 60 months after becoming resident. Needless to say, these structures became quite popular.

In a surprise move announced in February 2014, the tax benefit was withdrawn from 2015 onwards. However, if the trust received a contribution after February 22, 2014, it would become taxable from 2014 onwards. Importantly, no grandfathering was provided for existing trust arrangements, which is both unfortunate and unfair. The change impacts a large number of individuals, as many people have structured their tax planning on the basis of having this exemption for 60 months.

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CANADIAN TAX SYSTEM

Canada has a common law definition of residence, which is basically a facts and circumstances test. When an individual establishes sufficient ties to Canada, that person will become resident. While Canada also has a substantial presence rule (183 days in the calendar year), this rule is only applicable to persons who spend time in Canada without becoming resident under common law principles. Citizenship and immigration status are not a basis for levying tax.

Canada has relatively high personal income tax rates, which vary by province and are progressive based on income. The top tax rate is reached at income of about C$150,000 and varies from 39% to 50% depending on the province.

Given these high personal tax rates, clearly there was a large incentive for high net worth individuals to structure tax planning arrangements wherever possible. The so-called “immigrant trust” offered an excellent opportunity for tax reduction, at least for the first five years of Canadian residence.

CANADIAN CITIZENSHIP

Many immigrants to Canada do not actually intend to live in Canada permanently but are interested in obtaining a Canadian passport. This requires physical presence in Canada for three years over a four-year period. Allowing for some delays and the possibility of additional time spent outside of Canada, five years (or 60 months) was a very convenient and appropriate timeframe within which to apply for and obtain Canadian citizenship. Combined with the immigrant trust, a high net worth person coming from a country such as Russia or China or a geographical area such as the Middle East could obtain a Canadian passport within the five-year period and then leave Canada and pay virtually no Canadian tax.

"In a surprise move, the immigration trust exemption was completely withdrawn.”

This type of plan became very popular with immigration consultants who would often sell a Canadian investment fund (which allowed a fast track to permanent residency status, the Canadian equivalent of a green card) and earn a sizeable commission.

The physical presence requirement to obtain Canadian citizenship gave rise to many cases of abuse, where people lied about their physical presence in Canada and used false addresses. These issues, combined with a general lack of compliance on the part of many newcomers (not wanting to pay tax on foreign income after the 60-month exemption), together with political pressures (resulting from newcomers buying up old quaint properties, typically in Vancouver, then tearing them down and building “monster homes”) brought the topic to the forefront.

The first change was to tighten up the citizenship process and to change the rules to require four years of presence within six years rather than three years within four. More extensive and detailed reporting of foreign assets created additional scrutiny from the Canada Revenue Agency. Then, in a surprise move, the immigration trust exemption was completely withdrawn.

IMMIGRANT TAX PLANNING – WHAT IS LEFT?

Unfortunately, there is no equivalent to replace the immigrant trust exemption and the tax planning that remains is now quite limited.

If a Canadian resident has contributed to a nonresident trust, that trust will be deemed Canadian-resident, and therefore taxable on its world income, from January 1 of the year in which the person becomes Canadian resident. Accordingly, starting from 2015 (or 2014 if a contribution is made after February 22, 2014) the nonresident trust will be deemed resident from January 1 of that year. Someone who moves to Canada and has previously funded a nonresident trust (including a U.S. trust) will find that the trust is deemed resident from January 1 onwards (*viz*., it covers the period prior to the date when the person became Canadian resident).

To prevent Canadian tax on the pre-arrival income of the trust, that income should be paid out of the trust as an income distribution prior to the person becoming resident. Even then, a nonresident withholding tax might apply. Unfortunately, winding up the trust during the portion of the year before the person becomes Canadian resident will not prevent the trust from being deemed resident for that entire calendar year. This is a major trap for persons who are not properly advised, and the failure to obtain this advice before moving to Canada may results in a very unpleasant surprise. Therefore, pre-arrival planning is now vital and, as the rules have become complicated, requires specialized advice.

Two remaining plans for arriving persons involve accessing the bump-up in cost basis that occurs at the time of immigration and planning for distributions from inbound trusts funded by nonresident family members. Where the immigrant has a foreign business which is considered an active business, certain tax planning options are still available, as described below.

Canada allows a step-up for tax purposes in the cost of property owned at the time an individual becomes Canadian resident. The step-up can be combined with a distribution pattern incident to a series of redemptions to monetize that value for the benefit of the Canadian shareholder.

"Winding up the trust during the portion of the year before the person becomes Canadian resident will not prevent the trust from being deemed resident for that entire calendar year."

Suppose that the immigrant has a foreign active business operated in corporate form. Suppose further that the shares of the corporation have a nominal cost base (say $100 of share capital). However, the fair market value is, say, $6 million at the time Canadian residence is established. The shares will take on a cost base for Canadian tax purposes equal to $6 million. This $6 million cost base can be "extracted" free of Canadian tax in a number of ways (*e.g.*, a transfer of the shares to a holding company for a note, a redemption of the shares possibly combined with a corporate reorganization to segregate the share class into preferred shares, and so forth). This can allow tax-free repatriation of an amount up to the value of those shares, which may prove very useful. This tax planning will only work if the income of the foreign corporation is active business income and not passive income. Otherwise, the Canadian "Controlled Foreign Corporation ('C.F.C.') rules" will apply to impute the income directly to the Canadian resident shareholder as the income arises.

A second opportunity that remains for newly arrived Canadian residents is the inbound trust. This is a trust to which no Canadian resident has contributed property. Such a trust is not deemed Canadian resident, and a Canadian resident may receive capital distributions from that trust free of tax. A Canadian resident who has, for example, wealthy parents living abroad can benefit from a nonresident trust structure set up by the parents. The trust would earn income, retain the income such that it becomes capital, and distribute the capital to Canadian resident beneficiaries without tax. However, if the newcomer to Canada gives the assets to a nonresident individual – typically a family member – before arrival, who then puts these assets into a nonresident trust, this will be viewed as an indirect contribution, and the trust will be deemed Canadian resident.

L.L.C.'S – TRAPS FOR THE UNWARY

American citizens moving to Canada have a particularly complex task of tax planning because of the ongoing requirement to pay U.S. tax on worldwide income, subject to foreign tax credit relief.

Added to this is the unfortunate mismatch between how Canada and the U.S. regard limited liability companies ("L.L.C.'s"). For U.S. tax purposes, the L.L.C. will typically be a flow-through entity so that the owner will report the income. However, for Canadian tax purposes, the L.L.C. is regarded as a foreign corporation, and the income is not taxed until withdrawn (unless the income is passive income, in which case it will be taxed as it arises). Accordingly, the income can be taxed for U.S. purposes on an annual basis and taxed by Canada at a later date when funds are withdrawn from the L.L.C.

The failure to take this into account can lead to double taxation, particularly because Canada's foreign tax credit in this circumstance does not allow for a carryforward or a carryback. Careful attention must therefore be paid to analyzing the corporate structures of newcomers to Canada to make sure the structures are appropriate and will not lead to adverse Canadian tax consequences. A key problem is that the implementation of a restructuring plan prior to arrival in Canada may lead to unnecessary tax in the U.S., whether implemented during or after the period of U.S. residence.

CONCLUSION

Tax planning opportunities for newcomers to Canada are now much more limited and far less lucrative than was the case with the immigrant trust. Tax planning opportunities still exist, particularly for foreign active businesses, because of the step-up in cost base which is granted. But a large part of the tax planning will now be devoted to preventing problems, including double taxation, and making sure that any corporate structures are suitable within the Canadian context. For this reason, it is now even more important to obtain Canadian tax advice at an early stage and certainly well before the intended arrival date of the new Canadian resident.

VOLUNTARY TAX REGULARIZATION: A U.S. AND FRENCH COMPARISON

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U.S. AND FRENCH BACKGROUND

> The Tax Division is committed to using every tool available in its efforts to identify, investigate, and prosecute [noncompliant U.S. taxpayers who would use secret offshore bank accounts].[1]

The above statement, found on the U.S. Department of Justice's website, clearly sets forth the U.S. government's current approach to U.S. tax noncompliance with regard to foreign bank accounts.

In 2000, a State Department report found that $4.8 trillion are held by U.S. persons in offshore accounts.[2] In 2008, further investigation showed that the U.S. lost $100 billion in annual tax revenue as a result of tax abuse using offshore accounts.[3] The increase in online communications, global outreach, and sophistication of the taxpayer, made it easier to not only move money around but also to keep it hidden. As a result of these reports, the U.S. Department of Justice launched an offshore program in 2008 that involved investigations of global banks abroad, causing uproar among the international financial industry.

The program launched with the controversial investigation of UBS AG ("UBS"), Switzerland's largest bank, in 2008, and was prompted by the actions of Bradley Birkenfeld, who exposed the schemes the bank had used to lure U.S. taxpayers into avoiding payment of U.S. taxes.[4] In 2009, the investigation resulted in:

- UBS entering into a deferred prosecution agreement and admitting guilt on charges of conspiring to defraud the U.S. and impeding the I.R.S.;
- UBS terminating its banking relationships with U.S. taxpayers having undeclared accounts;

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1 United States Department of Justice, Offshore Compliance Initiative.
2 *State of the Offshore Voluntary Disclosure Program: Knowing Your Options and Avoiding Traps.* Ivins, Phillips & Barker. November 6, 2014.
3 United States Department of Justice, Offshore Compliance Initiative.
4 Kocieniewski, David. "Whistle-Blower Awarded $104 Million by I.R.S." *New York Times.* September 11, 2012.

- UBS paying $780 million in fines, penalties, interest, and restitution.

The most significant repercussion was the disintegration of Swiss bank secrecy laws as a result of an agreement negotiated between UBS, the U.S., and the Swiss government. In addition, the adoption of the Foreign Account Tax Compliance Act ("F.A.T.C.A.") in 2010, as part of the Hiring Incentives To Restore Employment Act, requires U.S. taxpayers with non-U.S. accounts to disclose these accounts to the Internal Revenue Service ("I.R.S."). It also requires foreign financial institutions to identify accounts held by U.S. persons and to share this information with the I.R.S.

On the heels of its success with UBS in Switzerland, and as a direct result of F.A.T.C.A., the I.R.S.'s scope now reaches banks and countries worldwide.

In light of these developments, voluntary compliance procedures were established to encourage taxpayers to come into compliance with U.S. laws. A series of voluntary disclosure programs focusing on the disclosure of foreign financial assets and income were offered, starting with the 2009 Offshore Voluntary Disclosure Program. Since then, over 45,000 taxpayers have come forward, voluntarily disclosing their foreign accounts to the I.R.S. and paying delinquent taxes, interests, and penalties to the Treasury. The I.R.S. website states that as of June 2014, $6.5 billion in tax was collected from more than 45,000 taxpayers.[5]

"Over 45,000 taxpayers have come forward, voluntarily disclosing their foreign accounts to the I.R.S."

The 2009 Offshore Voluntary Disclosure Program allowed taxpayers with unreported income related to offshore transactions to voluntarily disclose their information to the I.R.S. A voluntary disclosure did not automatically guarantee immunity from prosecution but did result in prosecution not being recommended. The program ran for a limited period of time and ended in October 2009. Soon after, a new Offshore Voluntary Disclosure Initiative was announced in February 2011 and ran through August of that year.

Because of the strong interest in and overall success of the 2009 and 2011 programs, the I.R.S. began the open-ended O.V.D.P. in January 2012. The biggest differences between this program and its predecessors are that the 2012 program could terminate at any time, the penalties are significantly higher (27.5% through June 2014), and the risk of criminal prosecution is eliminated upon pre-clearance into the program. On June 18 of the current year, the program was further revised to include an offshore penalty that can be as high as 50% of the highest aggregate amount of the offshore assets over the last eight years.[6] Along with this revised 2012 Offshore Voluntary Disclosure program, the Streamlined Filing Compliance Procedures have been revised and broadened to apply to taxpayers whose U.S. tax noncompliance was non-willful.

France also joined in the effort to combat international tax avoidance. In this spirit, France amended several of its income tax treaties to allow for information exchange procedures for which banking secrecy laws are no longer impediments.

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5 "IRS Offshore Voluntary Disclosure Efforts Produce $6.5 Billion; 45,000 Taxpayers Participate." Internal Revenue Service. June 2014.

6 "The 2014 Offshore Voluntary Disclosure Program (OVDP)." Tax Law Offices of David Warren Klasing. 2014.

Following the European trend to fight tax avoidance,[7] France decided to tighten up its rules[8] by allowing taxpayers to voluntarily declare assets held abroad in order to benefit from more flexible tax penalties and escape criminal tax avoidance proceedings.

The circular issued by the French Ministry of Economy on June 21, 2013 sets forth the requirements of this new tax regularization procedure.

FRENCH VOLUNTARY COMPLIANCE LANDSCAPE

Framework of the Procedure

The scope and the main principles of this procedure are the following:

- The tax regularization procedure applies to individuals whose tax residence is in France and who hold assets abroad through bank or securities accounts, life insurance contracts, trusts, corporate bodies, or similar arrangements.

- This procedure is only available in the case of a voluntary disclosure made to the French tax authorities ("F.T.A."). Taxpayers who are already under audit or subject to proceedings by tax or judicial authorities in relation to unreported assets held abroad are not eligible to participate.

- In a change from the previous 2009 regularization procedure, under the 2013 procedure a taxpayer can no longer enter the program on an anonymous basis. Taxpayers wishing to come forward must now do so by revealing their identity in the early stages of the process.

Regularization Process

Filing of Amended Tax Returns

Taxpayers who decide to regularize their tax situation must voluntarily file amended tax returns covering all years that are not covered by the statute of limitations and pay all relevant back taxes.

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[7] *E.g.*, the *Directive on Administrative Cooperation in the Field of Taxation*, applicable as of January 1, 2015, provides for information exchange procedures between Member States of the European Union. Also, the announced amendment of the *Taxation of Savings Income Directive*, relating to the automatic reporting by the paying agent of the beneficiaries to their tax authorities, should have an impact on the structuring made available to European clients.

[8] The law on the fight against tax avoidance and serious economic and financial crime was promulgated on December 6, 2013 and published in the Official Journal dated December 7, 2013 (law No. 2013-1117). This law provides for a toughening up of penalties incurred in the case of serious tax fraud organized in particular through accounts held abroad (the fine is raised from to €1 million to €2 million in this case).

“Taxpayers who decide to regularize their tax situation must voluntarily file amended tax returns covering all years that are not covered by the statute of limitations and pay all relevant back taxes.”

Considering the extended statute of limitations in the case of noncompliance with reporting requirements related to foreign assets, the following tax returns must be amended, when applicable:

- Income tax returns (including social security contributions) as of 2006;
- Wealth tax returns as of 2007; and
- Inheritance and gift tax returns if the death occurred after January 1, 2007.

Taxpayers must send their request with the amended tax returns to the relevant tax center or to the directorate for the verification of tax situations (“D.N.V.S.F.”).[9] All files will be dealt with by the D.N.V.S.F. in order to guarantee a centralized and uniform approach.

Supporting Documents

In addition to the amended tax returns, the submission must contain the following documents:

- A document detailing the origin/source of the foreign assets held directly or indirectly, with supporting evidence;
- Evidence relating to the value of the foreign assets held, whether directly or indirectly, and to the amount of income derived from these assets over the regularization period;
- A certificate from the foreign financial institution indicating the absence of deposit by the taxpayer or any other evidence to prove that no funds were deposited on the account by the taxpayer, if the assets were received by gift or by inheritance;
- A statement from the individual asserting that his or her file is complete and accurate and covers all the unreported accounts and assets held abroad or for which the taxpayer is the entitled or economic beneficiary;
- A certificate of ownership of the account, if applicable.

Tax Consequences of the Regularization Procedure

All the additional taxes resulting from the regularization will have to be paid. The following penalties must also be paid:

- Late payment interest at a rate of 0.4% per month;
- A willful negligence penalty of 40% or 15% depending on the behavior of the taxpayer (whether or not the taxpayer actively participates in the avoidance of French tax);

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9 *Direction Nationale des Vérifications de Situations Fiscales*.

- A penalty for noncompliance of the reporting obligations regarding the existence of foreign assets. This penalty amounts to:
    - €1,500 per year, per unreported bank account or life insurance policy;
    - €10,000 per year, if the unreported account or the life insurance policy is held in an entity based in a State or territory with which France has not entered into a tax treaty calling for administrative assistance in the fight against fraud and evasion which includes access to banking information (applicable as of the 2008 tax year);
- The penalties of €1,500 or €10,000 per year are increased to 5% of the balance of all the unreported accounts or policies when the aggregate balance of the unreported accounts exceeds €50,000 (applicable as of the 2011 tax year) on December 31 of the relevant year.
- In the case of assets held through an intermediary entity (*e.g.*, trusts, foundations, corporations, etc.) benefiting from a preferential tax regime, the provisions of Article 123bis of the French Tax Code ("F.T.C.") apply.[10]

"The offshore voluntary disclosure program ('O.V.D.P.') is for taxpayers whose noncompliance was willful."

Taking into consideration the voluntary compliance effort of the taxpayer, the F.T.A. may agree to reduce the 40% penalty and the penalty for failure to declare the foreign accounts.[11]

Moreover, new tax instructions dated December 12, 2013 increased the penalties in the case of noncompliance with reporting obligations relating to trusts. Failure to comply with these reporting obligations is now punishable by the higher of €20,000 or 12.5% of the value of assets put in the trust. In addition, the new law also provides a penalty of 40% applied to taxpayers subject to the wealth tax for the first time. These new provisions of the law are applicable to wealth tax due for the year 2014, but the tax instruction dated December 12, 2013 provides for a possible reduction of these penalties.

U.S. VOLUNTARY OFFSHORE COMPLIANCE

Willfulness, O.V.D.P., and a 27.5% or 50% Offshore Penalty: Protection Against Criminal Prosecution and Closure

The offshore voluntary disclosure program ("O.V.D.P.") is for taxpayers whose noncompliance was willful (*i.e.*, conduct not merely due to negligence,

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10 The application of this Article allows the F.T.A. to tax real or lump sum incomes of these entities on a progressive scale with regard to income tax (under the category of revenue from investment income) and to social security contributions, with an increase of 25% of the amount of incomes.

11 The interest for late payment does not benefit from a reduction because it is not considered to be a penalty. It aims to repair damage suffered by the French State because of noncompliance by taxpayers of their obligations to report and pay tax at maturity.

inadvertence, or mistake; or to conduct that is not merely the result of a good faith misunderstanding of the requirements of the law) and who are not currently under audit. It enables these taxpayers to become compliant and to incur substantially lower penalties than would be applied in an I.R.S. audit. It also generally eliminates the risk of criminal prosecution.

The O.V.D.P. process can be broken down in three steps: Pre-Clearance, Preliminary Acceptance, and Final Submission.

- Pre-clearance involves the submission of a fax to the Criminal Investigation Division of the I.R.S., providing basic identifying information about the taxpayer, the taxpayer's foreign bank accounts, and the way the foreign bank accounts were held. Upon receipt of the submission, the Criminal Investigation Division will either "pre-clear" the taxpayer or advise that he or she is not eligible for participation.

- If the taxpayer is pre-cleared, a Voluntary Disclosure Letter and Attachments must be prepared and submitted. These documents provide more information regarding the foreign, undisclosed assets, including the origin of the funds and the interactions with the foreign financial institutions. One attachment per foreign account must be attached to the Voluntary Disclosure Letter. Once these documents are submitted, the taxpayer waits for the I.R.S. to preliminarily accept the taxpayer into the voluntary disclosure program.

- Upon receipt of the Preliminary Acceptance, the taxpayer prepares the full submission package.

    - This includes copies of originally filed tax returns for the last eight years, copies of originally filed FinCEN Form 114 for the past eight years (if any), amended tax returns for the past eight years, delinquent or amended FinCEN Forms 114 for the past eight years, the payment of the 27.5% or 50% miscellaneous Offshore Penalty and the payment of back-taxes, failure-to-pay, and failure-to-file penalties if applicable, and a 20% accuracy-related penalty. In addition, interest applies to the back-taxes, the failure to file penalties and the 20% accuracy-related penalty.

    - Particular attention must be paid to international reporting forms. These include Form 5471 (*Information Return of U.S. Person with Respect to Certain Foreign Corporations*), Form 8938 (*Statement of Specified Foreign Financial Assets*), Form 8621 (*Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*), Form 8865 (*Return of U.S. Persons With Respect to Certain Foreign Partnerships*), Form 926 (*U.S. Transferor of Property to a Foreign Corporation*), and Form 3520 (*Annual Return to Report Foreign Trusts and Receipt of Certain Foreign Gifts*).

    - In addition, Form 8960 (*Net Investment Income Tax—Individuals, Estates, and Trusts*) is required when the foreign assets generated unreported net investment income for applicable years (2012 and subsequent years in the filing period), and Part III of Schedule B to

Form 1040 (*U.S. Individual Income Tax Return*) relating to the existence of foreign accounts must be submitted in accurate form.

Once the I.R.S. has concluded an examination of the final submission, a Form 906 (*Closing Agreement on Final Determination Covering Specific Matters*) is signed by the taxpayer and the I.R.S. and the matter is put to rest. This procedure thus gives finality to the taxpayer.

"Filing under the Streamlined Filing Compliance Procedures has a shorter look-back period than the O.V.D.P."

Non-willfulness, Streamlined Procedures, and a 0%-5% Offshore Penalty: No Protection against Criminal Prosecution and No Immediate Closure[12]

When the taxpayer's noncompliance was non-willful, and income generated from the foreign financial accounts was previously unreported, the Streamlined Filing Compliance Procedures may be applicable. Announced on June 18, 2014, this program is available to U.S. taxpayers residing within or outside the U.S. In contrast to the O.V.D.P., entering into the Streamlined Procedure does not eliminate the risk of criminal prosecution. Once a submission is made under the Streamlined Compliance Procedure, the O.V.D.P. cannot be entered anymore and vice-versa.

Filing under the Streamlined Filing Compliance Procedures has a shorter look-back period than the O.V.D.P. For income tax purposes, the look-back period is three years and for F.B.A.R. purposes, the look-back period is six years. In addition, a non-willful certification must be submitted by the taxpayer. In this certification, the taxpayer must certify, under penalties of perjury, that the past noncompliance was not willful. The rules vary slightly depending on whether the taxpayer is considered a U.S. resident.

- For taxpayers not spending more than 35 days in the U.S. in any of the most recent three years for which the due dates (including extensions) have passed, no offshore miscellaneous penalty is imposed on the highest aggregate value of the foreign assets over the past six years.
- If the 35-day threshold of U.S. presence is exceeded, the taxpayer can come into compliance under the Domestic Streamlined Procedures, as long as tax returns were actually filed for the most recent three years for which the due dates (including extensions) have passed. In this scenario, an offshore penalty of 5% of the highest aggregate balance of the taxpayer's foreign financial assets must also be paid at the time of the submission.
- In either scenario, once the final submission is made, the taxpayer must wait for the statute of limitations to run out to be certain that penalties will not be imposed.

This program is much less burdensome than the O.V.D.P., but facts supporting non-willful behavior must be carefully analyzed because the O.V.D.P. and the

[12] "The 2014 IRS Offshore Voluntary Disclosure Program and New Streamlined Filing Procedures." Duane Morris. June 23, 2014.

Streamlined Filing Compliance Procedures are mutually exclusive and a false certification of non-willfulness is itself a felony.

Non-Willfulness, Proper Past Income Reporting, Delinquent Submission Procedures and Potentially no Penalties

For taxpayers whose failure to file F.B.A.R.'s or international information returns was non-willful, delinquent submission procedures are available under certain circumstances. These procedures do not provide any protection against criminal prosecution. In addition, the I.R.S. may subject these filings to a full audit.

- Taxpayers whose failure to file F.B.A.R.'s was non-willful and who reported the income from the non-disclosed foreign accounts on their U.S. tax returns can file delinquent F.B.A.R.'s and provide a reason for late filing, provided they are not under civil or criminal investigation by the I.R.S., have not already been contacted by the I.R.S. regarding delinquent F.B.A.R.'s, or have no other noncompliance issue that is currently being addressed through either the Streamlined Procedure or the O.V.D.P.

- Taxpayers whose failure to file international information returns was non-willful, can file delinquent international information returns along with a reasonable cause statement, provided that they are not under civil or criminal investigation by the I.R.S., have not already been contacted by the I.R.S. regarding delinquent international information returns, or have no other international information return noncompliance that is currently being addressed through either the Streamlined Procedure or the O.V.D.P.

COMPARATIVE TABLE

	FRANCE	U.S.
Number of Official Offshore Compliance Programs	1	2 – O.V.D.P. and Streamlined Filing Procedures
Number of Steps Prior to Final Submission Package	1	3 for O.V.D.P.; 1 for Streamlined
Disclosure of Taxpayer's Identity	On the first step	As of first step for O.V.D.P.; At time of submission for Streamlined
Guidance	Yes – "Circulaire Cazeneuve"	On the I.R.S. webpage
Possibility for Taxpayers to Negotiate with I.R.S./ French Tax Authorities	No	No – Rules set on I.R.S. website and Frequently Asked Questions for O.V.D.P. and Streamlined
Back Taxes, Penalties, and Interest	Yes	Yes
Penalties on Highest Foreign Accounts	Yes	Yes
Criminal Charges	No	Generally not under O.V.D.P. and no reason under Streamlined if Streamlined requirements met

EXPANSION OF NON-WILLFUL STANDARD FOR RELIEF FROM NON-FILING OF GAIN RECOGNITION AGREEMENT REDUCES COMPLIANCE BURDENS

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Outbound Transfers

BACKGROUND

Outbound transfers (as defined) of stock or assets, as well as reorganization transactions that involve a foreign party to the reorganization, are subject to Code §367 and the regulations thereunder. Code §367(a) deals with outbound transfers of stock or assets and attempts to prevent the removal of appreciated property from U.S. taxing jurisdiction before its sale or other disposition. Code §367(b) applies to certain inbound and foreign-to-foreign reorganization transactions and is aimed at preserving the ability of the United States to tax, either currently or at a future date, the accumulated earnings and profits of a foreign corporation attributable to the stock of that corporation held by U.S. shareholders.

In the case of an outbound transfer of assets consisting of tangible property for use by the transferee, a foreign corporation in the active conduct of a trade or business outside of the United States, no gain under §367(a)(1) is triggered.[13] Otherwise, gain under Code §367(a) equal to the fair market value in excess of tax basis is triggered. Code §367(a)(2) and Treas. Reg. §1.367(a)-3, in pertinent part, provide for exceptions to the general Code §367(a) gain recognition for outbound transfers of stock or securities. These sections provide for non-recognition of gain where appropriate, upon entering into a gain recognition agreement (a "G.R.A.").

Under a G.R.A., gain recognition under §367(a) generally can be avoided on the condition that a G.R.A. is entered into by any U.S. transferor who owns at least 5% of the transferee foreign corporation immediately after transfer.[14] The 5% threshold for requiring a G.R.A. is determined based on the greater of vote or value, taking into consideration attribution rules. A U.S. shareholder who does not own 5% or more of the stock does not have to sign a G.R.A. in order to claim non-recognition treatment for their exchange of stock for stock. The foreign parent corporation that issues stock or securities to these U.S. transferors is treated as the transferee foreign corporation for purposes of applying the G.R.A. provisions.[15]

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13 Code §367(a)(3) and Treas. Reg. §1.367(a)-1T(b)(2)(ii).
14 Treas. Reg. §1.367(a)-3(b)(1)(ii).
15 Code §1.367(a)-3(d)(2)(i)(A).

If there is a triggering event by an actual or deemed disposition of the transferred stock or securities by the transferee foreign corporation during the terms of the G.R.A., the U.S. transferor must recognize the gain that was realized but not recognized on the initial transfer.[16]

The term of a G.R.A. generally runs for five full taxable years following the close of the taxable year of the initial transfer.[17] Certain events can trigger early termination of a G.R.A. without triggering the gain recognition requirements before the five-year expiration.

Under prior law, if a U.S. transferor failed to timely file an initial G.R.A. or failed to comply in any material way with applicable Code §367(a) regulations or an existing G.R.A., full gain recognition resulted unless the failure to file or comply was cured and it was shown that such failure was due to reasonable cause and not willful neglect. However, the reasonable cause standard, as interpreted in case law, might not have been satisfied by U.S. transferors in many common situations, even though the failure was neither intentional nor due to willful neglect.

In 2013, the I.R.S. issued proposed regulations that would apply a non-willful standard (defined generally as gross negligence, reckless disregard, or willful neglect) rather than the reasonable cause standard. The proposed regulations would apply the non-willful standard to avoid recognizing gain under Code §367(a)(1) on the initial outbound transfer as a result of a failure to timely file an initial G.R.A. or as a result of a failure to comply in all material respects with the applicable Code §367(a) regulations or the terms of an existing G.R.A.

Extension of Relief for Non-Willful Failures to Other Reporting Obligations

The I.R.S. has determined that it is appropriate to extend the relief for failures that are not willful to certain other reporting obligations under Code §367(a) that were not covered by the 2013 proposed regulations. Accordingly, Treas. Reg. §1.367(a)-2 (providing an exception to gain recognition under Code §367(a)(1) for assets transferred outbound for use in the active conduct of a trade or business outside of the U.S.) and Treas. Reg. §1.367(a)-7, (regarding application of Code §367(a) to an outbound transfer of assets by a domestic target corporation in an exchange described in Code §361) are revised so that a taxpayer may, solely for purposes of Code §367(a), be deemed not to have failed to comply with reporting obligations

16 Treas. Reg. §§1.367(a)-8(c)(1)(i), -8(j).

17 Treas. Reg. §1.367(a)-8(c)(1)(i) (first sentence). Before the 1998 Final Regulations, the G.R.A. term in certain cases was ten years. Pursuant to 1998 Treas. Reg. §1.367(a)-3(h), if a taxpayer elected to apply the 1998 Final Regulations retroactively to all prior transfers occurring after December 16, 1987, any ten-year G.R.A. that was in effect (had not been triggered in full) on the July 20, 1998, the general effective date of the 1998 Final Regulations would be deemed to be converted into a five-year G.R.A. Cf. F.S.A. 200221046 (taxpayer's five-year G.R.A. should have been a ten-year G.R.A.). Although the F.S.A. was issued after the 1998 Final Regulations, it addressed outbound transfers that preceded such regulations' general effective date, and there was no indication in the F.S.A. that the taxpayer had made an election to apply the 1998 Final Regulations retroactively to all prior transfers occurring after December 16, 1987.

under Treas. Reg. §1.367(a)-2 and Treas. Reg. §1.367(a)-7 by demonstrating that the failure was not willful. Additionally, Prop. Treas. Reg. §1.367(a)-7 of the temporary 2013 regulations regarding reasonable cause relief is removed.

T.D. 9704 and the Final Regulations on Point

"This lowering of the burden of proof from reasonable cause to non-willful allows the late-filing taxpayer to more easily meet the standards to receive non-recognition."

In T.D. 9704, the I.R.S. finalized the 2013 proposed regulations and issued temporary regulations, effective November 19, 2014. The G.R.A. is to be filed pursuant to requirements set forth in the regulations.[18] The U.S. target company is also subject to certain reporting requirements under Code §367 regulations.[19] The I.R.S. retained the approach taken in the proposed rules that eliminates the need for taxpayers to prove reasonable cause in seeking relief from penalties and gain recognition after failure to fully or properly file a G.R.A. or for the target company to make its required filings. The I.R.S. allows for non-recognition treatment provided the failure to file was not willful. This lowering of the burden of proof from reasonable cause to non-willful allows the late-filing taxpayer to more easily meet the standards to receive non-recognition. The I.R.S. also adopted their approach retroactively. As a result, the I.R.S. has said that taxpayers can resubmit prior filings under the new rules, even if the I.R.S. may have rejected them before.

However, the I.R.S. withdrew its directive (LMSB-4-0510-017) allowing broad relief for taxpayers to come in and fix faulty or missing G.R.A. filings. The significance of this retraction is reflected in Example 3 of the final regulations.[20] In that example, a taxpayer filed a G.R.A. with the statement that information on fair market value was "available upon request." Because the taxpayer "knowingly omitted" the information, it was subsequently deemed to have been a willful failure. The I.R.S. did allow a one-time failure to file a G.R.A. based on "accidental oversight" to be acceptable, and it allowed for non-recognition in that case.[21]

Enhanced Form 926 Filings Needed

Code §6038B requires that a U.S. person who transfers property to a foreign corporation (such as stock or securities) and enters into a G.R.A. is required to file Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*. The I.R.S. will now require more information on the Form 926 for these §367 reorganizations.

CONCLUSION

The I.R.S. has signaled a willingness to be flexible in failures to adhere to the strict reporting requirements of the §367 regulations. However, that flexibility is not unlimited. Thus, taxpayers should still act with care in both structuring their outbound reorganizations and complying with all documentation and filing requirements to insure that non-recognition tax treatment is achieved.

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18 Treas. Reg. §1.367(a)-8.
19 Treas. Reg. §1.367(a)-3(c)(6).
20 Treas. Reg. §1.367(a)-8(p)(2)(ii), Ex. 3.
21 Treas. Reg. §1.367(a)-8(p)(2)(ii), Ex. 1.

NEW I.R.S. PROCEDURES FOR CANADIAN RETIREMENT PLANS

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Tags
Canada
Estate Planning
R.R.S.P.

On October 7, 2014, the I.R.S. released Revenue Procedure 2014-55, which provides guidance for U.S. citizens or residents who own a Canadian Registered Retirement Savings Plan ("R.R.S.P."). In short, U.S. citizens/Canadian residents, Canadian citizens/U.S. residents, and dual citizens will no longer need to file Form 8891 to defer the accrued R.R.S.P./R.R.I.F income for U.S. tax purposes. The deferral will now occur automatically, assuming the individual is "eligible." These new procedures will apply even if the contributions to the R.R.S.P./R.R.I.F. were made as a resident of Canada.

However, practitioners should note that this does not alleviate the need to file Form 8938 or FinCen Form 114 upon receiving a distribution from an R.R.R.P.

<u>Original Treatment</u>

An individual who is both a U.S. citizen/resident and a beneficiary of a R.R.S.P will be subject to current U.S. income taxation on income accrued in the plan even though the income is not currently distributed to the beneficiary.[22] In Canada, the individual is not subject to Canadian income taxation until the accrued income is actually distributed from the plan. This leads to a mismatch in the timing of the U.S tax and the Canadian tax, resulting in possible double taxation.

Article XVIII, Paragraph 7 of the U.S.-Canada Income Tax Convention (the "Treaty") provides that an individual may defer U.S. taxation on income accumulated in an R.R.S.P., but only if the individual makes an annual election to defer the taxation of income.

Pursuant to Revenue Procedure 2002-23, beneficiaries of Canadian R.R.S.P.'s made the election by attaching to their timely filed U.S. federal income tax return Form 8891, *U.S. Information Return For Beneficiaries of Certain Canadian Registered Retirement Plans*. In addition, U.S. persons who are beneficiaries of

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[22] Unless the plan is an employees' trust within the meaning of Code §402(b) and the individual is not a highly compensated employee subject to the rule of Code §402(b)(4)(A).

R.R.S.P.'s must also file information reporting with respect to contributions to, distributions from, and ownership of certain foreign trusts.[23]

Form 8938 Not Required When Form 8891 Was Filed

Code §6038(D) requires a U.S. citizen or resident who holds any interest in a specified foreign financial asset to report that information via Form 8938, *Statement of Specified Foreign Financial Assets*. However, an individual who timely files Form 8891 with respect to an R.R.S.P. or an R.R.I.F. is currently exempt from the reporting obligations imposed by Code §6038(D) with respect to that plan, provided the individual reports on Form 8938 that Form 8891 was filed with respect to the R.R.S.P. or R.R.I.F.[24]

New Treatment

If the taxpayer is an "eligible individual," the taxpayer will report income on his or her U.S. tax return only upon receiving a distribution from the Canadian retirement plan.[25]

If an individual is not an "eligible individual," then he or she must request consent from the I.R.S. to make the election.

"In short, U.S. citizens/Canadian residents, Canadian citizens/U.S. residents, and dual citizens will no longer need to file Form 8891 to defer the accrued R.R.S.P./R.R.I.F income for U.S. tax purposes."

An "eligible individual" is a beneficiary of a Canadian retirement plan who:

- Is or at any time was a U.S. citizen or resident (within the meaning of Code §7701(b)(1)(A)) while a beneficiary of the plan;
- Has satisfied any requirement for filing a U.S. Federal income tax return for each taxable year during which the individual was a U.S. citizen or resident;
- Has not reported as gross income on a U.S. Federal income tax return the earnings that accrued in, but were not distributed by, the plan during any taxable year in which the individual was a U.S. citizen or resident; and
- Has reported any and all distributions received from the plan as if the individual had made an election under Article XVIII(7) of the Convention for all years during which the individual was a U.S. citizen or resident.

U.S. citizens in Canada (and Canadians residing in the U.S.) should note the ambiguity of the language, "satisfied any requirement for filing a U.S. return." Presumably this does not mean "all requirements," however, U.S. citizens who are Canadian residents and who have not been filing their U.S. tax returns regularly will not be considered eligible individuals who are permitted to defer accumulations in their R.R.S.P. and R.R.I.F. Additionally, retroactive relief is available for those Canadians who were not previously filing Form 8891. In other words, eligible individuals will be treated as having

[23] Revenue Procedure 2002-23
[24] Treas. Reg. §1.6038D-7T(a)(1).
[25] Rev. Proc. 2014-55, October 7, 2014.

made the election in the first year in which they would have been entitled to make the election under the treaty.[26]

Reporting Requirements

Beneficiaries, regardless of whether they are “eligible individuals” or not, are not required to report contributions to, distributions from, and ownership of a Canadian retirement plan under the simplified reporting regime established by Notice 2003-75 (Form 8891) or pursuant to the reporting obligations imposed by Code §6048 (Form 3520).

In addition, custodians are not required to file Form 3520-A*, Annual Information Return of Foreign Trust With a U.S. Owner,* with respect to a Canadian retirement plan. This revenue procedure does not, however, affect any reporting obligations that a beneficiary or annuitant of a Canadian retirement plan may have under Code §6038(D) or under any other provision of U.S. law, including the requirement to file *FinCEN Form 114, Report of Foreign Bank and Financial Accounts* (formerly known as F.B.A.R.’s).

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[26] Rev. Proc. 2014-55, Section 7, IR 2014-97, October 4, 2014.

CORPORATE MATTERS:
DON'T BE LATE – TIME IS OF THE ESSENCE

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Tags
Contract Adjournment
Law Date
Time Is of the Essence

When purchasing New York real estate, whether a commercial building or residential property, choosing the correct words with which to provide for the closing date in the contract of sale can make the difference between a smooth closing and a calamitous default. This article discusses the nuances of various terms of art so that a purchaser can protect its contract deposit and position as contract vendee.

New York is unusual in that a contract may recite a specific date for the closing of title but without the addition of certain talismanic words it is not the "Law Date" with regard to the property, meaning the date on which title must close. In order for a closing date specified in a contract of sale to become a Law Date, the specified date must be qualified by the phrase time is of the essence. "Time Is of the Essence" is a term of art that renders the specified closing date an ironclad date. Consequently, when Time Is of the Essence a purchaser's failure to close on a specified date will result in default; by the purchaser and typically the loss of its contract deposit.

Thus, a closing scheduled for "on," or "on or about," or "on or before" or "in no event later than" a specified date does not lock-in the parties to close on that date. Such phrases assure that the parties will be afforded a reasonable time within which to perform the closing, beginning on the specified date. Generally, utilization of one of the foregoing phrases is regarded as permitting a 30-day adjournment of the closing date set forth in the contract.

Often, however, the seller will attempt to set an initial closing date or agree to adjourn a closing date only if Time Is of the Essence with regard to the new date. The purchaser must beware because the new date will be set on an iron-clad basis.

So what happens when a purchaser is confronted with a seller who demands a Time Is of the Essence closing date? There are various strategies which can be implemented by the purchaser to avoid a default if it is not ready to close on the specified date.

The simplest arrangement would be to build an adjournment of the closing date into the contract itself. Under this scenario, there would be an initial closing date, followed by a 30-day extension of the closing date for which Time Is of the Essence would apply.

Alternatively, a purchaser could build an adjournment of the closing date into the contract accompanied by an additional deposit toward the purchase price payable

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on a certain date before the initially scheduled closing date. That adjourned date could be identified as being Time Is of the Essence, or the contract may provide for additional adjournments with additional deposits, and designating the final adjourned date as a date for which Time Is of the Essence. An interesting twist on this scenario results if there is no Time Is of the Essence condition attached to the `date on which the additional deposit is to be delivered. In such an event, since the initial date was not a Law Date, the purchaser could argue that even though no additional deposit were timely delivered, the purchaser would still be entitled to a 30-day adjournment, since the initial closing date was not specified as a date for which Time Is of the Essence.

That said, it bears emphasizing that the term Time Is of the Essence is one which is very strictly construed given the harsh penalty that can be imposed upon the purchaser. Consequently, there are circumstances in which even the presence of Time Is of the Essence language may not automatically result in a default by the purchaser if it does not close on the Law Date.

Such a situation may arise when a purchaser does not close on a scheduled date and, rather than agree to adjourn the closing, the seller delivers a letter to the purchaser unilaterally declaring a Law Date closing date. Should this occur, it behooves the purchaser to carefully examine the letter which may not satisfy all of the criteria required to trigger a default by the purchaser in the event it does not close by the purported Law Date.

New York case law requires that for a Time Is of the Essence notice to be effective, it must:

- Set forth a clear, unequivocal notice that Time Is of the Essence;
- Afford the purchaser a “reasonable time” within which to close under the circumstances; and
- Advise that the failure to perform on the scheduled closing date and at the time and place specified will result in a default under the contract of sale and a retention of the deposit by the seller.

In the event that the seller’s letter does not set forth all of these items, it is imperative that the purchaser object to the letter, depriving the seller of a claim that the failure to object constituted a waiver by the purchaser of the insufficiency of the letter.

Alternatively, the conduct of the parties may constitute a waiver of the Time Is of the Essence provision. For example, if the parties agree to schedule the closing on a date subsequent to the expressed Law Date, the Time Is of the Essence provision is deemed waived, and said later date will not automatically be a Time Is of the Essence date unless it is expressly stated to be one. A closing scheduled before the Time Is of the Essence date is also deemed a waiver. Even correspondence between the parties agreeing to adjourn the closing date in the event that a certain condition is satisfied may be deemed a waiver of the Time Is of the Essence provision.

While this article is drawn from the perspective of a purchaser being confronted with a Time Is of the Essence provision, a contract may be drafted such that both purchaser and seller are bound by the provision. However, since most contracts provide the purchaser with a remedy of specific performance, *i.e.*, allowing it to bring an action to force the seller to sell the property pursuant to the contract, a Time Is of the Essence provision does not afford the purchaser with any greater remedy than it would have under the contract. Moreover, it would almost certainly be more efficient to afford the seller an adjournment than to claim default. A claim of default is effective only if it triggers the commencement of a lawsuit for specific performance to obtain title to the property. It is not self-enforcing in the absence of legal action.

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Tags
F.A.T.C.A.
I.G.A.

BITCOIN ACCOUNTS MAY BE SUBJECT TO F.A.T.C.A. AND F.B.A.R. REPORTING

Bitcoin and other virtual currency accounts held in foreign exchanges may be treated as a foreign financial account and thus be subject to F.B.A.R. reporting. Eventually, it is even possible that the foreign exchanges themselves may be considered foreign financial institutions ("F.F.I.'s") that have to report the accounts to the I.R.S. under F.A.T.C.A.

This view follows caselaw where a court found that online accounts held for the purpose of foreign online gambling had to be reported on an F.B.A.R.

Currently, the I.R.S. treats virtual currency as property. However, some claim that it is only a short hop to apply the court's ruling in the online gambling case to digital currency accounts.

Speaking at the fall meeting of the American Bar Association Section of Taxation, a senior I.R.S. official said the I.R.S. doesn't have a stance yet on whether the currency is subject to F.B.A.R. or F.A.T.C.A. reporting, even though the agency is well aware of the issue.

RELAXED DEADLINE FOR REPORTING ACCOUNTS AS PRE-EXISTING

On November 17, the I.R.S. published a corrected amendment under which F.F.I.'s can treat all accounts that were opened before the date on which the F.F.I. signed an agreement with the I.R.S. to participate in F.A.T.C.A. (an "F.F.I. Agreement") as pre-existing accounts for 2014 reporting purposes. Before this announcement was made, only accounts opened on or before June 30, 2014 were treated as pre-existing accounts.

Pre-existing accounts valued at less than U.S.$1 million which were not previously documented as U.S. accounts may be electronically searched, and if no U.S. indicia is found, no further search of records or contact with the account holder is required. Therefore, categorizing more accounts as pre-existing accounts is an important relaxation for F.F.I.'s that signed an F.F.I. Agreement after July 1, 2014 and may be short on time to perform the required due diligence.

ISRAELI TAX BENEFITS FOR OLIM IMPEDE INTERNATIONAL TRANSPARENCY

Israel's State Comptroller said Israel should set a ceiling for the tax reporting benefits it gives an "Ole Hadash" to avoid abuse and tax evasion. To encourage immigration to Israel, Israel allows new immigrants ("Olim") and returning residents a ten-year tax exemption on income earned abroad. However, it was found that in 17% of all cases examined, the exemption was abused and used to evade taxes outside Israel and to launder funds. The Comptroller said, "The exemption does not meet international standards of transparency and exchange of information, and there is a concern that Israel could be infiltrated by funds derived from crime." The O.E.C.D. has also objected to the benefit. As a result, while a proposal to cancel the provision allowing the benefit, or at least the reporting exemption, failed in 2013, the Israeli tax authority has been gradually tightening oversight of the benefits' conditions for the past four years. The provision allowing for the exemption was extended until 2018, when the issue will be revisited by the Israeli Parliament.

"Canada's federal government has rejected assertions by two Canadian citizens born in the U.S. that the I.G.A. signed between Canada and the U.S. violates Canada's Charter of Rights and Freedoms."

CANADIAN I.G.A. FACES CONSTITUTIONAL CHALLENGE IN COURT

Canada's federal government has rejected assertions by two Canadian citizens born in the U.S. that the I.G.A. signed between Canada and the U.S. violates Canada's Charter of Rights and Freedoms, as well as an unwritten principle of the Canadian constitution.[27] The federal court hasn't yet set a date to hear oral arguments in the case.

The government claims that the I.G.A.'s provisions are constitutional because they don't cede Canada's sovereignty, and that if they are treated as violating the Charter rights, the infringements are justified because they are needed to relieve Canadian financial institutions and their clients from the "crippling" consequences of noncompliance with F.A.T.C.A. and to implement Canada's international commitments to share tax information to better enforce tax laws.

If Canadian F.F.I.'s were unable to comply with F.A.T.C.A., they would not be able to operate and invest in the U.S., nor would they be able to invest in non-U.S. jurisdictions if the investment was made through F.A.T.C.A.-compliant institutions. Complying without an I.G.A. would not be as beneficial as under an I.G.A. The I.G.A. relieves F.F.I.'s from having to file reports directly to the I.R.S., eliminates concerns about compliance with privacy laws, and clarifies which type of accounts may be exempt from reporting. It also exempts certain smaller deposit-taking F.F.I.'s from F.A.T.C.A. and exempts F.F.I.'s from the regulations' requirement to close certain client accounts.

The government added that any privacy implications are "minimal" and any potential infringement of privacy or other Charter rights is justified by the I.G.A.'s

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[27] *Virginia Hillis v. Attorney Gen. of Canada,* Federal Court of Canada, No. T-1736-14, *Statement of Defence* filed 11/10/14.

objectives of reducing the U.S. legislation's impact on Canadian individuals and F.F.I.'s. Officials stated, "Those objectives are of sufficient importance to warrant limiting any right which may be infringed, and any infringement is proportional to the objectives and to the benefits conferred by the impugned provisions."

DATA PROTECTION AUTHORITIES WILL NOT ATTEMPT TO BLOCK OR DELAY F.A.T.C.A. COMPLIANCE

Reporting under FA.T.C.A. is scheduled to begin in 2015. The E.U.'s executive branch has said that it is up to E.U. member countries to ensure they comply with national and E.U. data privacy laws while implementing F.A.T.C.A. under the applicable I.G.A., but that it may nevertheless intervene if it determines that a member state's F.A.T.C.A. implementation does not comly with E.U. data protection legislation.

As key European countries gear up for this automatic tax information exchange, certain persons questioned how data protection authorities ("D.P.A.'s") will treat such exchanges and whether they will delay reporting compliance. Bloomberg BNA contacted various European D.P.A.'s and learned that D.P.A.'s are not willing to block or delay F.A.T.C.A. information exchange on data protection grounds. Moreover, France, Germany, and the U.K. have already passed laws to implement F.A.T.C.A. into their own tax code, imposing fines on institutions failing to report F.A.T.C.A. information to the tax authorities for an automatic exchange with the I.R.S. under the I.G.A.

Most countries' D.P.A.'s mentioned they would rather focus on working collectively at the E.U. level to assure their country is complying with data protection laws. Other countries, such as France, plan to also work individually and "test" the system once it is up and running. The U.K., which was the first country to sign a F.A.T.C.A. I.G.A., allows the Information Commissioner Office to monitor and audit compliance with U.S. data protection laws. In theory, the Commissioner may block information exchange that violates those laws, but it is not believed that it will do so, as such exchange is a result of a mechanism established for international cooperation.

HONG KONG, BARBADOS, BULGARIA, CYPRUS AND ICELAND SIGN AN I.G.A.

The Hong Kong I.G.A., which was treated as in effect since May 9, was officially signed on November 13. The I.G.A. signed is a Model 2 I.G.A., which requires direct reporting to the I.R.S. by F.F.I.'s residents in Hong Kong. The I.G.A. requires Hong Kong F.F.I.'s to register themselves and negotiate separate, individual agreements with the I.R.S. to share information on their U.S. account holders. The first round of reporting doesn't start until March 2015. Under such individual agreements, Hong Kong banks have to get the consent of their U.S. account holders before they can give information to the I.R.S.

Barbados and the U.S. signed a Model 1 I.G.A. on November 17. The Barbados Minister of Industry, International Business, Commerce and Small Business

Development said that the signing of the agreement represents one of the “salient pillars” in the transformation of how Barbados interacts with clients. The agreement has been treated as in effect since May 27, 2014, when Barbados signed the agreement in substance.

"Under an I.R.S. announcement published December 1, jurisdictions that can demonstrate they are making ‘firm resolve to sign the agreement’ may get more time to get the I.G.A. signed beyond December 31."

Bulgaria and the U.S. signed a Model 1 I.G.A. on December 5. The agreement has been treated as in effect since April 23, 2014, when Bulgaria signed the agreement in substance.

Even though Cyprus and the U.S. did not sign an I.G.A. until December 2, 2014, a Model 1 I.G.A. between Cyprus and the U.S. was treated as in effect by the U.S. Treasury as of April 22, 2014. The Cypriot government announced it has signed an I.G.A. with the U.S. as part of its adoption of F.A.T.C.A. The Cypriot Finance Ministry said that the signing of the agreement signals another step in the progress made by Cyprus in tax transparency and the exchange of information, stating, “It is obvious that the conclusion of the Agreement under reference will upgrade Cyprus as a business center, will further boost investment between the two countries, strengthening their trade to the benefit of both economies.”

On December 2, Iceland's Ministry of Finance also announced its signing of a Model 1 I.G.A. with the U.S. Iceland has been treated as having an I.G.A. in effect since November 30.

2014 APPLICATION SEASON FOR QUALIFIED INTERMEDIARY STATUS ENDED DECEMBER 5

Financial institutions that did not apply for a qualified intermediary status on or before December 5 will not be able to obtain such status for 2014. Applications received before the end of the year but after December 5 will only be effective for the 2015 calendar year.

EXTENSION OF TIME TO SIGN I.G.A.’S FOR JURISDICTIONS THAT HAVE AN AGREEMENT IN SUBSTANCE TO IMPLEMENT F.A.T.C.A.

More than 50 jurisdictions have reached an agreement in substance with the U.S. with respect to F.A.T.C.A. Those jurisdictions are treated as having an I.G.A. in effect and their F.F.I.’s are allowed to register as Reporting Model 1 or 2 I.G.A. F.F.I.’s until December 31, 2014. However, under an I.R.S. announcement published December 1, jurisdictions that can demonstrate they are making “firm resolve to sign the agreement” may get more time to get the I.G.A. signed beyond December 31. No elaboration was made as to what the Treasury would consider “firm resolve.”

A Treasury Department spokeswoman said the government will conduct a monthly review of those jurisdictions’’ status to determine whether any countries should be taken off the list of those treated as having an I.G.A. in effect.

CURRENT I.G.A. PARTNER COUNTRIES

To date, the U.S. has signed more than 40 Model 1 I.G.A.'s and more than 40 other countries have reached such agreement in substance. Another six counties have signed a Model 2 I.G.A. and a handful of other countries also committed to this agreement. An I.G.A. has become a global standard in government efforts to curb tax evasion and avoidance on offshore activities and encouraging transparency.

At this time, the countries that are Model 1 partners by execution of an agreement or concluding an agreement in principle are:

Algeria
Angola
Anguilla
Antigua & Barbuda
Australia
Azerbaijan
Bahamas
Bahrain
Barbados
Belarus
Belgium
Brazil
British Virgin Islands
Bulgaria
Cabo Verde
Cambodia
Canada
Cayman Islands
China
Colombia
Costa Rica
Croatia
Curacao
Cyprus
Czech Republic
Denmark
Dominica
Dominican Republic
Estonia
Finland
France
Georgia
Germany
Gibraltar
Greece
Greenland
Grenada
Guernsey
Guyana
Haiti
Holy See
Honduras
Hungary
Iceland
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
Jersey
Kazakhstan
Kosovo
Kuwait
Latvia
Liechtenstein
Lithuania
Luxembourg
Malaysia
Malta
Mauritius
Mexico
Montenegro
Montserrat
Netherlands
New Zealand
Norway
Panama
Peru
Philippines
Poland
Portugal
Qatar
Romania
Saudi Arabia
Serbia
Seychelles
Slovak Republic
Slovenia
South Africa
South Korea
Spain
St. Kitts & Nevis
St. Lucia
St. Vincent & the Grenadines
Sweden
Thailand
Trinidad & Tobago
Tunisia
Turkey
Turkmenistan
Turks & Caicos Islands
Ukraine
United Arab Emirates
United Kingdom
Uzbekistan

The countries that are Model 2 partners by execution of an agreement or concluding an agreement in principle are: Armenia, Austria, Bermuda, Chile, Hong Kong, Iraq, Japan, Macao, Moldova, Nicaragua, Paraguay, San Marino, Switzerland, and Taiwan.

This list is expected to continue to grow.

FOREIGN CORRESPONDENCE: NOTES FROM ABROAD

Authors
Michael Peggs
John Chown
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Aliasghar Kanani

Tags
B.E.P.S.
Competition Bureau
Corporate Tax Diversions
Dollar-Adjusted Retail Price Disparity
Lump SumTaxation
Starbucks
Swiss Forfait
Transfer Pricing

Michael Peggs is a principal at Cadesky & Associates L.L.P., Toronto, where he heads the international transfer pricing group. He sits on the board of Transfer Pricing Associates and is a frequent author and lecturer on cross-border transfer pricing topics.

HOLIDAY SHOPPING, CANADIAN RETAIL PRICES AND TRANSFER PRICING CONTROVERSY

By Michael Peggs

When people think of massive transfer pricing cases, the driver typically is the diversion of profits to a low-tax jurisdiction. But transfer pricing issues are now filtering down to the level of retail shoppers facing retail price disparity in adjacent jurisdictions. A typical case is the premium that Canadian purchasers generally pay over prices charged in the U.S. for comparable products.

Before the internet, it was customary for Canadians to receive flyers in the mail from U.S. grocery and department stores. The flyers offered bargains for the holidays. The internet now allows instant price comparisons and greater choice for Canadian consumers. Disregarding *sub rosa* impediments to competition that permeate many areas of the Canadian economy – think of cultural preferences – Canadians have complained loudly that retail prices are unfairly high when compared with exchange-adjusted U.S. prices. A typical example is print media where the premium for pricing the Canadian edition was not reduced over the period in which the Canadian dollar reached parity with its U.S. counterpart.

The Canadian government is now preparing to give the Competition Bureau new powers to persuade U.S. multinationals with Canadian retail operations to lower prices or to achieve retail price parity, as will be determined. One hopes that Industry Canada will intervene with the Canada Revenue Agency ("C.R.A.") before drafting legislation, as an unintended consequence may be a new round of Canadian transfer pricing controversy.

Exchange rates and transport costs are variable, making a U.S. purchase a relatively better or worse deal than a Canadian purchase at different times. Tariffs, distribution and retail operating expenses, and the profit that Canadian retail subsidiaries of U.S. multinationals must report for tax purposes are relatively more fixed.

If a Canadian subsidiary sets its transfer prices for goods purchased from its U.S. parent by reference to its operating margin (as is not uncommon), a lowering of Canadian retail prices by government fiat will (all else being equal) lower the taxable income of the Canadian subsidiary. U.S. parent companies will be faced

"The Canadian government is now preparing to give the Competition Bureau new powers to persuade U.S. multinationals with Canadian retail operations to lower prices or to achieve retail price parity."

with a choice between keeping their customers and the Canadian government happy, and keeping the C.R.A. happy with their subsidiaries' transfer prices.

Good company managers, who don't allow the tax tail to wag the business dog, will likely vote to keep their customers happy and avoid bad Canadian press. A PR victory will come at the expense of either the U.S. treasury (if the parent cuts its transfer prices to maintain Canadian subsidiary profit) or the Canadian treasury (if the parent keeps its transfer prices the same or does not make the subsidiary whole for its loss).

The following chart illustrates the problem that occurs when politics and press attempt to trump intercompany pricing in the absence of a diversion of profits to a low tax country.

	A	B	C
P*	3	2.5	2.5
Q*	100	100	100
Sales	300	250	250
COGS	225	187.5	225
Gross Profit	75	62.5	25
SG&A	60	50	50
Operating Profit	15	12.5	-25
Gross Margin	25%	25%	10%
Operating Margin	5%	5%	-10%

* P = retail price, Q = quantity

Scenario A is the current state. Canadian Cost of Goods Sold ("COGS") depends on the transfer price charged by the parent. Selling, General and Administrative Expenses ("SG&A") includes salaries. It is assumed that the C.R.A. has settled a prior-year audit based on a 5% operating margin. When doing its annual transfer pricing analysis and documentation under paragraph 247(4)(b) of the Tax Act, the Canadian subsidiary continues to apply that margin as no material change has occurred in its business.

When P falls by 17% in response to government Consumer Protection regulation, and sales remain at Q, the multinational group faces a Hobson's Choice. Under scenario B, the parent decreases COGS by adjusting its intercompany transfer price ("TP") to maintain gross profit, and the subsidiary also decreases SG&A (perhaps by reducing Canadian payroll) from 60 to 50. This maintains the Canadian subsidiary's net profit ratio in accordance with its audit experience but reduces its top line sales. This pushes a portion of the tax reduction from the lower prices to the U.S. On the other hand, if the reduction in P reflects artificial government fiat, it is not clear that the I.R.S. will accept the decline in TP.

Currently, the I.R.S. is sensitive to “sweetheart” arrangements with foreign tax authorities that are entered into by foreign subsidiaries of U.S.-based multinationals. The I.R.S. may simply retain the former TP to ensure that the U.S. profit margin is not artificially reduced.

As the foregoing demonstrates, a move to “Peronist Economic Theory” has its inherent problems in a global economy. When one or both tax authorities lose, there are more audit disputes and greater difficulty in reaching bilateral advance pricing agreements.

"Any effective solution will be complex and in denial of the principle that tax law should be certain and simple."

SPECIAL TAX FOR ABUSIVE INTERNATIONAL TAX PLANNING (U.K.)

By John Chown

In its Autumn Statement 3 December 2014, the U.K. government proposed a new tax of 25% on what is described as “corporate tax diversions.” The proposal is an attempt to tax profits that are transferred to lower tax jurisdictions by means that are legal and within existing rules, but are not liked by the British government. Draft legislation is promised at the end of the year. The reaction among policy wonks and tax professionals is negative as it seems that the proposal will only work if it is anchored in the type of administrative discretion approach (they might call it “smell test”) that is totally unacceptable outside of certain BRIC countries.

There are no details. Draft Finance Bill provisions are promised by the end of the month. Given that the tax would be imposed on profits diverted to other countries legally, it is hard to see what a well-written definition would look like. Paul Johnson of the Institute for Fiscal Studies says, “The thinking behind it is understandable, the complexity that is likely to be created is considerable.”

The government seems convinced that it will raise money. Such announcements are always followed by some hundreds of pages of further information and explanatory notes sent to the press and professionals, and made available on a website. These things are typically exercises in economic doublespeak, but key information is found in the table showing the predicted revenue effects of policy decisions. The proposal is budgeted to raise £25 million in the first year, rising to £270 million in the second year and £360 million in the third year. Given that the net effect of announced tax changes will ultimately raise about £1 billion, these figures are significant in budgetary terms – and wildly optimistic! U.S. readers will have seen many similar predictions for the success of avoidance measures in their own country, which have fallen short by large measures.

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While the policy of preventing fictitious transactions from robbing a nation’s treasury is laudable, legislation should be enacted based on relatively clear guidelines. Regrettably, any effective solution will be complex and in denial of the principle that tax law should be certain and simple.

One of the published ‘scandals’ recently criticized Starbucks for paying only a trivial Corporation Tax (which produces only 7.0% of U.K. government revenue) in relation to its turnover and implied that turnover would be an appropriate basis. We do have a tax on turnover – Value-Added Tax (“VAT”) – and Starbucks has been collecting, and will continue to collect and account for VAT (18.3% of U.K.

government revenue), plus PAYE income tax (20.7%), and Social Security contributions (23%) on the same basis as other coffee shops. These ratios are fairly typical internationally, but nearly all the criticism of international tax fiddles is based on Corporation Tax. Given that the tax is avoided by transfers to low-cost jurisdictions, we in the U.K. also ask, "Why is the benefit not being clawed back under U.S. C.F.C. legislation?"

The general tone of the statement is partly, but not wholly, in support of the O.E.C.D.'s B.E.P.S. initiative. Apart from the definition, the legislation will have to fit in with the eventual B.E.P.S. proposals and, of course, with double tax agreements. At the present time, it is difficult to anticipate how the provision can be drafted without violating the provisions of most income tax treaties to which the U.K. is a party. Rather than thinking the issue through, the U.K. government seems to be taking lessons from the tax authorities in India. If a transaction is not liked by the authorities, it is attacked repeatedly, notwithstanding the validity of the underlying rationale. At some point, repeated attacks develop a patina of respectability for the government position.

Editor's Note

On December 10, 2014, the text of the draft legislation was published by HMRC.

Under the language of the draft, the diverted profits tax of 25% will be imposed in two broad circumstances. In very broad terms, the first relates to a person that is artificially avoiding a U.K. permanent establishment ("PE") in connection with supplies of goods or services made by the foreign company to customers in the U.K. and:

> . . . it is reasonable to assume that any of the activity of the avoided PE or the foreign company (or both) is designed so as to ensure that the foreign company is not carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom by reason of the avoided PE's activity (whether or not it is also designed to secure any commercial or other objective), * * * it is also reasonable to assume that the mismatch condition * * * or the tax avoidance condition * * * is met * * * [and] the avoided PE and the foreign company are not both small or medium sized enterprises.

For the new tax to be imposed in the first set of circumstances, one of two conditions must be met. The first test is that the arrangement must result in an increase in the expenses of a U.K. taxpayer that are claimed as deductions or a reduction in the income of a U.K. taxpayer and the resulting reduction in U.K. tax exceeds the amount of any resulting increase in the foreign party's total liability to tax outside the U.K. In addition, the main purpose or one of the main purposes of the arrangement that leads to this result is the avoidance of a charge to corporation tax. The second test is that there is a mismatch of economic substance in the entity based outside the U.K. and the amount of income arising from that activity. In addition, the tax paid outside the U.K. is less than 80% of the tax reduction in the U.K. resulting from the arrangement.

The second set of circumstances that triggers the tax is a lack of economic substance in an arrangement that reduces U.K. tax. In broad terms, this may exist when certain tests are met. One test is that the financial benefit of the tax reduction arising from a particular transaction or set of transactions is greater than any other financial benefit arising from the transaction and it is reasonable to assume that the transaction was designed to secure the tax reduction. Another test is that the contribution of economic value to the transaction or a series of transactions by the person outside the U.K., in terms of the functions or activities that the staff of that person perform, is less than the value of the financial benefit of the tax reduction and it is reasonable to assume that the transaction was designed to secure the tax reduction. For this purpose, the staff of a person outside the U.K. includes any director or officer of that person and the functions of the staff may include engaging and directing externally provided workers that are not connected within the meaning of existing U.K. tax law.

Further analysis will appear next month.

GOOD NEWS FROM SWITZERLAND – LUMP SUM TAXATION (FORFAIT) MAINTAINED

By Thierry Boitelle and Aliasghar Kanani

Following a referendum at the end of November, the Swiss people have decided to maintain the lump sum taxation system, *i.e.*, the so-called "forfait." An initiative led by the left wing parties to abolish lump sum taxation was rejected by a clear majority of 59.2%.

The result of the popular vote is reassuring for the Swiss economy. It confirms that Switzerland is a stable place from a legal point of view and that the country wants to remain competitive tax-wise.

The vote at the same time confirms the entry-into-force of the new Swiss Federal law on lump sum taxation, which will take effect on January 1, 2016. The new law will notably bring the following changes to the current system:

- The lump sum income should amount to at least seven times (instead of five times currently) the rental value or the annual rent of the Swiss residence;
- The lump sum amount should not be lower than CHF 400,000 at the Federal level;
- Each canton will have to (freely) fix a cantonal minimum lump sum amount;
- A grandfathering period of five years applies to all existing lump sum taxpayers − for them, the new law will only have consequences as of the tax year 2021.

The open question is whether the vote on lump sum taxation portends retention of the existing inheritance tax rules in Switzerland, which are generally viewed to be quite palatable.

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Aliasghar Kanani, also of Bonnard Lawson, advises multinationals and S.M.E.'s, as well as H.N.W.I.'s, on international tax planning and group and financial restructurings.

A BAD MONTH FOR LUXEMBOURG

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Galia Antebi

Tags
B.E.P.S.
E.U. Commission
I.C.I.J.
Luxembourg

Luxembourg made front-page news last month with the leak of hundreds of documents that had been signed when current European Commission President, Jean-Claude Juncker, was prime minister and finance minister of Luxembourg. The leak, exposed by the International Consortium of Investigative Journalists ("I.C.I.J."), revealed confidential agreements approved by Luxembourg authorities that provided tax relief to more than 340 global companies.

The leaked documents implicated not only private companies but also revealed that the Canadian government received a tax ruling for its Public Sector Pension Investment Board, which manages pensions for all Canadian federal employees. The Canadian Pensions Board issued a statement addressing this ruling and claimed that since it is tax-exempt in Canada its ruling is not tax avoidance as it has "no tax advantage."

The European Union Antitrust Authority is now expected to expand its ongoing illegal state aid probe using the leaked documents in its investigation. A high-level European Commission official said, "We expect to expand our current request for documents…These documents are now available. They are clearly relevant to the ongoing probe, which is a high political priority."

POLITICAL PRESSURE

The leaked documents put Luxembourg in hot water, especially former prime minister and finance minister, Jean-Claude Juncker, who now faces great political pressure to explain his role in the scandal. He is accused of acting to enrich his country at the expense of its European partners. His actions are purported to have been in defiance of the E.U. spirit, which he hopes to represent as the new Commission President.

Juncker had only been in office for a few days when the I.C.I.J. released the leaked documents. The leak gave anti-E.U. political parties the opportunity to use the motion of censure to demand his resignation. However, Juncker survived the November 27 no-confidence vote and remains in office. While speaking to Parliament, President Junker assured the E.U. that he would not interfere with the ongoing E.U. illegal state aid investigation into the tax schemes of Luxembourg, Ireland, and the Netherlands for tax rulings made with large multinational companies like Ikea, Apple, and Starbucks.

TAX HARMONIZATION

Speaking in front of Parliament, President Juncker insisted that that the Luxembourg tax rulings were legal and that 22 other E.U. member states have similar arrangements with multinational companies. He agreed that there was probably some tax avoidance in Luxembourg, just as in any other E.U. country, and blamed the problem on insufficient tax harmonization in the E.U. President Juncker promised both Parliament and the G-20 summit that he intends to fight tax evasion and tax avoidance by making it mandatory for E.U. member states to inform other member states of their tax rulings with multinational companies and renewing efforts to garner support from E.U. member states for a common consolidated corporate tax base system. On November 12, Juncker told reporters that, "At the moment, there are so many divergences between national legislation – between the definition of what income is taxable – it is possible to engage in a form of fiscal engineering." A harmonized system might reach a dead end, as it requires the support of all 28 member states. Addressing the harmonized tax system following the scandal, Luxembourg's current Prime Minister Xavier Bettel said in an interview with a Belgian newspaper that he will not support proposals to move the E.U. towards one tax system with uniform rates.

A long time has passed since the first discussions of a unified tax system started in Europe, but it is not surprising that the recent Luxembourg scandal has initiated renewed interest in the subject – if not for other reasons, then at least as an attempt to divert attention from Juncker's role in the controversy.

However, information exchange is not the only ongoing measure to combat tax evasion and tax avoidance; the Base Erosion and Profit Shifting ("B.E.P.S.") recommendations of the O.E.C.D. will also assist in furthering these efforts. Shortly after the leak was exposed, the O.E.C.D. Secretary-General spoke at a forum in Paris hosted by the Académie Diplomatique Internationale and the International New York Times. He referred to the Luxembourg scandal as a "wake-up call" to countries, saying that new tax rules are needed to fight B.E.P.S. by multinational companies and tax evasion by individuals. He noted, however, that in order to get smaller countries like Luxembourg to "play ball by the rules," big countries like the U.K. and the U.S. will also have to end practices that contribute to tax avoidance.

WHAT'S NEXT

At the E.U. level, the current scandal provides much-needed information in the investigation into the Luxembourg's taxation of intellectual property, which was hindered by two challenges filed by the state at the E.U. General Court in April against a request for information on tax rulings. This investigation continues and will likely be broadened.

On a wider scale, the action plan produced by the O.E.C.D. to combat B.E.P.S. calls for a new global tax system. The plan will close gaps in current rules and standards that allow some multinational companies, in particular big internet companies and those that utilize primarily intangible assets, to achieve low effective tax rates by shifting profits to low-tax jurisdictions. It is hoped that this plan, together with an automatic exchange of information, will resolve the existing issue of tax evasion and tax avoidance.

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Tags
B.E.P.S.
C.F.C.'s
Compliance
Corporate Tax
Criminal Violations
Google
Information Disclosure
Right to Be Forgotten
Tax Evasion
Tax System Administration

B.E.P.S. PROJECT FACES CHALLENGE IN ADDRESSING C.F.C. RULES

The O.E.C.D.'s pending base erosion and profit shifting action plan is due to face a significant challenge as to how to address controlled foreign corporations. Action 3, which strengthens C.F.C. rules, is set to be released in 2015. Currently, European case law restricts the scope of E.U. members establishing C.F.C. regimes.

Stephen E. Shay of Harvard Law School says the U.S. is encouraging the expansion of the C.F.C. rules as a way to solve several of the issues the B.E.P.S. action plan is trying to address, however, these new rules run the risk of being contrary to E.U. jurisprudence. The E.U.'s ability to adopt stringent C.F.C. rules is limited by the *Cadbury Schweppes* (C-196/04), a 2006 ruling from the Court of Justice of the European Union. The Court held that E.U. freedom of establishment provisions preclude the U.K. C.F.C. regime unless the regime "relates only to wholly artificial arrangements intended to escape the national tax normally payable."

Without resolving the issue among E.U. countries, Action 3 may not be effective in appropriately addressing earnings stripping. However, Shay also added that Action 2, which neutralizes the effects of hybrid mismatch arrangements, so far appears to include an approach that works without C.F.C. rules.

CHARGES LAID AGAINST U.S. CITIZEN FOR MAINTAINING ALLEGED SECRET SWISS BANK ACCOUNTS

Department of Justice announced that charges have been laid against Peter Canale, a U.S. citizen and resident of Kentucky, for conspiring to defraud the I.R.S., evade taxes, and file a false individual income tax return. It is alleged that Canale conspired with his brother and two Swiss citizens to establish and maintain secret, undeclared bank accounts in Switzerland.

In approximately the year 2000, a relative of Canale died and left a substantial portion of assets which were held in an undeclared Swiss bank account to Canale and his brother, Michael. The brothers met with two Swiss citizens, who agreed to continue to maintain the assets in the undeclared account for the benefit of the Canales.

In approximately 2005, an account was opened at the Swiss bank Wegelin in the name of a sham foundation under the laws of Lichtenstein to conceal Canale's ownership. By the end of 2009, the assets of the account amounted to approximately $789,000. For the years 2007 through 2010, the D.O.J. alleges that Canale willfully failed to report on his tax returns the interest and income accrued in the undeclared accounts and also failed to file F.B.A.R.'s with the I.R.S. as required by law. The charges carry a potential statutory maximum sentence of five years in prison.

G-20 LEADERS COMMIT TO FINALIZING B.E.P.S. PROJECT IN 2015

G-20 leaders at the November summit in Brisbane, Australia expressly committed to completing the joint action plan with the O.E.C.D. addressing B.E.P.S. Furthermore, they addressed a strategy to increase beneficial ownership and endorsed a common reporting standard ("C.R.S.") for the automatic exchange of information.

At the conclusion of the summit, the leaders issued a communiqué which promised the completion of all the action items of the B.E.P.S. project and expressed agreement that "profits should be taxed where economic activities deriving the profits are performed and where value is created." They also praised a Germany-U.K. proposal released on November 11 to abolish harmful intellectual property rights regimes. The proposal, which was based on the O.E.C.D.'s modified nexus approach, will ask the O.E.C.D. to formally approve the plan during the O.E.C.D.'s Committee on Fiscal Affairs meeting to be held in January.

Other commitments by the G-20 leaders included improving the transparency of beneficial ownership and both the public and private sectors. However, much to the dismay of non-governmental entities, it did not call for the creation of public beneficial ownership registries. The U.K. and Denmark have already committed to making the registries publicly available. The recommendations included:

- Ensuring that legal persons maintain adequate, accurate, and current beneficial ownership information onshore;

- Requiring financial institutions and designated nonfinancial businesses or professions to verify the beneficial ownership of their customers; and

- Ensuring that trustees of express trusts maintain accurate and current beneficial ownership information.

Each G-20 country will report in writing the steps it will take to implement the beneficial ownership principles and improve the effectiveness of the G-20's legal, regulatory, and institutional framework for making beneficial ownership more transparent.

Finally, the O.E.C.D.'s C.R.S. for the automatic exchange of information was endorsed with G-20 leaders promising that their countries will begin the automatic exchange of information by 2017 or 2018. This is consistent with the October signing of the competent authority agreement to implement C.R.S.

CREDIT SUISSE TO PAY $1.8 BILLION TO I.R.S.

"There has been a general expectation among tax practitioners that disputes will arise when the B.E.P.S. project is implemented."

On November 21, Credit Suisse was sentenced to pay $1.8 billion to the I.R.S. as a result of pleading guilty to conspiracy to aid and assist U.S. taxpayers in filing false income tax returns and other documents with the I.R.S.

The plea agreement, in addition to the agreements made with state and federal agencies, results in Credit Suisse paying approximately $2.6 billion to the U.S., in addition to the $196 million to the Securities and Exchange Commission ("S.E.C.") in disgorgement, interest, and penalties.

Under the plea agreement, Credit Suisse acknowledged that, for decades prior to and including 2009, it operated an illegal cross-border banking business that knowingly and willfully aided and assisted thousands of U.S. clients in opening and maintaining undeclared bank accounts and concealing offshore assets and income from the I.R.S.

Furthermore, Credit Suisse also agreed to make a complete disclosure of its cross-border activities, to cooperate in treaty requests for account information, to close the accounts of clients who fail to come into compliance with U.S. reporting obligations, and to implement programs to ensure compliance with U.S. laws in current and future dealings with U.S. customers.

U.S. WANTS TO AVOID AN INCREASE IN COMPLIANCE BURDEN AS A RESULT OF B.E.P.S.

At a Washington event in connection with the release of a joint report by the World Bank Group and PwC on November 20, the Treasury Deputy Assistant Secretary (International Affairs), Robert Stack, stated that the O.E.C.D.'s action plan expected to be completed in 2015 should avoid increasing companies' compliance burdens by creating solutions that are simple to administer and less likely to be prone to dispute. This might include redefining the transfer pricing rules to avoid vagueness.

There has been a general expectation among tax practitioners that disputes will arise when the B.E.P.S. project is implemented. However, in response, Stack says that a focus should then be put on modernizing dispute resolution mechanisms and modernizing tax administrations so disputes are avoided at the bottom level when an audit occurs, or such that the dispute can easily be resolved.

There has also been concern that the information reporting costs will increase the compliance burden, however, some of those concerns have been alleviated because the template has been scaled back to a more achievable set of information requirements. Otherwise, it could have resulted in "phenomenal costs" for country-by-country reporting.

An emphasis has been placed on improving administrative systems and resources. In an attempt to pave the way for other counties to follow, the I.R.S. outlined four digital initiatives it has been planning, including the creation of online accounts for transactions, customer education to simplify the complexity of tax information, third-party collaboration, and internal tools for I.R.S. employees. No timeline has been given for the completion of the project.

HOUSE MAY EXTEND LAPSED TAX BREAKS

Two congressional aides indicated that the House of Representatives will revive dozens of lapsed tax breaks and extend them through the end of this year. The proposal comes soon after the collapse of a bipartisan proposal to make some tax breaks permanent. The extension seems to indicate that Congress does not want to disrupt tax filing season in January.

I.R.S. USES CODE §956 ANTI-ABUSE RULE TO TARGET BACK-TO-BACK LOANS

"Two congressional aides indicated that the House of Representatives will revive dozens of lapsed tax breaks and extend them through the end of this year."

In a recent memorandum,[28] the I.R.S. re-characterized and collapsed a series of bank-to-bank loans between related controlled foreign corporations and indicated that the deemed inclusion for the parent companies was not limited to the applicable earnings of the intermediaries, but also included the earnings of the parent companies under Code §956.

The I.R.S. based its conclusion on several factors. However, the most salient was the rejection of the taxpayer's business purpose for making the back-to-back loans. Taxpayer tried to argue that that the business purpose of the loans stemmed from the parent C.F.C. acting as a shared service center for the cash management of the taxpayer's group in a certain region. The I.R.S. rejected the argument because the taxpayer did not adequately explain why the lower tier C.F.C.'s needed to borrow from the parent companies, other than the need to fund their loans to the taxpayer.

EMERGING CONSEQUENCES OF E.U.'S RIGHT TO BE FORGOTTEN

In May 2014, the European Court of Justice, the highest court in Europe, ruled against Google Spain SL and its parent company, Google Inc., (collectively "Google"), ordering the companies to comply with Europeans requesting the removal of certain results from its search engine. The court found that Google was responsible for the content of the information it posts and therefore was required to comply with E.U. data privacy laws.[29]

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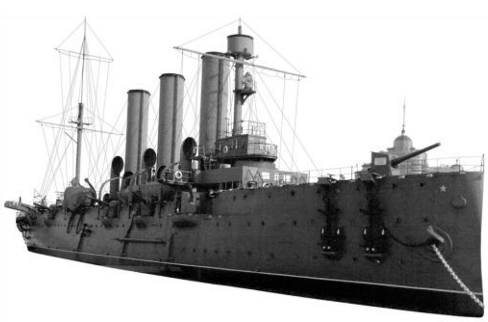
28 CCA 201446020, November 14, 2014.
29 Case C-131/12.

On the first day of compliance alone (May 30, 2014), Google received 12,000 requests to have personal details removed from its search engine.[30] Since then, figures suggest that Google has received more than 174,000 of these requests, of which it has removed approximately 41.5%, and other search engines, such as Bing and Yahoo are now following suit.[31]

In an age where most research is done online, it is necessary to balance the right to know with the right to protect an individual's privacy. While this ruling provides for the inherent right to the privacy, it also impinges upon freedom of speech, and its implications are now emerging in the international tax sector.

To quote U.K. attorney Sara Mansoori, "90 percent of investigators launch their offshore tax evasion cases by doing a search on Google."[32] This ruling obstructs investigations into offshore tax evasion by allowing for the removal of relevant personal data. At the same time, it is important to note that this ruling only effects European countries. The information that is deleted from search engines in Europe can still be accessed form outside the European Union, and with the help of websites such as HideMyAss.com and Hola.org, it is possible to conduct virtual searches from the country of one's choosing.



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30 "Removal of Google Personal Information Could Become Work Intensive." EuropeNews.net. June 1, 2014.

31 Dredge, Stuart. "Microsoft and Yahoo respond to European 'right to be forgotten' requests." *The Guardian.* December 1, 2014.

32 U.K. Attorney: Offshore Tax Investigators Can Bypass "Right to be forgotten" Ruling by Ali Qassim.

IN THE NEWS

OUR RECENT AND UPCOMING PRESENTATIONS

On October 29, 2014, Edward C. Northwood participateed on the panel "International Estate Planning (Focus on Taxation of Distributions from a Foreign Trust or Estate)" at the *ITSG 2014 World Conference* in Paris, France.

On October 29-30, 2014, Robert G. Rinninsland gave two presentations in conjunction with the *ITSG 2014 World Conference* in Paris, France. The first presentation, "Transfer Pricing – The IP Paradigm – U.S. Context," was part of the special interest group "Transfer Pricing, a Sharing of Experiences," and drew on recent U.S. court cases to address recent developments in I.P. valuation methodologies. "International Tax and B.E.P.S. a Reality Check" provided a review of various aspects of the O.E.C.D. proposals taken from the B.E.P.S. reports.

On October 30, 2014, Andrew Mitchel participated on the panel "International Tax and BEPS" at the *ITSG 2014 World Conference* in Paris, France where he addressed "Anti-Treaty Shopping: Limitation on Benefits Provisions." The panel discussed the anatomy of the current international tax system, its evolution and fundamental components (such as permanent establishment, withholding tax, thin capitalization, treaty interpretation, treaty shopping, C.F.C. rules, corporate residence, and transfer pricing), and examined whether the current system can survive the challenges of the modern world.

October 31, 2014, Stanley C. Ruchelman and Edward C. Northwood presented the "Foreign Grantor Trust" before the *ITSG 2014 World Conference* in Paris, France. The presentation addressed the foreign grantor trust as a viable solution to benefit U.S. persons and included practical guidance for grantors and beneficiaries.

October 31, 2014, Stanley C. Ruchelman also presented the "U.S. Tax Update" to the *ITSG 2014 World Conference* in Paris, France. He provided a look at major tax developments in the U.S. with particular focus on corporate inversions.

On November 3-4, 2014, Galia Antebi presened "F.A.T.C.A. and the I.G.A. – How German Businessed, U.S. Citizens, and German Financial Advisors are Affected" before the American German Business Club in Munich and Frankfurt, Germany. The presentation included a top level review of Form W-8BEN-E for German businesses, Form W-9/W-8BEN for German resident individuals, and the due diligence process for the financial services sector.

On October 29, 2014, Fanny Karaman participated in the panel "Oktoberfest-German VAT" at New York Law School. The panel provided an introduction to the European V.A.T. system, with discussion of how the system affects U.S. businesses today and how it can serve a model for future U.S. legislation.

On November 12, 2014 Stanley C. Ruchelman and Kenneth Lobo presented at the Halton-Peel C.P.A. Association's *Life of a U.S. Investment – U.S. Tax Issues Commonly Encountered* in Mississauga, Ontario. The discussion, entitled "U.S. Tax Points to Remember in a Cross Border Investment," addressed a full range of topics involved in managing inbound and outbound investments, including entity classification, tax treatment under §367 of asset transfers, working with Subpart F, working with P.F.I.C.'s, U.S. rules designed to eliminate excessive benefits, international attacks on excessive benefits, and permanent establishment issues.

On November 13, 2014, Nina Krauthamer lectured on "Understanding U.S. Taxation of Foreign Investment in Real Property: F.I.R.P.T.A. and Beyond" at New York Law School. The program, aimed at demystifying U.S. tax considerations for a foreign person investing in U.S. real estate, explained basic income, estate, and gift tax rules; presented special tax planning considerations; and considered common tax traps for the unwary foreign investor.

On November 24, 2014, Stanley C. Ruchelman and Kenneth Lobo lectured at the *U.S. Tax Bootcamp* hosted by Cadesky and Associates in Toronto, Canada, where they discussed inbound investment into the U.S., including the U.S. estate and gift tax regime, structures to avoid when purchasing U.S. real property and strategies when purchasing U.S. rental properties.

On December 19, 2014, Stanley C. Ruchelman and Kenneth Lobo presented "The Life of an Outbound Investment from the U.S. into Canada" to the B.C. chapter of the Canadian Bar Association in Vancouver, Canada. The topics addressed included entity classification, tax treatment under §367 of asset transfers, Subpart F, P.F.I.C.'s, U.S. and international attacks on excessive benefits, and permanent establishment issues.

Copies of our presentations are available on the firm website: www.ruchelaw.com/publications, or by clicking the above links.

About Us

We provide a wide range of tax planning and legal services for foreign companies operating in the U.S., foreign financial institutions operating in the U.S. through branches, and U.S. companies and financial institutions operating abroad. The core practice of the firm includes tax planning for cross-border transactions. This involves corporate tax advice under Subchapter C of the Internal Revenue Code, advice on transfer pricing matters, and representation before the I.R.S.

The private client group of the firm also advises clients on matters related to domestic and international estate planning, charitable planned giving, trust and estate administration, and executive compensation.

The tax practice is supported by our corporate group, which provides legal representation in mergers, licenses, asset acquisitions, corporate reorganizations, acquisition of real property, and estate and trust matters. The firm advises corporate tax departments on management issues arising under the Sarbanes-Oxley Act.

Our law firm has offices in New York City and Toronto, Canada. More information can be found at www.ruchelaw.com.

Disclaimers

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*Photos used in this issue were taken by Stanley C. Ruchelman, Simon H. Prisk, Galia Antebi, Philip R. Hirschfeld, and Jennifer Lapper.