



INSIGHTS

**WHAT GOES AROUND COMES AROUND: THE
MULTILATERAL INSTRUMENT IS SIGNED BY INDIA
BUT IS NOT YET EFFECTIVE**

**INVESTING IN VIETNAM: KEY LEGAL AND TAX
CONSIDERATIONS FOR FOREIGN INVESTORS**

**COLOMBIA: A PRIMER FOR THOSE DOING
BUSINESS WITH OR IN THE LOCAL MARKET**

AND MORE

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EDITORS' NOTE

In this month's edition of *Insights*, our articles address the following:

- **What Goes Around Comes Around: The Multilateral Instrument is Signed by India But Held Not Yet Effective.** India has been at the forefront of implementing B.E.P.S. measures. It submitted a ratified M.L.I. with the O.E.C.D. in 2019, with effect from April 1, 2020. However, the Indian Parliament never enacted legislation amending all covered income tax treaties. Relying on a relatively recent Supreme Court of India case involving the relationship between income tax treaties and domestic law (*Nestle SA*), the Income-Tax Appellate Tribunal ("I.T.A.T.") for Mumbai held that until Parliament enacts legislation adopting an income tax treaty, the treaty is not the law of the land (*Sky High Appeal XLIII Leasing Company Ltd.*). Abbas Jaorawala, a Senior Director and Head-Direct Tax of Khaitan Legal Associates, Mumbai, discusses the interesting conundrum faced by the Indian tax authorities. On one hand, they can continue litigating the matter, but victory is uncertain and a favorable decision by the Supreme Court is not assured by reason of the *Nestle SA* case. On the other hand, legislation can be enacted quickly, but it is not clear it can be effective on a retroactive basis.
- **Investing in Vietnam: Key Legal and Tax Considerations for Foreign Investors.** Vietnam has emerged as one of Southeast Asia's most dynamic investment destinations, supported by strong economic growth, a large and increasingly skilled workforce, and deep integration into the global trading system through numerous free trade agreements. Ho Chi Minh City plays a central role in attracting foreign direct investment, particularly in manufacturing, services, technology, logistics, and consumer-related industries. In their article, Nguyen Thi Quynh Nhu, the Managing Partner at Eruditus Legal, Ho Chi Minh City, and Nguyen Thi Hang Nga, a Tax Partner at Eruditus Legal, Ho Chi Minh City, provide a practical overview of the key legal and regulatory considerations that foreign investors should take into account before invest-ing in the country. Topics covered address investment structures, licensing requirements, corporate income tax, value-added tax, special consumption tax, and import and export duties.
- **Colombia: A Primer For Those Doing Business With or In The Local Market.** Colombia is a beautiful country, known for its unique biodiversity, natural landscapes, and cultural richness. It is the fourth largest economy in Latin America, and frequently serves as a regional operations platform for South America, Central America, and the Caribbean. However, tax rules in the country can be problematic. Foreign entrepreneurs providing consulting, technical, management, or administration services to local residents or businesses are subject to withholding tax at rates between 20% and 33%. Foreign providers of streaming services, online ads, data management, and digital goods may be subject to a gross tax based on sales that is triggered by reason of having a significant economic presence in the country. Other foreign companies may trip into worldwide tax exposure if Colombia is viewed to be the effective place of management of the company. The threshold for this risk is low as the risk potentially exists from short-term presence in Colombia by executives or employees. Finally, the standard under which an individual

is viewed to be tax resident is not straightforward. In his article, Eric Thompson, a Partner of attorneys Cañón Thompson, Bogota, identifies the various areas of risk and cautions that companies trading with Colombia or individuals who move to Colombia require careful advance planning.

- **Luxembourg’s New Carried Interest Tax Regime.** Carried interest tax regimes are under review across several countries in which major fund hubs are based. Policy trends diverge, with some jurisdictions tightening tax privileges in response to fairness and anti-avoidance debates, while others recalibrate to attract or retain fund talent and decision making substance within an investment fund context. Seeking to foster and strengthen its position as a major investment fund hub, the Luxembourg government proposed legislation to reform the existing carried interest regime. In his article, Adnand Sulejmani, a Senior Associate in the Luxembourg tax practice of Ashurst, explains that the existing law fostered inconsistent interpretations among practitioners regarding the taxation of carried interests and contained a sunset provision for the benefit. In comparison, the proposed legislation emphasizes tax certainty for participating investment management professionals and a permanent favorable tax regime. The proposed legislation is expected to be enacted before the end of January 2026, with an effective date as of January 1, 2026.
- **The Relevance of Relevance and the Economic Substance Doctrine.** The economic substance doctrine has a long-standing history in U.S. tax law, stretching back over 90 years. Case law also developed related doctrines, such as the business purpose doctrine and step-transaction doctrine. All attempted to answer the same question – was the business transaction real or was it a charade intended solely to reduce tax. Code §7701(o), entitled “Clarification of economic substance doctrine,” was enacted in 2010 to codify the preexisting regime. The legislative history provided an angel list of transactions that were not viewed abusive. For those transactions and others that did not contain hallmarks of tax avoidance, it was accepted that the economic substance doctrine was not relevant. Indeed, the statute provides that, with limited exception, if the economic substance doctrine was not relevant to a fact pattern prior to the enactment of Code §7701(o), the economic substance doctrine would not be relevant after the enactment of that provision. Then, in 2023, the I.R.S. put on its sheriff’s hat and turned the angel list into a hit list, taking the position that Code §7701(o) was a game changer. In their article, Stanley C. Ruchelman and Wooyoung Lee examine two recent cases, *Liberty Global* and *Patel*, in which the I.R.S. position was that case law was no longer relevant if planning became too aggressive. The I.R.S. won both cases, but the jury is out as to the validity of its position.

We hope you enjoy this issue.

- The Editors

WHAT GOES AROUND COMES AROUND: THE MULTILATERAL INSTRUMENT IS SIGNED BY INDIA BUT IS NOT YET EFFECTIVE

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INTRODUCTION

An article published in this journal several years ago¹ welcomed the signing of the Multilateral Instrument (“M.L.I.”) by India as part of the O.E.C.D.’s Base Erosion and Profit Shifting (“B.E.P.S.”) Project in the following language:

One of the most significant outcomes of the B.E.P.S. Project is the signing of the multilateral instrument (“M.L.I.”) in 2017. The M.L.I. seeks to address B.E.P.S. concerns in thousands of bilateral tax treaties through one common treaty. While the M.L.I. does not replace bilateral tax treaties, it acts as an extended text to be read along with the covered bilateral tax treaties for implementing specific B.E.P.S. measures. In order to be considered a “covered tax treaty” under the M.L.I., each partner jurisdiction to a tax treaty must notify the treaty and then agree on the specific provisions of the M.L.I. that will apply.

India has been at the forefront of implementing B.E.P.S. measures and submitted a ratified M.L.I. with the O.E.C.D. on June 25, 2019. The date of entry into force of the M.L.I. has been notified by India as of October 1, 2019. Accordingly, India’s covered tax treaties will need to be read with the M.L.I. from April 1, 2020. * * *

Several years later, an article published in this journal addressed the holding in the *Assessing Officer Circle (International Taxation) 2(2)(2) New Delhi v. M/s Nestle SA*.² case regarding the effective date of an income tax treaty signed by the Indian government.³ The case involved protocols to several tax treaties that contained a clause known popularly as a most favored nation (“M.F.N.”) clause. In principle, an M.F.N. clause allows the treaty partner country to import benefits from a subsequently signed Indian income tax treaty with another country when certain conditions are met. The question posed in the case was whether the M.F.N. benefit was automatic. The Indian Supreme Court concluded that income tax treaties are not self-executing, and the article summarized the holding in the following language:

The Supreme Court, relying on various judgments and interpretations of Article 253 of the Indian Constitution and Section 90 of the

¹ Sakate Khaitan and Abbas Jaorawala, [“The Multilateral Instrument and its Applicability in India.”](#) *Insights* Volume 7 Number 2, p. 19, (2020).

² TS-616-SC-2023.

³ Sakate Khaitan, Abbas Jaorawala, and Weindrila Sen, [“Invoking M.F.N. Clause Under Indian Tax Treaties Requires Notification.”](#) *Insights* Volume 10 Number 6, p. 5 (2023).

Act, concluded that, when India signs a treaty or protocol, it is not enforceable until Parliament enacts legislation enforcing the agreement. It is up to Parliament to decide whether the treaty should be binding or ignored. In such latter case, the Union will be in default of its obligations. To approve a treaty or a protocol, a notification is required under section 90(1) of the Act. Without such approval, a court, authority, or tribunal has no power to give effect to an income tax treaty or any protocol changing its terms or conditions.

Consequently, an M.F.N. clause does not automatically allow integration of a tax benefit granted to another country. As a result, the power of an M.F.N. clause to amend an earlier treaty requires separate notification under Section 90 of the Act.

While the above was the general understanding Indian tax advisers and tax administrators, a recent decision in case of *Sky High Appeal XLIII Leasing Company Ltd*⁴ (“*Sky High*”) has given rise to the proposition that while India has signed the M.L.I., it has not undertaken necessary administrative procedures to give effect to the M.L.I. The inference is that until such administrative steps are undertaken, the M.L.I. continues to not apply even as of the date of publication of this article.

SKY HIGH FACTUAL SETTING

The case involved an Irish Company that was engaged in the business of leasing aircraft to airline operators worldwide. It entered into dry operating lease agreements with Indigo, an Indian airline. According to information on the internet,⁵ a dry operating lease in aviation is an agreement where the owner provides only the aircraft to the lessee. The lessee takes on full responsibility for the operation of the aircraft, including (i) providing the crew, (ii) handling maintenance, (iii) arranging for insurance, and (iv) complying with all aviation regulations. In this way, a dry lease gives the lessee full operational control over their aircraft.

The Irish company filed its Indian tax return declaring that it had no taxable income, contending that (i) the lease rentals did not constitute a “royalty” under paragraph 3.a of Article 12 (Royalties and fees for technical services) of the India-Ireland Income Tax Treaty (the “Treaty”)⁶ that might otherwise be subject to a 10% withholding tax, (ii) no permanent establishment existed in India under Article 5 (Permanent Establishment), and (iii) its income arising in India constituted business profits taxable

⁴ [2025] 177 taxmann.com 579 (Mumbai - Trib.)

⁵ Brown, Jordan. “Wet Lease vs Dry Lease Aircraft: What Are the Differences.” Charter Flight Group, June 17, 2024.

⁶ Paragraph 3(a) of Article 12 provides as follows:

The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft, or for information concerning industrial, commercial or scientific experience

exclusively in Ireland under Article 7 (Business Profits) in the absence of a permanent establishment in India. Alternatively, it argued that its income was exempt from Indian tax under paragraph 1 of Article 8 (Shipping and air transport)⁷ as the income was derived from the operation of aircraft in international traffic.

The Indian tax authorities proceeded on the basis that the P.P.T introduced through Article 7 of the M.L.I. applied automatically to the Treaty, being a covered tax agreement. Accordingly, the tax authorities sought to invoke the P.P.T. to deny relief under the Treaty in respect of aircraft lease rentals paid by an Indian taxpayer to an Irish company. The tax officer invoked the M.L.I. provisions on the premise that the principal purpose of the Irish company's incorporation was to obtain treaty benefits. The first level appellate authority upheld this approach and questioned the existence of substantive operations in Ireland. The tax assessment order treated the lease rentals as taxable under the Act and denied the benefit claimed under the Treaty.

On appeal, the Income-Tax Appellate Tribunal ("I.T.A.T.") relied on the Supreme Court judgment in the *Nestle SA* case to hold that, in the absence of a specific notification by the Indian government authorities implementing the M.L.I. in India to specific covered tax treaties, the provisions of the M.L.I. are not effective in India. While the Treaty was duly notified and was a covered tax agreement under the M.L.I., the M.L.I. was not specifically notified as applicable to the Treaty. Consequently, the M.L.I. could not be read into the Treaty or enforced against the taxpayer. The I.T.A.T. further observed that the mere issuance of a synthesized text of the modified tax treaty could not be a substitute for the statutory requirement of notification. In this context, reliance was placed squarely on the rationale adopted by the Supreme Court in *Nestle SA* as to the legal precondition for enforcing treaty modifications. The I.T.A.T. observed as follows:

The ratio[nale] of the Supreme Court in *Nestle SA* (supra) leaves no room for ambiguity on this issue. [Summarizing] its conclusions of the judgment, the Court emphatically held that a notification under section 90(1) of the Income-tax Act is an indispensable and mandatory condition for any court, authority or tribunal to give effect to a Double Taxation Avoidance Agreement, or to any protocol or instrument that purports to alter the terms or conditions of such agreement. Put differently, any subsequent treaty-based modification of an existing DTAA can be enforced under municipal law only where a specific section 90(1) notification has been issued incorporating that modification into Indian law.

It may be noted that the I.T.A.T. expressed an alternative basis for its ruling. The P.P.T. is intended to operate as a general anti-abuse rule and cannot be applied mechanically. On the facts presented, the Irish company was found to be a genuine tax resident of Ireland, operating from a jurisdiction recognized globally for aircraft leasing, and the structure was consistent with the object and purpose of the Treaty. In this context, the I.T.A.T. emphasized that the application of the P.P.T. must be

⁷ Paragraph 1 of Article 8 provides as follows:

Profits derived by an enterprise of a Contracting State from the operation or rental of ships or aircraft in international traffic and the rental of containers and related equipment which is incidental to the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State.

“The tax assessment order treated the lease rentals as taxable under the Act and denied the benefit claimed under the Treaty.”

based on an holistic evaluation of the transaction and its commercial substance, The I.T.A.T. observed as follows:

The structure and purpose of the impugned transaction must be examined holistically, not in isolated fragments. The [P.P.T.] is, by its very language, a general anti-abuse rule of last resort, to be invoked only where it is reasonable to conclude, having regard to all relevant facts and circumstances, that one of the principal purposes of an arrangement was to obtain treaty benefits in a manner contrary to the object and purpose of the treaty provisions.

The ancillary grounds relied upon by the tax authorities were also rejected as the lease was an operating lease and the aircraft did not constitute a permanent establishment in India under such a dry-lease arrangement.

EFFECT OF THE *SKY HIGH* DECISION

Given that India has been an early adopter of the anti-abuse measures sought to be tackled by the O.E.C.D.'s B.E.P.S project, this new proposition puts India's international commitment to the B.E.P.S. initiative under the spotlight. This is especially crucial in terms of applicability of the minimum standards under Article 6 (Purpose of a Covered Tax Agreement) and Article 7 (Prevention of Treaty Abuse which includes the Principal Purpose Test).

Essentially, the ruling in *Sky High* illustrates that the M.L.I. cannot be applied in the absence of a specific notification by the Indian Government. Even where such provisions are applicable, they must be applied in conformity with the object and purpose of the treaty and the M.L.I. itself.

WHAT IS NEXT FOR THE M.L.I. IN INDIA?

In India, rulings of the I.T.A.T. are not the final law of the land and are subject to appeal before the relevant High Court, and High Court rulings are subject to appeal before the Supreme Court of India. Only when the Supreme Court of India rules favorably would the rationale expressed by the I.T.A.T. in *Sky High* be considered the law of the land in India, as was the case with the *Nestle SA* ruling.

It is likely that the Indian tax authorities will challenge the *Sky High* decision before the relevant High Court. This controversy is far from settled.

In the meantime, an interesting conundrum has arisen for the Indian tax authorities. On one hand, they can continue litigating the *Sky High* ruling before the courts. The risk of a series of cases is twofold. First the authorities run the risk that the matter will be decided against them. Second, a series of losses may cause India to be viewed as violating its international commitment towards implementation of the M.L.I. Typically, matters take years before they are concluded by the Supreme Court. Consequently, the tax authorities risk that the M.L.I. signed in 2020 may hang by a fine thread till the Supreme Court decides on it, years later.

On the other hand, the Indian tax authorities could swiftly take a cue from the *Sky High* ruling and issue the necessary notifications implementing the M.L.I. in case of each covered tax agreement. However, would such notification be prospective or

retroactive? The answer would have a bearing on the application of the M.L.I. from the period 2020 till 2025 and on tax assessments issued during that period. Any attempt to retroactively validate the M.L.I. could give rise to constitutional challenges. It would also embolden taxpayers in the position of the taxpayer in *Nestle SA* to demand that all recognition of treaty rights should be allowed on a retroactive basis once the government issues a notification. In sum, the pathway ahead for the Indian tax authorities it is not straightforward.

REVIEW OF THE *SKY HIGH* RULING

The Supreme Court judgment in the *Nestle SA* case was reached in the context of a protocol to an income tax treaty whereas the M.L.I. is a multilateral instrument that has been designed from the outset to alter treaty outcomes across jurisdictions. Accordingly, it can be argued that the M.L.I. operates in a fundamentally different space. The M.L.I. is intended to change how bilateral tax treaties are read and applied through agreed mechanisms that modify or override existing provisions where the parties have so chosen. Whether such changes are labelled as amendments or modifications, the fact remains that the outcome under the tax treaty stands altered by mutual consent.

The M.L.I. has been negotiated, signed, and notified with contracting states expressly accepting that it will affect their covered tax agreements, as mutually agreed. Requiring a fresh, treaty-by-treaty notification for each modification may arguably dilute the very purpose of adopting a multilateral solution.

In light of the above, and with due respect to the I.T.A.T. ruling in *Sky High*, perhaps a case exists for the ruling to be reviewed. But in the eyes of some advisers, that may affect the validity of the decision in *Nestle SA*.

PATH FORWARD

One of the possible solutions to expedite a resolution might be a fast-track judgment on the *Sky High* I.T.A.T. ruling by a High Court, followed by an expedited confirmatory Supreme Court judgment.

If the Courts decide in favor of the tax authorities, the position that the M.L.I. is applicable in India since 2020 would be confirmed. To reiterate, this would put the issue to rest. Otherwise, both taxpayers and tax authorities would continue navigating through uncertainty, despite the stated objective of bringing clarity and consistency through the B.E.P.S. project.

At the same time, the *Sky High* ruling demonstrates that the world of tax in India is anything but static, straightforward, and simple. This is a classic case of a judgment in favor of the tax authorities in one case (*Nestle SA*), being used against the tax authorities in another (*Sky High*).



INVESTING IN VIETNAM: KEY LEGAL AND TAX CONSIDERATIONS FOR FOREIGN INVESTORS

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INTRODUCTION

Vietnam has emerged as one of Southeast Asia's most dynamic investment destinations, supported by strong economic growth, a large and increasingly skilled workforce, and deep integration into the global trading system through numerous free trade agreements ("F.T.A.'s"). Ho Chi Minh City, as the country's largest commercial and financial center, continues to play a central role in attracting foreign direct investment, particularly in manufacturing, services, technology, logistics, and consumer-related industries.

Recent policy developments – including the implementation of National Assembly Resolution No. 98 on piloting special mechanisms and policies for Ho Chi Minh City – signal the Vietnamese government's intention to grant greater regulatory flexibility to the city in areas such as investment management, public finance, urban development, innovation, and the attraction of strategic investors. These developments, while still evolving in practice, have contributed to a generally positive investment climate.

This article provides a practical overview of the key legal and regulatory considerations that foreign investors should take into account when investing or conducting business in Vietnam. Rather than focusing solely on doctrinal analysis, the article adopts a practitioner-oriented approach, addressing investment structures, licensing requirements, capital planning, market access conditions, labor and employment issues, and key tax considerations. Particular attention is paid to corporate income tax, value-added tax, special consumption tax, and import and export duties, as these areas frequently have a material impact on the feasibility and long-term sustainability of foreign investment projects in Vietnam.

VIETNAM AND HO CHI MINH CITY AS AN INVESTMENT DESTINATION

Over the past decade, Vietnam has consistently strengthened its position as a preferred destination for foreign investment in Southeast Asia. Factors contributing to this trend include political stability, relatively competitive labor costs, a strategic geographic location within regional supply chains, and the government's long-standing policy of economic openness. Vietnam's participation in major F.T.A.'s – such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("C.P.T.P.P."), the E.U. - Vietnam Free Trade Agreement ("E-V F.T.A."), and the Regional Comprehensive Economic Partnership – has further enhanced its attractiveness as a manufacturing and export base.

Ho Chi Minh City occupies a unique position within Vietnam's economic landscape. The city accounts for a significant share of national G.D.P., budget revenue, and foreign investment inflows. It hosts the headquarters or major operations of many multinational corporations, financial institutions, and professional service firms. In addition, Ho Chi Minh City is often the first point of market entry for foreign investors seeking to test or expand their presence in Vietnam.

National Assembly Resolution No. 98, adopted in 2023, introduces pilot mechanisms that allow Ho Chi Minh City greater autonomy in selected areas, including investment approval procedures, public-private partnerships, financial management, and innovation-related activities. Although the detailed implementing regulations are still being developed, the resolution reflects a broader policy direction toward decentralization and regulatory experimentation. For foreign investors, this may translate into greater flexibility and faster decision-making at the local level, albeit within the overall framework of national laws.

In addition, the National Assembly of Vietnam has issued Resolution No. 222/2025/QH15 on the establishment of international financial centers ("I.F.C.'s") in Vietnam, located in two major centrally governed cities: Da Nang in central Vietnam and Ho Chi Minh City ("Resolution No. 222"). Resolution No. 222 aims to position Vietnam as a leading international financial center, enhancing Vietnam's standing in the global financial network while driving economic growth.

Following this, the Government of Vietnam promulgated Decree No. 323/2025/ND-CP to provide detailed regulations and guidance for the implementation of Resolution No. 222. This decree officially decides on the establishment of I.F.C.'s in Vietnam and introduces a range of special mechanisms and policies to encourage investment activities in these centers.

The I.F.C.'s will promote sustainable finance, encourage the development of green financial products, and mobilize resources for energy transition and green transition projects. They will also attract and develop high-quality human resources, including domestic and foreign financial experts, to live and work in the international financial centers. At the same time, Vietnam has been harmonizing relevant regulations in its legal system to ensure transparency and safeguard the investment process for investors and professionals operating in these centers.

FORMS OF FOREIGN INVESTMENT IN VIETNAM

Vietnamese law requires most foreign investment activities to be implemented through an investment project. In practice, foreign investors typically choose one of the following forms:

Establishment of a Vietnamese Economic Organization

This is the most common form of foreign investment and usually takes the form of a limited liability company or a joint stock company. Such entities may be wholly foreign-owned or established as joint ventures with Vietnamese partners, depending on the applicable market access conditions.



Capital Contribution or Acquisition of Shares or Equity Interests

Foreign investors may acquire equity in existing Vietnamese companies through share purchases or capital contributions. This form is often used in merger and acquisition (“M&A”) transactions and may be subject to prior regulatory approval, particularly where the target company operates in a conditional business sector or where foreign ownership thresholds are exceeded.

Business Cooperation Contract

A business cooperation contract (“B.C.C.”) allows parties to cooperate on a specific business activity without establishing a separate legal entity. While less common in practice, B.C.C.’s are sometimes used in sectors such as telecommunications or energy, where regulatory considerations or risk-sharing arrangements favor contractual cooperation.

In addition, for certain sectors permitted under the Commercial Law and specialized legislation, foreign investors may establish branches or representative offices. A representative office is limited to liaison, market research, and promotional activities and is not permitted to generate revenue in Vietnam.

INVESTMENT AND BUSINESS LICENSING FRAMEWORK

The licensing requirements applicable to a foreign investment project depend on the chosen investment form and the nature of the business activities. Key licenses and approvals may include

- an Investment Registration Certificate (“I.R.C.”) for the investment project, or an approval for capital contribution or share acquisition in M&A transactions,
- an Enterprise Registration Certificate (“E.R.C.”) for the establishment of a Vietnamese legal entity,
- an Operation Registration Certificate for a branch, and
- an Establishment License for a representative office.

In most cases involving foreign investment, the I.R.C. must be obtained before the E.R.C. can be issued. Although the recently passed Law on Investment 2025 has focused on simplifying investment procedures, the I.R.C. - E.R.C. sequence remains the standard approach in practice. Failure to follow the correct licensing order may result in delays, particularly in relation to opening capital accounts and making capital contributions.

BUSINESS PLANNING AND CAPITAL STRUCTURE

A well-prepared business plan is essential for foreign investors entering the Vietnamese market. It serves as the basis for determining the project’s total investment capital, which typically consists of

- charter capital, representing the equity contribution of the investor; and
- medium- and long-term loan capital, which may include shareholder loans or third-party financing.

Vietnamese authorities closely monitor compliance with capital contribution commitments. Charter capital must be contributed in full within the statutory timeline of 90 days upon the E.R.C. issuance, and contributions must be made through a direct investment capital account (“D.I.C.A.”) opened at a licensed bank in Vietnam. Medium-term and long-term offshore loans generally require registration with the State Bank of Vietnam prior to disbursement.

In practice, underestimating investment capital or failing to align the capital structure with actual operational needs may create compliance risks. Subsequent adjustments to total investment capital are possible but involve additional regulatory procedures and scrutiny.

BUSINESS LINES AND MARKET ACCESS CONDITIONS

Vietnam does not apply a uniform open-market policy across all sectors. Instead, foreign investment is subject to a system of market access conditions, derived from Vietnam’s international commitments and domestic legislation.

Certain business lines are fully open to foreign investors, allowing 100% foreign ownership. Other sectors are subject to conditions such as foreign ownership caps, joint venture requirements, or specific licensing criteria. These conditions are particularly relevant in sectors such as logistics, distribution, education, healthcare, and telecommunications.

In addition, for activities conducted in business lines falling under the List of conditional business and investment sectors, enterprises must fully satisfy all applicable business and investment conditions and ensure that such conditions are continuously maintained throughout the course of their operations. Business and investment conditions may be imposed in the following forms:

- Licenses
- Certificates
- Practice certificates
- Written confirmations or approvals
- Other statutory requirements that individuals or economic organizations must satisfy in order to carry out business or investment activities, without requiring formal written confirmation from a competent authority

Collectively, these are commonly referred to as “sub-licenses.” To conduct the corresponding conditional business lines, the relevant sub-licenses are required.

Accordingly, foreign investors should carefully define their intended business scope at an early stage and assess whether any market access restrictions apply. Misalignment between the registered business lines and actual operations may expose

the company to regulatory sanctions and, in the worst case, result in all related costs being disallowed as deductible expenses, and triggering tax consequences relating to revenue recognition and V.A.T. invoicing.

PROJECT LOCATION AND LAND USE CONSIDERATIONS

The location of an investment project must be consistent with its registered business activities. Manufacturing and processing projects are generally required to be located in industrial zones or export processing zones, which offer pre-approved infrastructure and, in some cases, investment incentives.

Service-oriented businesses typically establish their offices in approved commercial buildings. At the initial stage, some investors opt for serviced offices or co-working spaces, provided that such locations are legally eligible for enterprise registration and accepted by the licensing authorities.

Land use rights in Vietnam remain subject to a distinct legal regime, as land is owned by the entire people and managed by the State. Foreign-invested enterprises – meaning enterprises having foreign investors – may obtain land use rights through land allocation or lease from the State, or through sub-lease arrangements within industrial zones.

LABOR AND EMPLOYMENT CONSIDERATIONS

Vietnamese labor law provides a comprehensive framework for governing employment relationships. Upon establishment, foreign-invested enterprises may recruit Vietnamese employees under fixed-term or indefinite-term labor contracts, subject to statutory limitations on consecutive fixed-term contracts.

Employers are required to contribute to the compulsory social security regime, which includes social insurance, health insurance, and unemployment insurance for Vietnamese employees. The combined contribution rate is approximately 32% of the salary used as the contribution base, with the majority borne by the employer.

Foreign employees working in Vietnam generally require a work permit prior to employment, unless a statutory exemption applies. Work permits are issued for a maximum term of two years and may be renewed once. Noncompliance with the work permit regulations may result in serious consequences, including financial penalties or even expulsion of the foreigner from Vietnam. Foreign employees working under a fixed term labor contract of at least 12 months with a Vietnamese employer are subject to social insurance and health insurance obligations but are not covered by unemployment insurance, except in cases where exemptions are provided. The total compulsory social insurance contribution rate applicable to the case of foreign employees is 30% of the monthly salary used as the contribution base, of which foreign employees contribute 9.5% and employers contribute 20.5%.

OVERVIEW OF VIETNAM'S TAX FRAMEWORK

Tax considerations play a central role in investment planning and ongoing operations. Vietnam's tax system includes corporate income tax, value-added tax,

“The location of an investment project must be consistent with its registered business activities.”

personal income tax, special consumption tax, and import and export duties. Compliance obligations are procedural and documentation-intensive, and tax authorities retain broad audit and inspection powers.

Corporate Income Tax

Corporate income tax (“C.I.T.”) is generally imposed at a standard rate of 20% on taxable profits. Preferential C.I.T. rates of 15% apply to small enterprises with annual revenue below 3 billion VND, while a 17% rate applies to medium-sized enterprises with annual revenue between 3 billion and 50 billion VND. (On January 12, 2026, 1 Vietnamese dong equaled U.S. \$0.000038.) Projects in encouraged sectors or disadvantaged locations may qualify for tax holidays, reduced rates, and extended loss carry-forward periods, subject to statutory conditions.

From 2025, Vietnam applies O.E.C.D. Pillar Two rules for large multinational enterprises, enforcing local top-up taxes and compliance obligations.

Value-Added Tax

Value-added tax (“V.A.T.”) applies to the supply of goods and services in Vietnam and to imported goods. Standard V.A.T. rates are 0%, 5%, and 10%, with 10% being the default rate. From 1 July 2025 to 31 December 2026, the standard rate is reduced to 8% for most goods and services (excluding telecom, finance, real estate, and items liable for special consumption tax). Exported goods and services that meet statutory conditions may qualify for the 0% rate.

Special Consumption Tax

Special consumption tax (“S.C.T.”) is imposed on the production, importation, and, in certain cases, trading of goods and services deemed to be luxury or socially sensitive. S.C.T. applies to items such as cigarettes, alcoholic beverages, automobiles, motorcycles with large engine capacity, aircraft, yachts, and certain services including golf and casino business.

S.C.T. is typically levied on the selling price of the goods or services, at rates that vary depending on the category. For imported goods, S.C.T. is calculated based on the import price plus import duty. In practice, S.C.T. can significantly affect pricing structures and market entry strategies, particularly for consumer-facing businesses.

Foreign investors in S.C.T. covered sectors must carefully assess the cumulative tax burden, including S.C.T., V.A.T., and import duties, as well as the impact on cash flow and competitiveness.

Import and Export Duties

Vietnam imposes import and export duties on certain categories of goods. Import duty rates vary depending on the classification of the goods and their country of origin. Preferential rates may apply under Vietnam’s F.T.A.’s, provided that the goods satisfy applicable rules of origin.

Export duties are imposed on a limited range of goods, primarily natural resources and certain processed products, in line with Vietnam’s policy objectives.

In addition to customs duties, imported goods may also be subject to V.A.T. and, where applicable, S.C.T. Proper customs valuation, tariff classification, and origin determination are therefore critical to managing overall tax exposure and avoiding disputes with customs authorities.

Personal Income Tax

The scope of personal income tax (“P.I.T.”) of an individual depends on his or her residence status. The taxable income of resident individuals includes income arising in or outside of Vietnam, irrespective of the place of payment of the income. In comparison, the taxable income nonresident individuals is limited to income arising in Vietnam, irrespective of where the income is paid. P.I.T. is discussed below in more detail.

DISPUTE RESOLUTION, TAX ENFORCEMENT, AND REGULATORY AUDITS

From a foreign investor’s perspective, understanding how disputes are resolved and how regulatory enforcement is carried out in Vietnam is as important as understanding the substantive investment and tax rules, themselves. Vietnam remains a civil law jurisdiction with a strong administrative enforcement culture, particularly in tax, customs, and land-related matters.

Administrative Enforcement and Inspections

Foreign-invested enterprises (“F.I.E.’s”) in Vietnam are subject to periodic and ad hoc inspections by various authorities, including tax authorities, customs authorities, labor authorities, and sector-specific regulators. In practice, tax inspections and audits are the most frequent and have the most material financial impact on F.I.E.’s.

Tax inspections may be conducted at the taxpayer’s premises or at the tax authority’s office and typically focus on corporate income tax, V.A.T., foreign contractor withholding tax, and transfer pricing compliance. While the law sets formal limits on the frequency of inspections, in practice different authorities may conduct inspections independently of one another.

Customs audits often focus on import valuation, HS code classification, country of origin, and eligibility for preferential import duty treatment under free trade agreements. Errors in classification or valuation may lead to retroactive tax assessments, late payment interest, and administrative penalties.

Dispute Resolution Mechanisms

Disputes between investors and Vietnamese authorities generally arise in the form of administrative disputes rather than civil litigation. An investor may choose to pursue an administrative complaint or reconsideration procedure with the issuing authority, or to initiate administrative litigation, subject to specific statutory exceptions.

Administrative litigation is conducted before the Vietnamese courts. While the legal framework for administrative litigation is well established, proceedings can be time-consuming, and courts often defer to administrative agencies on technical matters.



For disputes between private parties, such as shareholder disputes or contractual disputes, investors may choose Vietnamese courts or arbitration. International arbitration is commonly used in contracts involving foreign investors, with arbitration seated either in Vietnam or offshore, such as in Singapore. Vietnam is a party to the New York Convention, and foreign arbitral awards are, in principle, enforceable in Vietnam, subject to public policy review.

Transfer Pricing and Related-Party Transactions

Transfer pricing enforcement has become a major focus area for Vietnamese tax authorities. F.I.E.'s engaging in related-party transactions must comply with detailed documentation requirements, including local files, master files, and country-by-country reporting where applicable.

Failure to comply with transfer pricing regulations may result in tax reassessments, penalties, and denial of deductible expenses. Investors are strongly advised to implement transfer pricing policies early and maintain contemporaneous documentation rather than adopting a reactive compliance approach.

PRACTICAL PITFALLS FOR FOREIGN INVESTORS IN THE FIRST 24 MONTHS

Despite Vietnam's increasingly investor-friendly legal framework, foreign investors often encounter practical challenges during the early stages of their operations. The following issues frequently arise within the first two years of investment.

Underestimating Capital and Cash Flow Needs

Investors sometimes register charter capital at an unrealistically low level to accelerate licensing timelines, only to face difficulties later when additional capital is required. Increasing charter capital requires regulatory approvals and amendments to investment registration certificates that are often time-consuming.

Misalignment Between Licensed Scope and Actual Operations

Vietnamese authorities strictly enforce the principle that a company may only conduct business activities within its licensed scope. Engaging in unlicensed activities – even if ancillary to the main business – may trigger administrative penalties or suspension of operations.

Banking and Foreign Exchange Constraints

While Vietnam has gradually liberalized its foreign exchange regime, capital flows remain regulated. Delays in opening the direct investment capital account or failure to comply with foreign loan registration requirements can disrupt capital contributions and intercompany financing.

Employment and Immigration Compliance

Foreign investors often underestimate the complexity of work permit, visa, and temporary residence card procedures. Noncompliance may result in fines, deportation of foreign employees, and reputational risks for the enterprise.

“P.I.T. is a critical consideration for foreign investors, expatriate executives, and senior managers working in Vietnam.”

Tax Compliance Culture

Vietnamese tax compliance emphasizes form and documentation. Even commercially reasonable expenses may be disallowed if supporting documentation does not strictly meet statutory requirements.

TAX INCENTIVES, FREE TRADE AGREEMENTS, AND STRATEGIC TAX PLANNING

Vietnam’s participation in multiple F.T.A.’s, including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the E.U. – Vietnam Free Trade Agreement creates significant opportunities for strategic tax and customs planning.

Interaction Between Investment Incentives and F.T.A.’s

Investment incentives under domestic law, such as C.I.T. holidays or reduced tax rates, may coexist with preferential import duty treatment under F.T.A.’s. However, eligibility for F.T.A. benefits requires strict compliance with rules of origin and documentation requirements.

Customs Planning and Supply Chain Structuring

Investors engaged in manufacturing and export-oriented activities may benefit from bonded warehouses, export processing enterprise regimes, and free trade zones. These structures can reduce import duties and V.A.T. on imported inputs but require careful compliance with customs supervision rules.

Long-Term Incentive Sustainability

Tax incentives are generally granted for fixed periods and may be subject to claw-back if project conditions are not met. Investors should assess the long-term sustainability of incentives rather than focusing solely on short-term tax savings.

PERSONAL INCOME TAX (“P.I.T.”) CONSIDERATIONS FOR FOREIGN INVESTORS AND EXECUTIVES

P.I.T. is a critical consideration for foreign investors, expatriate executives, and senior managers working in Vietnam.

Tax Residency Status

An individual is generally considered to be a Vietnamese tax resident if he or she is present in Vietnam for 183 days or more in a tax year or maintains a permanent residence in Vietnam. Tax residents are subject to P.I.T. on worldwide income, while nonresidents are taxed only on Vietnam source income.

P.I.T. Rates and Tax Base

As of January 1, 2026, employment income is subject to progressive P.I.T. rates ranging from 5% to 35%. Nonresidents are generally subject to a flat P.I.T. rate on Vietnam source employment income. The personal deduction for a taxpayer is VND

15.5 million per month, and the dependent deduction is VND 6.2 million per month per dependent.

Equity-Based Compensation and Benefits-in-Kind

Stock options, restricted stock units, and other equity-based compensation are subject to P.I.T. in Vietnam, typically at the time of exercise or vesting. Benefits-in-kind, such as housing, education for dependents, and certain allowances, are also taxable.

P.I.T. Incentives for High-Tech and Digital Talent

Vietnam grants P.I.T. exemptions for up to five years for certain categories of high-quality human resources in digital technology, semiconductor manufacturing, artificial intelligence, and high-tech research and development. These incentives aim to attract global talent and are particularly relevant for technology-driven foreign investors.

CONCLUSION

Vietnam continues to position itself as a dynamic and increasingly sophisticated investment destination in Southeast Asia. The evolution of special mechanisms for Ho Chi Minh City, coupled with ongoing reforms in investment, tax, labor, and innovation policies, reflects a broader commitment to attracting high-quality foreign investment.

For foreign investors, success in Vietnam depends not only on understanding the legal framework but also on anticipating regulatory enforcement practices, planning for tax and customs compliance, and aligning business strategy with local operational realities. With careful planning and informed execution, Vietnam offers compelling opportunities for long-term investment and growth.

Key Legal Sources

- Law on Investment No. 61/2020/QH14 (as amended) and Law on Investment No. 143/2025/QH15 (effective from March 1, 2026)).
- Law on Enterprises No. 59/2020/QH14 and amended by Law on Enterprises 2025, governing corporate formation, charter capital, and corporate governance.
- Resolution No. 98/2023/QH15 of the National Assembly on special mechanisms and policies for the development of Ho Chi Minh City, as amended by the National Assembly in December 2025.
- Law on Social Insurance No. 41/2024/QH15 (effective July 1, 2025). • Labor Code No. 45/2019/QH14 and implementing decrees governing employment contracts, probation, and foreign labor.
- Law on Personal Income Tax (as amended, effective January 1, 2026).
- Law on Corporate Income Tax (as amended), including provisions on preferential tax rates and incentives.

- Law on Value Added Tax and relevant resolutions on temporary V.A.T. rate reductions (as amended by Law No. 48/2024/QH15).
- Law on Special Consumption Tax No. 66/2025/QH15 issued on July 1, 2025 and effective from January 1, 2026, governing excise taxation of restricted and luxury goods.
- Law on Export and Import Duties, regulating customs valuation, tariff classification, and preferential treatment under free trade agreements (as amended by Law No. 90/2025/QH15).
- Vietnam's WTO Schedule of Specific Commitments in Services and relevant free trade agreements, including the EU–Vietnam Free Trade Agreement and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.



COLOMBIA: A PRIMER FOR THOSE DOING BUSINESS WITH OR IN THE LOCAL MARKET

Author

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Tags

C.F.C. Taxation

Colombia

Corporate Income Tax

Entrepreneur

Individual Income Tax

Permanent Establishment

Place of Effective

Management

Significant Economic

Presence

Tax Residence

Tax Value Units

Wealth Tax

Withholding Tax

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INTRODUCTION

Colombia is a beautiful country, known for its unique biodiversity, natural landscapes, and cultural richness. With a population of approximately 52 million, it is a major economic and demographic presence in the region. Its location on the northern edge of South America, its access to two coastlines, and its proximity to North America create strong advantages for trade and connectivity.

Colombia is the fourth largest economy in Latin America, surpassed only by Brazil, Mexico, and Argentina. It offers highly competitive conditions for the domestic market while serving as a regional operations platform for South America, Central America, and the Caribbean.

With the advancement of the digital economy, Colombia's relatively low cost of living and high quality of life attract foreign entrepreneurs and executives, for both local business activities and remote work, many of whom choose to establish a primary or secondary residence in the country.

However, when Colombia is considered as a destination for frequent visits, extended stays, or permanent relocation, the implications of its tax system – particularly with respect to income tax and wealth tax – require careful planning. To that end, this article discusses several key points for effective tax planning.

TAXATION OF NONRESIDENT INDIVIDUALS AND FOREIGN CORPORATIONS

In General

For nonresidents whose stay in the country is short or temporary, tax is imposed only on domestic income generated in Colombia. This includes common situations such as salaries paid by a Colombian company or a local branch and rental income from apartments owned by nonresidents. Entrepreneurs providing consulting, technical, management, or administration services to local residents or businesses are subject to withholding tax at rates between 20% and 33%. Here, withholding tax is imposed if the client is based in Colombia, meaning that it does not matter whether the service is performed in Colombia or abroad.

Significant Economic Presence

Colombia applies the concept of significant economic presence (“S.E.P.”) to tax foreign companies selling digital services or goods to Colombians above certain thresholds.

- Covered services or goods include streaming, online ads, subscriptions, data management, and the transfer of digital goods. Not covered by the S.E.P. concept are specific services such as consulting or technical assistance, even when the advice is delivered in digital format.
- Two separate thresholds must be met for the S.E.P. to be met.
 - The first is that the foreign company must maintain systematic and deliberate interactions with the Colombian market. This threshold is presumed to be met if (i) interactions are maintained with at least 300,000 customers or users in Colombia, or (ii) prices are displayed in local currency or payment in local currency is accepted.
 - The second threshold is that Colombian source gross revenue exceeds 31,300 Tax Value Units. The Tax Value Unit is an index the tax authorities use to calculate tax obligations, penalties, income tax brackets, and various tax-related thresholds. The value is adjusted annually to reflect cost of living increases and serves as a hidden form of “escalator.” As of January 1, 2026, one Tax Value Unit was worth 52,374 Colombian Pesos amounting to approximately U.S.\$14.15. This results in the second threshold being approximately U.S.\$ 442,895.

All thresholds are computed on an aggregate basis among foreign related parties.

Tax under the S.E.P. regime may be assessed either by (i) paying a 3% tax imposed on gross income, which requires the preparation of tax returns or (ii) the imposition of a 10% withholding tax collected by the Colombian client and remitted to the tax authorities.

When the service provider resides in a country that has a double taxation agreement (“D.T.A.”) in effect with Colombia, S.E.P. withholding tax may be waived entirely. As a result, the nonresident is taxed only in its country of residence. Regrettably, Colombia has a limited network of D.T.A.’s covering all types of income, despite taxing worldwide income and being an O.E.C.D. member country. Although the United States remains Colombia’s main trading partner, no income tax treaty exists between the two countries.

Place of Effective Management

In addition to potential tax exposure under the S.E.P. regime, foreign companies may trip into exposure to worldwide tax if Colombia is viewed to be the place of effective management of the company. The threshold is low and the risk potentially exists from short-term presence in Colombia by executives, directors, or shareholders of foreign corporations or other structures such as investment funds. The Colombian Tax Code incorporated this concept in 2013, with wording closely aligned to the Place of Effective Management developed in the O.E.C.D. Model Tax Treaty. In 2023, the government lowered the standard, to the extent that even non-strategic administrative tasks performed in Colombian territory by executives other than senior management or C-level executives may trigger a tax risk.

Permanent Establishment

Finally, an executive may temporarily operate in Colombia through a fixed place of business or by contractually binding the foreign entity to local transactions. These are situations that would result in the creation of a permanent establishment. In those facts, a foreign company must comply with its Colombian income tax obligations. These begin by calculating its Colombian taxable profits based on a transfer pricing study in order to identify the profits attributable to the permanent establishment, as if each was independent of the other and both entity operated on an arm's length basis. The permanent establishment would be taxed at the rate applicable to a domestic Colombian company and applied to the same worldwide tax base.



TAX RESIDENCE FOR INDIVIDUALS

In General

In general, tax residence for individual is determined based on physical presence in Colombian territory for at least 184 days within a 365-day period, as verified through records of entries and exits by the Immigration Office. The 365-day period is not limited to the calendar year. Rather, it is a rolling, 365-day lookback period. Accordingly, as of January 1st of a given year, it must be verified whether the 184-day threshold was met within the 365-day period counted retroactively from that date to January 1st of the preceding year. If, at any point during the current year, this rolling 365-day period reaches or exceeds 184 days of presence, tax residence for Colombian Income Tax purposes is deemed to be established.

This is certainly a simpler counting method than that used for determining U.S. tax residence, which can span up to three years, but because it operates as a rolling count throughout the year, close and continuous monitoring is required.

It is not an exaggeration to state that in Colombia, cases of accidental tax residents frequently arise each tax period, both among foreigners who maintain second homes in the country and among some executives of multinational companies.

Colombian Nationals

Colombian nationals who reside abroad but retain certain ties to Colombia may find that they have retained tax residence in Colombia even if the standard 184-day threshold is not met. Individuals who hold the Colombian nationality and fall within one or more of the following traits in the corresponding fiscal year may be deemed to be tax resident in Colombia:

- The individual's significant other or the individual's underage children are deemed as tax residents in the corresponding fiscal year.
- 50% or more of the individual's income is deemed to be Colombian sourced income unless 50% or more of the individual's income is derived from the country where the individual's is domiciled.
- 50% or more of the individual's assets are administered in Colombia, unless 50% or more of the individual's assets were held in the country where the individual's is domiciled.

- The individual fails to provide evidence that of tax residence in another country in response to an inquiry from the Colombian tax authorities.
- The individual is a tax resident of a jurisdiction deemed to be a tax haven by the Colombian tax authorities.

In practical terms, holding a Colombian passport increases the likelihood of triggering Colombian tax residency.

EFFECTS OF TAX RESIDENCE

In General

Once tax residency for income tax purposes is established, an individual is subject to Colombian tax on worldwide income. The resident schedular income tax regime applies, providing a top marginal rate of 39% through the 2025 tax year.

In addition to income tax, a resident individual is subject to capital gains tax, which in Colombia also applies to inheritances and gifts. The rate of capital gains tax is 15%, a rate that may be considered preferential by Latin American standards. The 15% rate for capital gains tax applies to residents and nonresidents.

C.F.C. Taxation

Colombia has a particularly expansive controlled foreign corporation (“C.F.C.”) tax regime. It applies when at least 50% of the voting power, value, or the right to receive profits of foreign legal entity is controlled by one or more Colombian tax residents each of whom holds shares representing 10% or more of the voting power, value, or the right to receive profits of the foreign corporation.

In general, the C.F.C. regime taxes the 10% shareholders on a *pro rata* share of the C.F.C.’s passive income such as interest or rental income generated by the C.F.C. Income of a C.F.C. is considered to be active if it has its origin in real economic activities carried by the C.F.C., its subsidiaries, or permanent establishments. Those activities have to be carried out in the jurisdiction where the C.F.C., subsidiaries, or permanent establishments have their tax residence or where they are located.

While investment dividends derived by a C.F.C. are generally viewed to be passive income, dividends received by a C.F.C. from a subsidiary or any other form of profit distribution received by the C.F.C. are exempt from C.F.C. taxation as long as the profits are produced by real economic activities carried out by the C.F.C., its subsidiaries, or its permanent establishments in the jurisdiction where they are located, and in the case of subsidiaries or permanent establishments they are directly or indirectly controlled by one or more Colombian tax residents.

Other forms of passive income of a C.F.C. include the following:

- Interest or financial yields, unless derived by a C.F.C. that is a regulated entity
- Intellectual property income
- Gains arising from the sale of assets that produce passive income
- Income and gains related to real property

- Gains derived by a C.F.C. from transactions with related parties when the transaction in issue has no economic connection with country of residence of the C.F.C.
- Income derived from the provision of technical services, technical assistance, administrative, engineering, architecture, scientific, industrial and commercial, or other “qualified services” in a transaction involving a related party based in a different country

Wealth Tax

Colombia imposes a wealth tax on individuals who are tax residents for income tax purposes. For individuals that are nonresident, only assets located within Colombian territory are subject to wealth tax, such as an apartment in a trendy destination such as Medellín or Cartagena.

INTERNATIONAL DOUBLE TAXATION

Where a nonresident individual is subject to income tax and wealth tax in Colombia on income and assets in the country, taxation may arise simultaneously in another country where permanent residence is maintained. Potential double taxation of income and wealth may be addressed through an applicable D.T.A., if any.

Where no D.T.A. exists, a taxpayer must rely on domestic rules governing relief from international double taxation, which generally focus on the Foreign Tax Credit mechanism.

When reliance is placed on the Foreign Tax Credit, a significant issue may arise where both Colombia and the other country consider the income to arise from sources in that respective country. In this scenario, neither country would allow a foreign tax credit to be claimed. In these circumstances, it may be possible to claim taxes imposed by one of the countries as a deduction in computing income in the other country. At best, this allows a solution that partially mitigates double taxation. If the U.S. is involved, a deduction may not be possible if the individual wishes to claim foreign tax credits offsetting U.S. income tax on other items of foreign source income.

VOLATILITY IN TAX LEGISLATION

One distinctive feature of the Colombian tax system is the high frequency of tax reforms, which in the current decade has followed a pattern of nearly one tax reform every two years. This pattern has increased uncertainty and reduced the stability of the tax rules, making long-term tax planning a volatile and constantly shifting target.

The current Petro Administration has further intensified this volatility. On December 29, 2025, Legislative Decree 1474 was published that establish tax reform measures for the 2026 tax year without congressional approval. The legal basis for the Legislative Decree was an earlier decree dated December 22, 2025, which declared an economic state of emergency and justified by a current fiscal deficit and the level of national public debt. According to certain constitutional legal experts, the proper approach before the Constitutional Court would be to annul both Decree. Nonetheless, the ultimate outcome remains uncertain.

The timing of these Decrees was clearly tax-driven, aimed at expediting the collection of additional tax revenue. As an example, wealth tax rates entered into force as of January 1.

CONCLUSION

It is not unusual for an uninformed individual arriving in a new country on a temporary or permanent basis to believe that tax laws across the globe more or less contain the same provisions. The unique tax rules in Colombia demonstrate that similarity in the details of tax laws is the exception rather than the rule, notwithstanding the O.E.C.D. B.E.P.S. project and the common reporting framework applicable to large multinational enterprises. Those who move to Colombia on a temporary basis and those wishing to engage in business in or with the country are cautioned to plan in advance for the unique tax laws and tax culture of the country.

“Those who move to Colombia on a temporary basis and those wishing to engage in business in or with the country are cautioned to plan in advance for the unique tax laws and tax culture of the country.”

LUXEMBOURG'S NEW CARRIED INTEREST TAX REGIME

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Tags
A.I.F.M.
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Carried Interests
Fund Managers
Luxembourg

INTRODUCTION

Carried interest tax regimes are under review across several countries in which major fund hubs are based. Policy trends diverge, with some jurisdictions tightening tax privileges in response to fairness and anti-avoidance debates, while others recalibrate to attract or retain fund talent and decision making substance within an investment fund context.

In these circumstances, Luxembourg is seeking to foster and strengthen its position as a major investment fund hub. To that end, the Luxembourg Government submitted draft law nr. 8590 (the “Bill”) to Parliament in July 2025 to reform its existing carried interest regime. Among other things, the Bill seeks to reduce ambiguity that fostered inconsistent interpretations among practitioners regarding the taxation of carried interests. By emphasizing legal certainty and a permanent favorable tax regime, the Bill is intended to attract investment fund management activity to Luxembourg.

CARRIED INTEREST: PURPOSE, FORMS AND MECHANICS

The term “carried interest” refers to a share of a fund’s profits allocated to its investment management professionals when results exceed a pre-agreed threshold. In this way, it aligns the managers’ incentives with those of investors by rewarding performance. It is separate from management fees, which are paid as consideration for ongoing services.

There can be as many types of carried interest as there investment fund sponsors, given that this mechanism is a pure contractual arrangement between fund managers and investors. Payment of the carried interest generally sits in a distribution waterfall. Investors first recover their drawn capital, followed by a preferred return on capital or hurdle, generally 8%. A catchup may allocate a larger marginal share to managers until the agreed carry split is reached. Thereafter, residual profits are shared at the carry percentage. The carry percentage typically ranges between 10% and 20% in market practice. The carried interest is a form of remuneration for the performance of the fund management.

A carried interest can take multiple legal and economic forms. It can be a purely contractual form under which case the fund manager holds a contractual entitlement to a share of the performance of the fund without being required to invest in the fund. The entitlement vests and pays when the waterfall conditions are met. No separate participation is required in order to receive the carry. Alternatively, the carry can be investment linked. In this configuration, the carry is bundled with an investment

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position. Two variants are common. In one, the fund manager must hold an ordinary stake in the fund alongside a contractual carry right. In the other, the carry is embodied in a specific participation instrument, often held through a special purpose vehicle or a partnership interest that tracks the carry economics.

The timing for the payment of the carry can also differ from carry to carry. Some structures pay the amount of the carry on a deal-by-deal basis. The carry is paid upon each qualifying realization event, subject to escrow and clawback protections enjoyed by the investors. Other structures are calculated and paid only after the portfolio is substantially realized and final performance is known. The choice depends on strategy, investor negotiations, and risk allocation.

Governance and retention features are common. Vesting means the right to carry builds up over time; if you leave early, you may lose the unvested portion. So called “good leaver” and “bad leaver” rules control continued entitlement to the vested and unvested carry when a fund manager departs. Misconduct can trigger forfeiture. Carry rights are usually nontransferable, so they cannot be sold or pledged. Some carried interest provide an escrow arrangement that retains a portion of the carry until a later event occurs or a later date is reached. Clawback provisions require a repayment to the fund of an excess carry if later fund results show the amount paid was excessive in light of subsequent events.

The participants in the fund manager group are often compensated by reference to the role played. Partners, core portfolio managers and risk managers are the primary recipients. Senior advisors, operating partners, and board members often participate as well. Persons holding a purely administrative role typically do not participate but exceptions exist. Carried interests can be paid directly by the fund to the fund manager group or be channeled via a dedicated carried interest vehicle, often in the form of a partnership. It can also flow through the alternative investment fund managers, the general partner, or service entities, depending on the platform.

THE PRIOR REGIME: STRUCTURE AND CRITIQUES

Luxembourg’s existing carried interest tax regime under Article 99bis (1a) of the Luxembourg income tax law is of limited material scope. It applies only to employees of alternative investment fund managers or alternative investment fund management companies (referred to as “A.I.F.M.’s”). For any other person not being an A.I.F.M. employee, the general tax rules apply. The same tax treatment applies where any of the other conditions mentioned below is not met.

Article 99bis (1a) of the Luxembourg income tax law makes a distinction between (i) a carry derived from a carried interest entitlement and (ii) income derived from the realization of an investment coupled with a carried interest entitlement. The income targeted under point (i) expressly excludes any income falling within the scope of point (ii).

Point (i) of Luxembourg’s existing carried interest tax regime, involving a carried interest entitlement, relates to carried interests attributed to A.I.F.M. employees on the basis of the status of the employee and the express condition that the investors of the alternative investment fund have recovered their full amount of contributions. If these conditions are met, the carried interest is taxed as speculative profit subject to

the progressive tax rates of up to 45.78%, including a surcharge for the employment fund. Consequently, it is taxed in the same way as employment income, except that it is not subject to social security contributions.

In 2013, a favorable temporary tax regime was introduced under which the holder of the carry would be subject to a favorable tax rate of one-quarter of the speculative the global tax rate, yielding a maximum tax rate of 11.45%. The temporary tax regime is limited to individuals who establish tax residence in Luxembourg between 2013 and 2018. The benefit lasts for 10 years and in no event provides benefits beyond 2028.

Point (ii) of Luxembourg's existing carried interest tax regime, involving income derived from the realization of an investment coupled with a carried interest entitlement, is the provision for which divergent interpretations exist. While certain practitioners advise that this provision applies to investments other than carried interest,¹ others have argued that this provision targets the situation where an investment has been coupled with a carried interest entitlement.² In any case, the income falling within point (ii) would be taxed as speculative profits at the progressive tax rates unless the investment has been held for more than six months and represents less than 10% of the capital of the alternative investment fund, in which case the income would be exempt. While the first interpretation in relation to point (ii) would usually lead to high taxation of carried interests, the second interpretation would lead to an exemption of carried interest in the hands of a Luxembourg resident beneficiary meeting the conditions of point (ii).

The current carried interest regime has been widely criticized:

- Its scope is overly narrow, limited mainly to employees of A.I.F.M's., excluding directors, partners, individual advisors performing core portfolio management functions.
- It is temporary in scope, limited to newly arrived tax residents between 2013 - 2018 and will terminate in 2028, undermining certainty over long fund cycles.
- Its rigid "return of capital first" statutory condition does not fit deal-by-deal waterfalls where investor protection is ensured through escrow and clawback.
- It is ambiguous in characterization and scope.
- It suffers from transparency complications for an investment-linked carry that can defeat straightforward exemption logic and create divergence between opaque and transparent A.I.F.'s.

THE NEW REGIME: DEFINITIONS, SCOPE, AND ARCHITECTURE

The proposed carried interest regime would provide a response to all the criticisms directed at the existing previous tax regime, as follows:

¹ P.-J. Estragerie, "Carried Interest – Luxembourg Taxation," *Revue de Droit Fiscal* (2024), Legitech.

² K. O'Donnel, P. Dimitrova, M. Bentley, "Carried Interest in Luxembourg: Individual Tax Regime," *Revue de Droit Fiscal* (2025), Legitech.

"The temporary tax regime is limited to individuals who establish tax residence in Luxembourg between 2013 and 2018."

First, the concept of a carried interest departs from the notion of entitlement to capital gains. The existing rule refers to an entitlement that is due to the “outperformance” of an alternative investment fund above a given hurdle rate. The new regime aligns the concept of carried interest with market practice waterfall structures in the context of alternative investment funds. The hurdle rate should be compliant with market practice to shield against application of the general anti-abuse rule. It is therefore important to have clear, complete, and market practice documentation in place to avoid any requalification.

Second, the scope of eligible participants is expanded beyond employees of an A.I.F.M. to a broader set of fund professionals. Following formal opposition from the Council of State based on claims of vagueness and legal uncertainty,³ the parliamentary amendment to the Bill now describes the following classification of persons as eligible persons:

- Individuals exercising portfolio management or risk management functions as employees, partners, managers, or directors of any of the following companies: A.I.F.M.’s, management companies of alternative investment funds, and alternative investment funds
- Individual service providers involved in alternative investment fund management under advisory service contracts concluded directly or through one or more entities

This definition is intended to reflect the operational diversity of alternative investment fund platforms while excluding purely administrative roles. Eligible participants are limited to natural persons. The Council of State confirmed that this language resolves its formal opposition by supplying the needed criteria, thereby resulting in legal certainty. For completeness, the new carried interest tax regime would only apply within the context of an alternative investment fund.

Third, the trigger for imposing tax is clarified. Tax becomes due when the carried amount is “touched” or otherwise received. Separate rules regarding taxation of below market acquisitions and employment related benefits continue to apply.

Fourth, the Bill eliminates the prior statutory condition that investors must first have fully recovered capital before carry distributions can be made. This change accommodates deal-by-deal models and recognizes that robust investor protections can be implemented via escrow or clawback mechanisms to police interim misallocations.

Fifth, due to the divergent interpretation in the provisions of the previous tax regime, the various carried interest entitlements that fall within each subdivision can be summarized as follows:

1. **Contractual (non-investment) carry.** This carried interest is not economically tied to a participation. The reform classifies this as extraordinary miscellaneous income and permanently applies the existing reduced global rate to

³ Initially, the Bill defined participants either as (i) managers or (ii) any person directly or indirectly at the service of a manager or management company of an A.I.F., without regard of the person’s status as an employee. The Council of State held that this was too broad, and could lead to legal uncertainty as to scope of persons covered. Accordingly, it asked for a more precise set of participants.

Nonresident carry holders in relation to Luxembourg wishing to benefit from the new favorable tax regime will need to relocate to Luxembourg. The new regime presumes Luxembourg residence for application, but facts may create dual residence issues when families remain abroad and travel patterns trigger ambiguity as to the center of vital interests or habitual abode debates. Dual residence risks merit careful planning.

Finally, permanent establishment risk exposure may arise where a carry holder is employed by a foreign office of a non-Luxembourg entity. The exposure must be addressed at the front-end of the arrangement. Retroactive planning likely is too late to address the exposure.

CONCLUSION

Luxembourg's 2026 carried interest reform offers a clearer, more adaptable framework that separates contractual and investment linked carry and anchors contractual carry in a permanent reduced tax rate regime. It widens eligibility to the functional core of investment management while erecting boundaries against recharacterized wage income and administratively focused roles. It recognizes deal-by-deal realities, neutralizes vehicle transparency for carry classification, and removes legacy requirements that were misaligned with market practice. The new Luxembourg carried interest tax regime clearly stands out among international regimes as one of the simplest and most transparent options for carried interest holders seeking reduced tax rates if not full exemption.

The open questions now focus on cross border residency issues and permanent establishment defensive measures. With careful design and documentation, market participants can align compensation structures to the new rules and support Luxembourg's strategic aim of anchoring front office asset management capabilities within its financial ecosystem. Pending adoption of the Bill in the coming days, the entry into force is set for January 1, 2026.

THE RELEVANCE OF RELEVANCE AND THE ECONOMIC SUBSTANCE DOCTRINE

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Tags

Business Purpose
Code §7701(o)
Economic Substance
Gregory v. Helvering
Liberty Global
Patel
Relevance
Step Transaction

INTRODUCTION

The economic substance doctrine in the U.S. has its roots in case law that aimed to deny tax benefits generated from certain abusive transactions entered into solely or primarily to obtain tax benefits. The doctrine broadly requires that a transaction have a non-tax-related, economic motivation and effect for the tax benefit to be allowed.

GREGORY V. HELVERING

*Gregory v. Helvering*¹ is an early case on the subject. In *Gregory*, the taxpayer, Mrs. G, was the sole shareholder of U-Corp, having a cost basis of \$350,000 in her U-Corp shares. In turn, U-Corp owned 1,000 shares of M-Corp, which substantially appreciated in value during the period held by U-Corp. Mrs. G expressed an interest in arranging the sale of M-Corp shares. However, were U-Corp to sell those shares and distribute the proceeds to Mrs. G, corporate tax would be imposed on U-Corp's gain and income tax would be paid on the dividend distributed to Mrs. G.

To avoid double taxation, U-Corp dropped the M-Corp shares into Newco and distributed the Newco shares to Mrs. G. Under the law in effect at the time, the drop-down to Newco and the distribution of Newco shares to Mrs. G arguably comprised a tax-free spinoff. A portion of Mrs. G's \$350,000 cost basis in U-Corp shares was apportioned to Newco shares received by Mrs. G. Within a few days, Newco adopted a plan of liquidation and distributed the M-Corp shares to Mrs. G. Under the law in effect at the time, neither Newco nor Mrs. G recognized gain. Mrs. G then sold the shares and paid tax on the gain, which was the excess of the sales price over the apportioned tax basis in the Newco shares.

Mrs. G's tax return was challenged by the Bureau of Internal Revenue. It contended that the creation of the Newco was without substance and must be disregarded. Mrs. G should be taxed as if she received a dividend consisting of the amount received upon the sale of the M-Corp shares. The mere organization of Newco for the purpose of enabling Mrs. G and U-Corp to avoid tax followed almost immediately by the dissolution of Newco was a transparent fiction. The determination of the Bureau was appealed to the Board of Tax Appeals, which ruled in her favor,² but the decision was reversed on appeal³ and the reversal was affirmed by the Supreme Court.

The decision in *Gregory v. Helvering* took aim at transactions that meet statutory requirements but are “outside the plain intent of the statute.”

¹ 293 U.S. 465 (1935).

² 27 B.T.A. 223 (1932).

³ 69 F.2d 809 (2nd Cir. 1934).

It is earnestly contended on behalf of the taxpayer that since every element required by the * * * [Code] is to be found in what was done, a statutory reorganization was effected; and that the motive of the taxpayer thereby to escape payment of a tax will not alter the result or make unlawful what the statute allows. It is quite true that if a reorganization in reality was effected within the meaning of * * * [the Code], the ulterior purpose mentioned will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. * * * But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. The reasoning of the court below in justification of a negative answer leaves little to be said.

When [the Code] * * * speaks of a transfer of assets by one corporation to another, it means a transfer made “in pursuance of a plan of reorganization” * * * of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case here. Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose – a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. * * *

In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of * * * [the Code], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

OTHER CASES LOOKING TO ECONOMIC SUBSTANCE

Numerous cases of addressed aggressive tax planning using comparable reasoning to attack aggressive tax plans. Examples include the following:

- The incidence of taxation depends upon the substance of the transaction and not mere formalism⁴

⁴ *Commr. v. Court Holding Co.*, 324 U.S. 331, 334 (1945).

- Taxation is not so much concerned with refinements of title as it is with actual command over the property⁵
- A mere transfer in form, without substance, may be disregarded for tax purposes⁶
- A given result at the end of a straight path is not made a different result because reached by following a devious path⁷
- Where a taxpayer has embarked on a series of transactions that are in substance a single, unitary, or indivisible transaction, the courts have disregarded the intermediary steps and have given credence only to the completed transaction⁸
- Transactions that are challenged as intermediary steps of an integrated transaction are disregarded only when found to be so interdependent that the legal relations created by one transaction would have been fruitless without the completion of the series⁹
- A taxpayer cannot insulate himself from taxation merely by assigning a right to income to another¹⁰
- The absence of a non-tax business purpose for a partnership is fatal to its validity¹¹
- While taxpayers are allowed to structure their business transactions in such a way as to minimize their tax, these transactions must have a legitimate

⁵ *Corliss v. Bowers*, 281 U.S. 376, 378 (1930); see also *Commr. v. P. G. Lake, Inc.*, 356 U.S. 260 (1958); *Helvering v. Clifford*, 309 U.S. 331 (1940); *Griffiths v. Commr.*, 308 U.S. 355 (1939); *Sachs v. Commr.*, 277 F. 2d 879, 882-883 (8th Cir. 1960), affirming 32 T.C. 815 (1959).

⁶ *Commr. v. P. G. Lake, Inc.*, *supra*; *Commr. v. Court Holding Co.*, *supra*; *Commr. v. Sunnen*, 333 U.S. 591 (1948); *Helvering v. Clifford*, *supra*; *Corliss v. Bowers*, *supra*; *Richardson v. Smith*, 102 F. 2d 697 (2nd Cir. 1939); *Howard Cook*, 5 T.C. 908 (1945); *J. L. McInerney*, 29 B.T.A. 1 (1933), *affd.* 82 F. 2d 665 (6th Cir. 1936).

⁷ *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938).

⁸ *Redwing Carriers, Inc. v. Tomlinson*, 399 F. 2d 652, 654 (5th Cir. 1968); *May Broadcasting Co. v. U.S.*, 200 F. 2d 852 (8th Cir. 1953); *Whitney Corporation v. Commr.*, 105 F. 2d 438 (8th Cir. 1939), affirming 38 B.T.A. 224 (1938); *Commr. v. Ashland Oil & R. Co.*, 99 F. 2d 588 (6th Cir. 1938), reversing sub nom. *Swiss Oil Corporation v. Commr.*, 32 B.T.A. 777 (1935), certiorari denied 306 U.S. 661 (1939); *Kuper v. Commr.*, 61 T.C. 624 (1974); *Kimbell-Diamond Milling Co. v. Commr.*, 14 T.C. 74 (1950), affirmed per curiam 187 F. 2d 718 (5th Cir. 1951), certiorari denied 342 U.S. 827 (1951).

⁹ *American Bantam Car Co. v. Commr.*, 11 T.C. 397, 405 (1948), affirmed 177 F. 2d 513 (3rd Cir. 1949), certiorari denied 339 U.S. 920 (1950); see *Scientific Instrument Co. v. Commr.*, 17 T.C. 1253 (1952), affirmed per curiam 202 F. 2d 155 (6th Cir., 1953).

¹⁰ *Commr. v. Sunnen*, *supra*; *Helvering v. Horst*, 311 U.S. 112 (1940); *Corliss v. Bowers*, *supra*; *Lucas v. Earl*, 281 U.S. 111 (1930).

¹¹ *Andantech L.L.C. et al. v. Commr.*, 331 F.3d 972 (D.C. Cir. 2003).

non-tax avoidance business purpose to be recognized as legitimate for tax purposes¹²

- A transaction entered into solely for tax benefits without economic, commercial, or legal effect other than expected tax benefits is to be disregarded¹³

CODE §7701(O)

In more recent times, Congress, hoping to provide greater clarity and efficiency, codified the economic substance doctrine in Code §7701(o). Code §7701(o) provides that prior caselaw on economic substance will continue to remain relevant. It also provides, however, that the doctrine, as applied under the statute, does not apply to every transaction. Recent moves by the I.R.S. suggest that the agency disagrees with this aspect of Code §7701(o) and is applying the doctrine more broadly.

Background

The economic substance doctrine has a long-standing history, stretching back over 90 years. For most of its history, it has been contained in and developed through caselaw. Caselaw also developed several other related doctrines, such as the business purpose doctrine and step transaction doctrine, among others, that ask similar questions. The requirements of each doctrine and their roles in relation to each other were not clear.

Also unclear was the standard that should apply. Some courts applied an objective standard that looked to whether the facts supported a conclusion that the expectation of profit was reasonable. Other courts applied a subjective standard that looked to whether the taxpayer was motivated by more than the expectation of tax savings. Still other courts concluded that either standard, by itself, could justify the presence of economic substance or required that both standards needed to be met in order for a transaction to have economic substance.

Statutory Codification

Code §7701(o), entitled “Clarification of economic substance doctrine” and enacted in 2010, codifies the preexisting regime. The Joint Committee on Taxation explained that this provision was enacted because of the above-described inconsistency of the caselaw behind the economic substance regime.¹⁴ Congress was also concerned with taxpayer justification of transactions based on state and local tax savings and the positive financial effect derived from dressed-up financial statement results.

Code §7701(o) requires that two prongs must be met for a transaction to have economic substance. First, the transaction must meaningfully change the taxpayer’s economic position aside from tax effects. Second, the taxpayer must have a substantial purpose for entering into the transaction aside from tax effects.

Nonetheless, Code §7701(o)(1) specifically is intended to apply to transactions where the economic substance doctrine was “relevant” under existing case law in existence at the time of enactment.

¹² *Boca Investering Partnership v. U.S.*, 314 F.3d 625 (2003).

¹³ *Nicole Rose Corp. v. Commr.*, 320 F.3d 282 (2nd Cir., 2002).

¹⁴ JCX-18-10.



The legislative history indicated that the relevance language was not superfluous and that Congress did not believe Code §7701(o) should reach every possible transaction. The Joint Committee on Taxation further explained:

The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages.

The Committee then provided a non-exhaustive list of such transactions:

- The choice between capitalizing a business enterprise with debt or equity
- A U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment
- The choice to enter a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C
- The choice to utilize a related-party entity in a transaction, provided that the arm's length standard of Code §482 and other applicable concepts are satisfied

“The I.R.S. provided internal guidance to its employees in 2011 to assist in applying Code §7701(o).”

INITIAL I.R.S. GUIDANCE

Code §7701(o)(5)(C) specifies that the determination of whether the doctrine is relevant to a transaction is to be made as it would be in the absence of Code §7701(o). The I.R.S., in Notice 2010-62, acknowledged this aspect of Code §7701(o):

Consistent with these provisions, the IRS will continue to analyze when the economic substance doctrine will apply in the same fashion as it did prior to the enactment of section 7701(o). If authorities, prior to the enactment of section 7701(o), provided that the economic substance doctrine was not relevant to whether certain tax benefits are allowable, the IRS will continue to take the position that the economic substance doctrine is not relevant to whether those tax benefits are allowable.

The I.R.S. provided internal guidance to its employees in 2011 to assist in applying Code §7701(o).¹⁵ The guidance established a four-step procedure. The first step required examiners to determine whether it was likely inappropriate to apply the doctrine to a transaction. In addition to reproducing the four examples from the legislative history, the guidance lists various indicators that suggest the doctrine is not applicable:

- The transaction is not promoted/developed/administered by tax department or outside advisors.
- The transaction is not highly structured.
- The transaction contains no unnecessary steps.

¹⁵ LB&I-04-0711-015.

- The transaction that generates targeted tax incentives is, in form and substance, consistent with Congressional intent in providing the incentives.
- The transaction is at arm's length with unrelated third parties.
- The transaction creates a meaningful economic change on a present value basis (pre-tax) Taxpayer's potential for gain or loss is not artificially limited.
- The transaction does not accelerate a loss or duplicate a deduction.
- The transaction does not generate a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset).
- The taxpayer does not hold offsetting positions that largely reduce or eliminate the economic risk of the transaction.
- The transaction does not involve a tax-indifferent counter-party that recognizes substantial income.
- The transaction does not result in the separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years.
- The transaction has credible business purpose apart from federal tax benefits.
- The transaction has meaningful potential for profit apart from tax benefits.
- The transaction has significant risk of loss tax benefit that is not artificially generated by the transaction.
- The transaction is not a pre-packaged transaction or is not outside the taxpayer's ordinary business operations.

In addition, the guidance stated that it likely is not appropriate for an examiner to raise the economic substance doctrine if the transaction being considered is related to the four transactions deemed to be acceptable in the legislative history previously mentioned.

If an examiner determined that application of the economic substance doctrine was likely not inappropriate to apply to a transaction, a series of approvals were required before the economic substance doctrine could be asserted.

THE I.R.S.'S REVISED APPROACH

In April 2022, the I.R.S. revised its position regarding the circumstances in which arguments could be raised to challenge the economic substance of a transaction.¹⁶ The guidelines adopted in 2011 were revised in order to (i) remove their "halo" effect and (ii) eliminate the requirement of advance approvals by "higher-ups" that were required to raise the issue. At the same time, the Internal Revenue Manual was revised to seemingly suggest that the economic substance doctrine in Code § 7701(o) differed from the doctrine in case law.

¹⁶ LB&I-04-0422-0014.

PURPOSE OF GUIDANCE

The purpose of this guidance is to instruct examiners and their managers on how to determine when it is appropriate to raise the economic substance doctrine, (the codified economic substance doctrine under IRC 7701(o) or the common law economic substance doctrine) and related penalties.¹⁷ [Emphasis supplied.]

LIBERTY GLOBAL CASE

In the last several years, the I.R.S. appears to have turned away from their previously stated position with respect to relevance. A catalyst in this shift seems to have been *Liberty Global Inc. v. U.S.*,¹⁸ a case where the government won summary judgment.

In *Liberty Global*, a U.S. corporation known as Liberty Global sought to offset gains from the sale of its interest in a Belgian telecommunications company using the dividends-received deduction under Code §245A. Liberty Global converted an indirectly held foreign disregarded entity into a foreign corporation, causing that entity to also become a controlled foreign corporation (“C.F.C.”). By virtue of previous steps taken, including a note issued by the then-disregarded entity, the newly converted C.F.C. had earnings and profits, a prerequisite to the availability of the Code §245A deduction. Liberty Global then sold the new C.F.C. to its foreign parent. The gains from this sale were recharacterized as a dividend to the extent of E&P under Code §1248 and qualified for the Code §245A deduction. But because the C.F.C. was owned by the foreign parent on the last day of the tax year, the C.F.C.’s Subpart F income was attributed to the parent instead of Liberty Global.¹⁹

It does not appear that the I.R.S. raised relevance as an issue, but Liberty Global argued that the I.R.S. failed to show the economic substance doctrine was relevant to its transaction. In particular, Liberty Global pointed out that the conversion of a disregarded entity to a corporation was the sort of transaction that lacked economic substance but was respected nonetheless. This echoes the I.R.S.’s evolution in this area. Under pre-1997 regulations, the I.R.S. required that an entity substantively match the characteristics of its claimed form, *e.g.*, was it properly treated as a corporation or was it properly treated as a partnership. The modern check-the-box regulations do away with such substantive analysis and are almost purely elective. Effective as of January 1, 1997, eligible foreign entities are entitled to choose their status as a corporation or a partnership for most purposes of the Code.²⁰

¹⁷ See Attachment 1 – IRM 4.46.4.12.9 and Exhibit 4.46.4-4.

¹⁸ No. 1:20-cv-03501 (2023) reported unofficially at 132 AFTR2d) 2023-6406 (D. Colo. 2023); the case is currently on appeal to the 10th Circuit.

¹⁹ Note also that the C.F.C. remained a C.F.C. after it was sold to the foreign parent due to constructive ownership. Note also that the Code §951(a)(1) requirement regarding ownership on the last day of the year has been modified effective for years beginning on or after January 1, 2026. Instead of looking at stock ownership on the last day of the tax year, §951(a)(1)(A) now requires inclusion of a *pro rata* share of Subpart F income by any U.S. shareholder owning stock in a foreign corporation on any day in the corporation’s tax year if the corporation is a C.F.C. at any time during the tax year.

²⁰ An eligible foreign entity is any foreign entity that is not listed in Treas. Reg. §301.7701-2(b)(8). See Treas. Reg. §301.7701-3(a).

“The decision of the District Court in *Liberty Global* in favor of the government’s motions for summary judgment seems to have encouraged the I.R.S. to minimize the importance and role of the relevance question.”

The District Court ruled that there was no threshold inquiry separate from the statutory factors to determine the relevance of the doctrine. The court cited legislative history suggesting that the doctrine was always applicable to transactions that have no economic purpose other than a taxpayer obtaining tax benefits unintended by Congress. It also cited case law where courts did not engage in a relevance determination.

In particular, the court did not address any of the following considerations:

- The statutory language that applies the doctrine to transactions to which the doctrine is relevant
- Code §7701(o)(5)(C), which provides further guidance on the relevance determination (*i.e.*, it is to be made in the same manner as if the provision had never been enacted
- The legislative history indicating that there are certain transactions to which the doctrine is not relevant, even though the choice between transactions is mostly or entirely tax-driven.

Instead, the court concluded as follows:

[T]he doctrine’s relevance is coextensive with the statute’s test for economic substance, provided by the operative clause. * * * At the risk of tautology, I proceed with the conclusion that the economic substance doctrine applies when a transaction lacks economic substance.

PATEL CASE

The decision of the District Court in *Liberty Global* in favor of the government’s motions for summary judgment seems to have encouraged the I.R.S. to minimize the importance and role of the relevance question.

In *Patel v. Commr.*,²¹ the taxpayer was a doctor who owned several medical businesses and had a strong business background. He formed multiple captive insurance companies. Contemporaneous emails suggest that his main motive was tax avoidance, and there seems to have been little regard for whether the insurance companies were otherwise economically viable.

In a briefing in *Patel*, the I.R.S. argued that there was no relevance question under Code §7701(o). In the alternative, it argued that Code §7701(o) was only irrelevant if Congress explicitly provided that a certain transaction was valid in spite of a lack of economic substance.

The economic substance doctrine, as codified in section 7701(o), does not impose a “threshold” relevance determination, and certainly not one divorced from the facts and circumstances of each case. Rather the relevance of the economic substance doctrine to a transaction is heavily dependent on facts and circumstances, as courts repeatedly determined before and after codification.

²¹ 165 T.C. No. 10 (November 12, 2025).

Should this Court conclude that section 7701(o) does require a “threshold” relevancy determination, that determination should be a limited inquiry into whether Congress explicitly provided that taxpayers are entitled to the claimed tax benefits despite the underlying transactions lacking economic substance. *Section 7701(o) is a substantive anti-abuse rule that applies to all Subtitle A Code provisions unless a taxpayer shows that Congress indicated otherwise.* [Footnotes omitted and emphasis added.]

Thus, in the I.R.S.’s view, the relevance determination is already satisfied in all cases unless Congress has indicated otherwise. The relevance determination is part of the overall application of the economic substance doctrine.

In a unanimous reviewed decision,²² the U.S. Tax Court held that the codified economic substance doctrine can be considered by a court only when the doctrine is relevant to a transaction. The Tax Court did not agree with the I.R.S.’s analysis, citing plain statutory language and legislative history.

Statutory interpretation . . . always . . . begins with the text.” * * * The text before us is section 7701(o), which states in no uncertain terms that it applies to “transaction[s] to which the economic substance doctrine is relevant.” §7701(o)(1). It further states that “[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.” §7701(o)(5).

Faced with these provisions, we easily conclude that the statute requires a relevancy determination. To put it plainly – the statute says so, right there, on its face. First, section 7701(o)(1) signals that a determination is required by conditioning application of the doctrine on certain circumstances – namely, the doctrine applies if there is a transaction to which it is relevant. Next, section 7701(o)(5) expressly directs us to make the determination (whether the doctrine is relevant) and, if that were not enough, the same provision explains how to make the determination (as if the statute had never been enacted). In short, Congress could hardly have been clearer, at least on this narrow point.

* * *

For those who consider legislative history relevant,” * * * the legislative history of the codified economic substance doctrine is fully consistent with our interpretation that section 7701(o)(1) requires a relevancy determination * * *. Observing the lack of uniformity in the application of the economic substance doctrine, * * * the committee expressed its intent “to provide greater clarity and uniformity in the application of the economic substance doctrine in order to improve its effectiveness at deterring unintended consequences,” *id.* at 295, 2010 U.S.C.C.A.N. at 228.



²² In a reviewed case, one Tax Court judge writes the opinion, but all Tax Court judges vote on the outcome and concurring or dissenting opinions may be written by other judges.

Further, the House report made clear that the economic substance doctrine does not apply to every transaction. *Id.* at 296, 2010 U.S.C. C.A.N. at 228-29 (providing a nonexhaustive list of transactions to which the doctrine does not apply). The House report stated that the codified economic substance doctrine applies “in the case of any transaction to which the economic substance doctrine is relevant” and that “[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if the provision had never been enacted.” *Id.* at 295, 2010 U.S.C. C.A.N. at 228. The House report also confirms that “the provision does not change current law standards in determining *when* to utilize an economic substance analysis.” *Id.* at 295 -96, 2010 U.S.C. C.A.N. at 228 (emphasis added). Thus, the legislative history confirms that the codified economic substance doctrine is not intended to apply to every transaction and may be applied only when it is “relevant.”

Based on the above legislative history, The Tax Court heeded Congress’s direction that the issue of economic substance should proceed in the same manner as if Code §7701(o) had never been enacted. Accordingly, it expressly disagreed with the decision in *Liberty Global* and other courts²³ that have held that the relevancy requirement is coextensive with the requirements of Code §7701(o)(1)(A) and (B).

On the facts before it, the court found that the economic substance doctrine was relevant to the taxpayer’s transactions. It further found that both prongs were satisfied. The taxpayer’s economic substance did not meaningfully change, as there was a circular flow of funds among related entities, and the taxpayer had no substantial business purpose other than avoiding taxes.

CONCLUSION

When initially adopted, Code §7701(o) was viewed by many to be a hammer provided by Congress to address aggressive tax planning. While initial I.R.S. guidance recognized certain fact patterns as benign from the point of view of the taxpayer, a change in policy was adopted in 2022. Since then, the I.R.S. appears to be making expansive use of this hammer. The summary judgment in *Liberty Global* in favor of the I.R.S. has been appealed and the *Patel* decision expressly disagrees with the rationale of the District Court. At the microcosm level, the I.R.S. is winning the cases, but at the macrocosm level, its argument has been shot down by the U.S. Tax Court and the directed verdict has been appealed. For the I.R.S. and taxpayers alike, much is riding on the outcome of the appeal in *Liberty Global*.

²³ *Chemoil Corp. v. U.S.*, No. 19-cv-6314, 2023 WL 6257928, at *5 (S.D.N.Y. Sept. 26, 2023).

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Ruchelman P.L.L.C. is a boutique law firm based in New York City. It was founded in 1989 by an alumnus of a legacy firm that is now Deloitte's.

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