

GAAR rising

Mapping tax enforcement's evolution

February 2013







Contents

Introduction

2

Today's shifting GAAR landscape:
highlighting recent changes around
the world

5

Common traits of anti-avoidance
and GAARs: the differences in local
design and approach

10

GAAR and SAAR: what's the
difference, and when do they
intersect?

16

GAAR and tax treaties

18

GAAR design and administration:
the balancing act

20

Living with GAAR: leading practices
for tax life cycle management

22

Business as usual?

28

Appendix

GAAR assessments by country

31

1

Introduction

Complexity in the world's tax systems has grown in tandem with the challenges of doing business in an increasingly connected global economy. Today, the application of many of those laws lags business innovation.

As a result, some laws do not operate as originally intended, or create uncertainties that were not foreseen. At their extreme they can impede desirable business activity. In other instances, taxpayers may be seen as taking advantage of some laws in ways that tax administrators find undesirable. These resulting uncertainties can limit economic growth and impede tax administration.

Many countries have taken steps to modernize their corporate tax systems to align better with rapidly shifting business models. Several countries have reduced their corporate tax rates and have moved to a more territorial approach to taxing business income. The United States, home to a large number of the world's largest multinational corporations, continues to debate whether a switch to a territorial tax system will be a central part of the tax reform that leaders in both political parties say they want, while countries such as Japan and the United Kingdom have moved closer to territorial taxation.

A widening anti-abuse net

The globalization of business and the mobility of capital, however, continue to challenge tax administrators who worry about the potential exploitation of what are perceived to be unintended tax benefits. Emerging markets such as Chile, China and India are making headlines by widening their tax net and, in some cases, disregarding holding company entities. And some countries that are enacting reforms aimed at increasing their competitiveness are at the same time considering anti-avoidance measures that may actually increase uncertainty.

A global effort

The recent focus on tackling "tax abuse" can also be attributed to the rising deficits and falling tax revenues that have resulted from the global financial crisis. Governments have been spurred to act by multilateral organizations, including the G20, the Organisation for Economic Co-operation and Development (OECD) and the European Commission. Tax activist groups have turned a spotlight on tax havens, high-net-worth individuals and, now, the seemingly low effective tax rates reported by some multinational companies. A series of steps, including increased information exchange, expanded disclosure requirements, and joint and simultaneous tax audits have been put in place to address what countries view as unacceptably aggressive tax planning.

Defining GAAR

Anti-avoidance rules are divided into two main categories: "general" and "specific."

A general anti-avoidance rule (GAAR) is a set of broad principles-based rules within a country's tax code designed to counteract the perceived avoidance of tax. GAAR is a concept within law that provides the taxing authority a mechanism to deny the tax benefits of transactions or arrangements believed not to have any commercial substance or purpose other than to generate the tax benefit(s) obtained.

Tax law designed to deal with particular transactions of concern are termed as either specific anti-avoidance rules (SAARs) or, less commonly, targeted anti-avoidance rules (TAARs).

Other countries are flexing GAARs long on their books, becoming bolder about threatening to apply them or actually applying them.

A wave of national change

Many countries are now taking a different and more dramatic approach. Countries such as the United Kingdom, India and China have either proposed or adopted broader anti-avoidance statutes that empower authorities to challenge what they perceive to be “aggressive” tax planning or “treaty abuse.” Countries including Ireland and South Africa are flexing GAARs long on their books, becoming bolder about threatening to apply them or actually applying them. And countries that have been testing the judicial limits of their anti-avoidance statutes for decades, such as Australia, are becoming even more assertive in the wake of economic adversity and are looking to further tighten their rules. Other countries, including emerging economies, are watching these developments and contemplating their own policies, either to replicate what they see as leading practices or as a defensive measure in response to other countries’ use of such legislation.

Feeding uncertainty

Businesses increasingly fear that countries that once used GAAR only reluctantly, and in the most extreme circumstances, are beginning to use it more extensively than it was originally designed to be used. They have good reason to be worried. While judges in several GAAR cases have defended businesses against overly broad application of the rule, some countries that lose in court have responded by proposing new laws to make their GAAR tougher and, in the case of India, retroactive. In countries without a GAAR, tax authorities are increasingly challenging business arrangements on the grounds that they lack substance, even if such arrangements comply with the applicable law. GAAR’s rise as a favored enforcement tool, however, has the potential to increase the uncertainty businesses already feel operating in the challenging global economy; a poorly designed or administered GAAR is in neither the taxpayer nor the government’s interest.

Table 1: GAAR introduction timeline

1915	Australia	1990	South Korea
1924	The Netherlands	1997	Italy
1941	France	2006	South Africa
1977	Germany	2008	China
1981	Sweden	2008	Indonesia
1988	Singapore	2012	Belgium (revised)
1988	Canada	2013	United Kingdom (proposed)
1988	Brazil	2016	India (proposed)
1989	Ireland		

British Prime Minister’s letter to G8 leaders

“[O]n tax, we know that in a globalised world, no one country can, on its own, effectively tackle tax evasion and aggressive avoidance. But as a group of eight major economies together we have an opportunity to galvanise collective international action. We can lead the way in sharing the information to tackle abuses of the system, including in developing countries, so that Governments can collect the taxes due to them. ... But I do believe that as leaders, we all have a common interest in being able to tell our taxpayers who work hard and pay their fair share of taxes, that we will make sure others do the same.”

David Cameron, Prime Minister, United Kingdom, 2 January 2013

<http://www.g8.utoronto.ca/summit/2013lougherne/130102-cameron.html>

The proliferation of anti-avoidance rules amplifies the uncertainty global businesses already feel as they operate in this intensely interconnected and interdependent economy.

The proliferation of anti-avoidance rules amplifies the uncertainty global businesses already feel as they operate in this intensely interconnected and interdependent economy. Such rules can breed distrust where cooperation would more likely generate mutually satisfactory resolution to controversy, as evidenced in the headline of an October 2012 Reuters news agency story about the new GAAR proposal in the United Kingdom: "Businesses spooked by UK tax avoidance clampdown." Adding to the complexity of this new environment is the fact that GAAR approaches vary from country to country, along with the penalties they may carry and the administrative procedures for appeal and relief.

Jean-Baptiste Colbert, Controller-General of Finances under France's King Louis XIV, once described taxation as the art of "plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." With so many challenges from so many directions now facing multinational corporations, the hissing is getting louder.

The rise of GAAR – and the growing interest by multilateral organizations and other interest groups in targeting what they perceive as overly aggressive tax planning – represents part of the next chapter in this evolving tax enforcement story. In this report, we look at the growing number of countries developing such measures, the characteristics of these measures, how and when the measures may be invoked, and what companies can do to mitigate risk in each phase of their tax risk management.

"We do need a debate in this country, not only what is against the law – that's tax evasion, that is against the law, that's illegal and if you do that the Inland Revenue will come down on you like a tonne of bricks – but what is unacceptable in terms of really aggressive tax avoidance.

Because some people say to me, 'Well, it's all within the law; you're obeying the law, it's okay'. Well, actually there are lots of things that are within the law [that] we don't do because actually we have some moral scruples about them and I think we need this debate about tax too.

I'm not asking people to pay massive rates of tax. We've got a low top rate of income tax now; we've got a low rate of corporation tax now; we are a fair tax country. But I think it's fair then to say to business, you know, we're playing fair by you; you've got to play fair by us."

David Cameron, Prime Minister, United Kingdom,
Comments on tax avoidance¹

¹ The Daily Telegraph, 4th January 2013. [www.telegraph.co.uk, http://www.telegraph.co.uk/news/politics/david-cameron/9779983/david-cameron-tax-avoiding-foreign-firms-like-starbucks-and-amazon-lack-moral-scruples.html](http://www.telegraph.co.uk/news/politics/david-cameron/9779983/david-cameron-tax-avoiding-foreign-firms-like-starbucks-and-amazon-lack-moral-scruples.html)

2

Today's shifting GAAR landscape: highlighting recent changes around the world

Anti-avoidance rules in the tax law have been around for many years. Of the 24 countries surveyed for this report, Australia designed the first in 1915. While the concept of addressing tax avoidance transactions with either a SAAR or a GAAR is hardly new, the increasing resort to such rules by many governments in an effort to combat what they perceive to be widespread tax avoidance is predictable in the current climate. Assessing the frequency with which GAAR is invoked (whether with ultimate effect or not) is a difficult task, and not all countries publish statistics. China is one country that does, however, and its 2011 report states that 248 GAAR cases were started and 207 concluded, with taxes collected as a result totaling around CNY24 billion (US\$3.81 billion). China considers this as full justification for continuing to develop its GAAR approach.



Listen to the webcast

GAAR rising: a new chapter in tax enforcement

For the corporate enterprise, the unfolding trend of new GAAR law presents yet another layer of uncertainty to be managed. Join our team of Ernst & Young professionals as they discuss how the anti-avoidance landscape continues to take shape, how individual countries are approaching anti-avoidance and how companies can proactively manage all stages of their tax life cycle to reduce the risk of a controversy arising from GAAR or other anti-avoidance measures. Our panelists' viewpoints will be supplemented by recorded insights from subject matter professionals in Canada and China.

Moderator:

- ▶ Rob Hanson, Ernst & Young LLP (US), Global Director of Tax Controversy Services

Featured panelists:

- ▶ Christopher Sanger, Ernst & Young LLP (UK), Global and EMEA Director of Tax Policy Services
- ▶ Howard Adams, Ernst & Young, Asia-Pacific and Australia Tax Controversy Leader
- ▶ Satya Poddar, Ernst & Young Private Limited, Tax Policy Services – India
- ▶ Jeffrey Owens, Ernst & Young LLP (UK), Senior Policy Adviser to the Global Vice-Chair of Tax Services

Access an on-demand archive of the webcast at

http://www.ey.com/gl/en/Issues/webcast_2012-10-26-0200_gaar_rising_a_new_chapter_in_tax_enforcement

European Commission recommends a common GAA(b)R to EU Member States

In the March 2012 European Union (EU) Council conclusions, Member States asked the European Commission “to rapidly develop concrete ways to improve the fight against tax fraud and tax evasion, including in relation to third countries.” On 6 December 2012, the Commission published a Communication titled *An Action Plan to strengthen the fight against tax fraud and tax evasion (COM(2012) 722 final)*.² The Action Plan identifies a series of specific measures that could be developed now and over the next several years, provided that the necessary support from Member States exists to do so.

Two specific recommendations were made in the Action Plan to address aggressive tax planning, an area that the Commission defines as practices that reduce tax liability through “strictly legal arrangements” but at the same time contradict the “intent” of the law. Both recommendations address direct taxation only.

In relation to instances of double non-taxation, the first recommendation is that Member States should include a provision within their treaties that income may only remain untaxed in a Contracting State if it is subject to tax in the other Contracting State (which may be either another Member State or a third country).

The second recommendation is that Member States should adopt a common general anti-abuse rule in their national legislation. Aside from the complexity of the legislative language suggested in the Communication, the short phrase “it is appropriate to recommend the adoption by Member States of a common General Anti-Abuse Rule” contains three issues of

interest. First, the language used in the Communication refers to the common adoption of a general anti-abuse (GAA(b)R) and not a GAAR. While this may seem of little consequence, as we note on page 15 of this report the difference in phrasing might possibly be intended to suggest that the abuse version (GAA(b)R) covers a narrower range of situations than its broader sibling, the GAAR. This, however, is not necessarily indicated by the scope and operation of the GAA(b)R described within the Communication.

Notwithstanding this potentially significant difference, a second issue of interest is the recommendation that the GAA(b)R language should be common across all 27 Member States. This is a tall order for a bloc of countries as diverse as the EU. In fact, of the nine Member States included in this report, eight already have a GAAR. Reworking an existing GAAR to encompass a new approach risks creating further uncertainty for business.

Finally, although not explicitly mentioned in the Communication text, these recommendations are just that; they are not binding upon Member States. Thus their adoption in a fully consistent manner might be difficult to achieve.

The proposed wording of the anti-abuse clause in the Communication is somewhat complex and requires close analysis. Assuming implementation occurs, national tax administrations will have a new standard against which to measure and examine transactions. This is a key area for continued monitoring by multinational companies as the debate continues to unfold.

² http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf

The SAT in China intends to incorporate more internationally accepted practices into its GAAR. At the same time, the SAT also noted that a panel review for GAAR cases might be created in the near future.

Australia's GAAR legislation has seen much change since its inception nearly a century ago. The 1981 GAAR (known as Part IVA) is currently viewed by many stakeholders as one of the most mature and comprehensive in the world. The current GAAR was originally designed to replace what had been perceived as ineffective anti-avoidance laws. Australia's then-Treasurer John Howard stated that the 1981 rules were designed to strike down transactions believed to be "blatant, artificial and contrived." Over the years, the Australian courts have expanded the GAAR's scope and reach to apply to what many view as normal, commercial transactions.

But more recently, this landscape has changed with the Australian Government in March 2012 announcing plans to amend the GAAR (Part IVA). The Australian Taxation Office (ATO) has lost seven out of nine Part IVA cases in the last three years, resulting in a call for an overhaul of the provisions. The announcement to change the law occurred just days after the High Court refused the ATO's special leave application to appeal the Full Federal Court decision in *RCI Pty Ltd v FCT*.

On 16 November 2012, Australia's Assistant Treasurer released for public comment the exposure draft legislation (ED) and explanatory materials (EM) for the changes to Australia's GAAR (Part IVA) announced on 1 March 2012. Importantly, the start date of the proposed changes is now altered, to apply to arrangements carried out or commenced on or after 16 November 2012. The ED is intended to deal with perceived deficiencies in the operation of Section 177C of Part IVA (Income Tax Assessment Act 1936), which deals with the issue of "tax benefit." The EM state that the proposed amendments "are not intended to disturb the operation of Part IVA in any other respect."

China has a GAAR provision and introduced a substance-over-form principle into its tax regime in January 2009 when the State Administration of Taxation (SAT) issued *Guoshuifa* (2009) No. 2 (Circular 2), the trial version of the Implementation Measures for Special Tax Adjustments. Since then, measures and enforcement efforts, aimed particularly at nonresidents, have been announced to address situations that China views as tax avoidance or inappropriate treaty shopping. China's most well-known measure in this regard is Circular 698, which raises significant issues for pre-existing investments in China.

A new circular issued in April 2012 indicates that the SAT intends to incorporate more internationally accepted practices into its GAAR. At the same time, the SAT also noted that a panel review for GAAR cases might be created in the near future to fairly and consistently implement GAAR across the nation.³ A panel review feature is also included in recent GAAR proposals in India and the United Kingdom, and it has long been a part of Australia's GAAR administration. The SAT plans to issue its updated GAAR implementation rules soon. In designing its rules, the SAT will no doubt consider the GAARs of other jurisdictions, as well as the recommendations of ongoing consultations and refinements elsewhere.

India first proposed a GAAR into its domestic tax law through the Finance Act 2012 in response to perceived aggressive tax planning. The question of "substance over form" has consistently arisen in the implementation of taxation laws in India. Statutory provisions are intended to codify that doctrine, under which the "real intention" of the parties and the effect of the transactions and purpose of an arrangement are taken into account for determining the tax consequence, regardless of the legal structure.

Shortly after the legislative proposals – and in response to strong criticism from the domestic and global business communities – the Indian Government formed an expert committee to address stakeholder concerns. The expert committee report, which was submitted on 1 September 2012, contained a number of recommendations, including the deferral of a GAAR to tax year 2016-17, the inclusion of overarching principles to be considered as a pre-condition to GAAR applicability, the grandfathering of existing investments, some limitations on the application of GAARs in respect to income tax treaties, the formation of an independent Approving Panel and the upholding of the validity of the administrative circular issued in the context of Mauritius entities.⁴ The majority of the recommendations of the expert committee (including the delay of a GAAR until 2016) were adopted by the government in a 14th January 2013 press release.

³ See *Guoshuifa* (2012) No. 41, *The work plan of strengthening China's international tax administration system*, for more information.

⁴ Report on General Anti-avoidance Rules (GAAR) in Income-tax Act, 1961, <http://www.ey.com/GAARWebcast>

The legislation's stated overall intention is to apply only to "artificial and abusive" tax schemes, bolstering the UK Government's message that Britain is open for business and has a competitive tax system.

The US approach

The United States does not have a GAAR, but it does have a very long history, dating back to the 1930s, of addressing potentially abusive arrangements through a series of disclosure rules, penalties, and targeted anti-avoidance statutes and regulations in addition to a number of judicially developed doctrines. Also, the United States in 2010 adopted a general statutory provision, codifying the "economic substance doctrine," that could be viewed as somewhat comparable to a GAAR provision.

The economic substance statutory provision, which carries a strict liability penalty of up to 40%, did not replace the country's long common law history. The US common law includes a number of other substance-focused doctrines in addition to the common law economic substance test. That voluminous history of court decisions remains in place and presumably will continue to evolve along with interpretations of the new statutory provision.

In June 2012, the **United Kingdom** launched a formal consultation on a new GAAR. This followed the Budget 2012 announcement that such a rule will be introduced in Finance Act 2013 (with a commencement date of 1 April 2013), which in turn followed the publication of a report by an independent study group led by Graham Aaronson QC.⁵ The stated aim of the proposed GAAR is in line with the Aaronson report's recommendation to introduce a rule that targeted only artificial and abusive arrangements and not "the centre ground of tax planning."

The UK GAAR as originally proposed requires taxpayers (and potentially a court) to consider whether there are arrangements where: (i) "having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements," and (ii) the entry into the arrangements "cannot reasonably be regarded as a reasonable course of action, having regard to all the circumstances."

⁵ Graham Aaronson QC, GAAR study: a study to consider whether a general anti-avoidance rule should be introduced into the UK tax system, 11 November 2011, http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf

With GAAR now being introduced in several countries around the globe, what does this mean for businesses? Clearly the ability to plan and execute transactions with a high degree of certainty will be reduced where governments rely on the catchall properties of a GAAR.

Concerns had been expressed, however, that this formulation did not provide sufficient certainty that the key operative provisions will apply only to their intended target and not to a broader range of circumstances. This led to the announcement in the Chancellor's autumn statement of 5 December 2012 that the wording has been clarified. Similar concerns had been expressed that the draft legislation set out in the UK Consultation Document itself does not contain sufficient safeguards to prevent possible "mission creep" – the use of the GAAR in circumstances not intended at the outset. The legislation's stated overall intention is to apply only to "artificial and abusive" tax schemes, bolstering the UK Government's message that Britain is open for business and has a competitive tax system.

Assessing the impact

With GAAR now being introduced in several countries around the globe, what does this mean for business? Clearly the ability to plan and execute transactions with a high degree of certainty will be reduced where governments rely on the catchall properties of a GAAR. With other countries watching these developments for policy direction and as leading practice – or considering defensive reaction – this uncertainty is likely to grow.



3

Common traits of anti-avoidance and GAARs: the differences in local design and approach

Anti-avoidance rules typically apply by focusing on the substance of a transaction or arrangement. When insufficient substance is present, GAAR may allow the tax authority to change the tax result of a transaction or of steps within the transaction that it finds objectionable.

Anti-avoidance rules generally are aimed at making sure tax benefits flow only to their intended beneficiaries by empowering tax authorities to reject claims for benefits that are regarded as artificial or contrived. While it would be foolish of businesses to ignore the tax consequences of any transaction, governments are concerned about the potential for aggressive tax positions that may comply with the letter of the law, but in their view, may violate its spirit or legislative intent.

GAAR and the courts

GAAR and other anti-avoidance approaches frequently utilize subjective criteria, often looking beyond the form of a transaction to its underlying substance, purpose or intent. As a result, there is oftentimes a close connection between developments with respect to GAAR and developments in the courts, with litigation arising over the application of GAAR provisions and pre-GAAR litigation experience often one of the driving forces for enactment of such provisions.

The number of controversies litigated based on GAAR or GAAR-like arguments is on the rise around the world, sometimes involving the first court tests of long-established but rarely used or challenged statutes. In December 2011, for example, the Irish Supreme Court delivered its first judgment on the Irish GAAR, which has been in place since 1989. In *O'Flynn Construction Ltd and others v. Revenue Commissioners*, the Irish Supreme Court held, by a 3 to 2 majority, that the transactions carried out by the taxpayer ran afoul of the GAAR. The court upheld the argument of the Revenue Commissioners that the use of specific relief provisions by the taxpayers amounted to a misuse or abuse of those provisions, in light of the purpose for which the relief was provided.

Litigation over anti-avoidance provisions can also lead governments to respond by adjusting their GAAR approach. Where a government sees the courts siding with taxpayers on a relatively frequent basis, the legislature sometimes responds by enacting a stronger GAAR or more targeted provisions. After losing the *Vodafone* case in its Supreme Court, for example, the Indian Government proposed a change to existing law that would allow the tax authority to look back 50 years to challenge similar transactions. That proposed change is now under review.

The courts have been instrumental in shaping US tax policy also, starting with a key articulation of what it means for a transaction to have “economic substance,” which can be found in the 1935 US Supreme Court case of *Gregory v. Helvering*. The United States has several common law doctrines that are similar to many GAAR regimes. These doctrines include the substance-over-form doctrine, the step transaction doctrine, the sham transaction doctrine, the business purpose doctrine and the economic substance doctrine. Many of these doctrines overlap and the doctrines have been applied somewhat differently by various courts over the years. These differences in judicial interpretation were part of the impetus for codification of the economic substance doctrine. In 2010, the Health Care and Education Reconciliation Act created Section 7701(o), which defines the economic substance doctrine as the common law doctrine under which certain tax benefits are not allowable if the transaction either does not have economic substance or lacks a business purpose.

Typical elements of a GAAR

Countries develop and implement their GAAR regimes differently. Some establish independent panels to provide oversight of the tax authority’s use of GAAR. Some (e.g., Ireland, Japan) have explicit treaty override protections, while others (South Africa, Sweden) do not have specific provisions on this point. And around the world, there is little consistency on whether the burden of proof is on the taxpayer or the taxing authority or is shared between the two. That said, there are a number of common characteristics generally found in a GAAR.

Governments generally try to achieve one or more of the following objectives with a GAAR:

- ▶ Codify judicial rulings on what they feel constitutes avoidance or abuse
- ▶ Target transactions that may comply with a technical interpretation of the law but that generate tax benefits the government considers to be unintended or inconsistent with the spirit of the law
- ▶ Define what constitutes an artificial scheme, transaction or arrangement that has been concocted to extract a tax benefit
- ▶ Apply some type of substance or purpose test as a filter for determining whether a transaction is legitimate

A core question when considering GAAR – and often a difficult question to answer – is what types of transactions or arrangements are potentially subject to challenge under the particular GAAR.

- ▶ Provide the tax authority a mechanism to recharacterize or disregard a transaction or otherwise eliminate the tax benefits claimed
- ▶ Allow the imposition of special assessments, penalties and interest where violations are determined
- ▶ Provide the taxpayer with reconstructive relief so they pay only the new tax or penalties assessed by the authority (i.e., they avoid domestic double taxation on a transaction), although this would not necessarily provide relief in a cross-border situation

Defining a potentially abusive transaction

A core question when considering GAAR – and often a difficult question to answer – is what types of transactions or arrangements are potentially subject to challenge under the particular GAAR. Each country will have its own definition of what constitutes an “abusive” or “avoidance” transaction that could be the target of its GAAR.

In Canada, for example, the definition is as follows:

- ▶ Did the transaction (or series of transactions that includes the transaction) result in a tax benefit?
- ▶ If so, is the transaction or any transaction in the series an avoidance transaction? A transaction is not an avoidance transaction if it can reasonably be considered to have been undertaken primarily for a bona fide purpose other than to obtain the tax benefit in question.
- ▶ If a transaction is an avoidance transaction, did it result in a misuse of the provisions of the (Income Tax) Act, Income Tax Regulations, Income Tax Application Rules, a tax treaty, or any other legislation relevant in computing tax or amounts payable or refundable under the Act, or did it result in an abuse with regard to these provisions (other than section 245 of the Act) read as a whole?

This approach, which reflects significant subjective elements, is consistent with the approaches in many other countries, underscoring the uncertainties inherent in the use of a GAAR.

In India, the tax authorities start from the use of the term “arrangement.” Under the current Direct Taxes Code (DTC), an arrangement refers to any step, part or whole transaction, scheme, operation, contract, agreement or understanding.

“...tax considerations may play a primary role in a taxpayer’s choice of available structuring options to implement a transaction or series of transactions without necessarily making the transaction itself primarily tax motivated.”

– Justice Boyle of the Tax Court of Canada, *Spruce Credit Union v. The Queen*, 2012 TCC

An arrangement that is the subject to GAAR is further defined as having the main purpose of attracting a tax benefit and either:⁶

- ▶ Not having a bona fide purpose
 - ▶ Creating rights and obligations that would not normally be present between two parties dealing at arm’s length
 - ▶ Resulting, directly or indirectly, in the misuse or abuse of the provisions of the DTC
- Or
- ▶ Lacking commercial substance either in whole or in part

Under the DTC, an arrangement that satisfies the main purpose condition can be subjected to a GAAR if any of the above additional conditions are also satisfied, making its scope very wide. In other jurisdictions (e.g., Canada), the test is somewhat more stringent in that it requires that all of the specified conditions be met, thus making the reach of the GAAR narrower.

In some cases, the picture is even less clear. In Brazil, for example, a GAAR has been in place since 1988, but the approach to GAAR administration has not further developed in the near quarter-century since its introduction. Brazil’s Complementary Law 104/2001, Article 116, provides that “The administrative authority may disregard legal acts or transactions that are effected with the purpose of dissimulating the occurrence of a taxable event or of (dissimulating) the nature of the elements that trigger the tax obligation, under procedures to be established by ordinary law” (freely translated). However, no such procedures have been established.

The Brazilian Government has attempted to enact legislation providing such procedures, but the provisions were widely criticized and it was not approved by the Brazilian Congress. Despite the substantial uncertainty created by this unsettled situation, the Brazilian tax authorities issue tax assessments using the anti-avoidance rule as a legal basis. In making these assessments, tax inspectors are disregarding the fact that the rule is structured so as not to be applicable in the absence of the required procedural rules.

Not only is every country unique in its definition of what is considered to constitute abuse, but many countries’ application of a GAAR also presents taxpayers with anomalies that require close attention and understanding.

⁶ Ernst & Young LLP, *Deciphering the Direct Tax Code*, 2010.

How each country identifies and quantifies a tax benefit is as varied as the ways in which they each define a transaction or arrangement potentially falling within the scope of the GAAR.

Tax benefit

While some might consider that a tax benefit is limited to a reduction in the overall tax liability of a taxpayer, the reality is that a tax benefit can take many different forms. Many countries take a broader view, considering a tax benefit to have occurred if an arrangement alters either the incidence of tax or the liability of a taxpayer to pay tax.

Looking across the countries surveyed in this report, the definitions of tax benefit include one or more of the following:

- ▶ A deduction, relief, rebate or refund
- ▶ A reduction, avoidance or deferral of income
- ▶ An increase in a deduction, rebate or refund of tax or other amount
- ▶ A reduction, avoidance or deferral of tax or other amount that would be payable but for a tax treaty
- ▶ An increase in a refund of tax or other amount as a result of a tax treaty
- ▶ A reduction in tax base, including an increase in loss, in the relevant financial year or any other financial year

How each country identifies and quantifies a tax benefit is as varied as the ways in which they each define a transaction or arrangement potentially falling within the scope of the GAAR. Again, close understanding of each country's definitions – and how those definitions may change as a country reviews and refines its GAAR – is an imperative for business.

In Australia, for example, the litmus test is whether there is another way that the taxpayer could have achieved the same commercial results without obtaining the tax benefit (i.e., the counter factual).

Purpose test

Countries with a GAAR generally apply some form of business purpose test to determine whether the arrangement, transaction or scheme makes commercial sense absent the tax benefits or whether it was entered into to achieve a tax benefit.

In the United States, the economic substance doctrine provides that a transaction will be treated as not having economic substance unless the taxpayer can show that:

- ▶ The transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position
- ▶ The taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction

In Australia, the test requires an objective analysis of eight factors to determine whether the scheme was entered into or carried out for the "dominant purpose" of enabling the taxpayer to obtain the tax benefit(s). Those factors include:

- i. Manner in which the scheme was carried out
- ii. Form and substance of the scheme
- iii. Timing of the scheme and length/duration of the scheme
- iv. The result that would otherwise be achieved by the scheme
- v. Change in financial position of the taxpayer as a result of the scheme
- vi. Any change in the financial position of any person connected with the relevant taxpayer as a result of the scheme
- vii. Any other consequences for the relevant taxpayer or any person referred in part vi. above, as a result of the scheme being carried out
- viii. The nature of any connection between the relevant taxpayer and any person referred to in point vi. above

Importantly, when considering all eight factors, weighting may be placed on one factor over another in determining the dominant purpose of the scheme.

In some jurisdictions, the invocation of GAARs is recognized as so sensitive that panels have been established to oversee or provide advice regarding its application.

Use of a GAAR “review panel”


In some jurisdictions, the invocation of GAAR is recognized as so significant that panels have been established to oversee or provide advice regarding its application. Australia and France have GAAR panels, and it is proposed that India and the United Kingdom will also establish such panels.

There have also been calls for a GAAR-type panel to be introduced in South Africa, but there have been no specific developments in this regard yet.

GAAR administration should involve an independent consultancy panel to make sure consistency, fairness and equity are afforded to taxpayers. The development of the United Kingdom’s GAAR proposal (among others) demonstrates how much importance is attached to the composition and role of a review panel. The consultation document proposes the establishment of an Advisory Panel as recommended by an independent report on GAAR issued in 2011. It is proposed that the Advisory Panel will advise on the application of the GAAR to particular transactions and approve guidance produced by Her Majesty’s Revenue and Customs (HMRC) that must be taken into account by a court in determining whether the GAAR applies in a particular scenario. This panel is expected to have significant influence over how the GAAR will apply in practice, and the composition and operational mechanics of the panel are therefore critical in determining whether the GAAR achieves its intended objectives.

Table 2: Upon whom is the burden of proof?

Australia	Taxpayer
Belgium	Tax authority
Brazil	Taxpayer
Canada	Shared
China	Taxpayer
France	Tax authority
Germany	Shared
India	Tax authority (proposed)
Indonesia	Shared
Ireland	Taxpayer
Italy	Tax authority
Japan	Tax authority
Mexico	Tax authority
The Netherlands	Tax authority
Poland	Shared
Russia	Taxpayer
Singapore	Taxpayer
South Africa	Shared
South Korea	Taxpayer
Sweden	Taxpayer
Switzerland	Shared
Turkey	Shared
United Kingdom	Tax authority (proposed)
United States	Taxpayer



GAAR administration should involve an appropriate review process aimed at making sure consistency, fairness and equity are afforded to taxpayers.

“Burden of proof”

At its heart, any GAAR regime will establish which party is responsible for proving whether an arrangement or transaction has sufficient economic substance. There is no global consistency on this issue, and as shown in table 2 on page 13, in some countries the burden of proof is on the taxpayer (Australia, Brazil, China, Ireland, Russia, Singapore, South Korea, Sweden and the United States) while in others it is on the tax authority (Belgium, France, India (proposed), Italy, Japan, Mexico, the Netherlands and the United Kingdom (proposed)).

In about one-quarter of the countries in our survey (Canada, Germany, Indonesia, Poland, South Africa, Switzerland and Turkey), the burden of proof is shared. Whatever approach a country takes on this matter, it is important for taxpayers to have the right documentation in place.

Mechanisms to cancel

Most GAARs empower tax administrators to cancel or otherwise disallow benefits they determine are obtained using an improper scheme, transaction or arrangement. In some cases, the tax authority will recharacterize the arrangement or transaction consistent with its determination regarding the substance.

Penalties and interest

GAAR regimes typically involve the potential for significant penalties and penalty interest, and there is substantial variation in the level and operation of penalties across countries.

In Italy, for example, if a transaction is found to be abusive, then a penalty of between 100% and 200% of the additional taxes due may be levied. In China, the penalty is in the form of increased interest, which is imposed at a rate of 500 basis points above the benchmark lending interest rate published by the People’s Bank of China for the year in which the tax payment occurs.

In Sweden, while there are no specific penalty rules included in the GAAR regime, penalties under other applicable tax laws will apply, including the penalty associated with the failure to provide the tax authority with sufficient information to make a correct assessment.

These three examples illustrate the variation in penalty and interest costs associated with the application of a GAAR. Moreover, as a GAAR case can take many years to reach conclusion, the final interest or penalty interest charges can reach a multiple of the underlying tax cost.

Finally, it is worth noting that most GAARs do provide some form of reconstructive relief so that the taxpayer pays only the new taxes and penalties and/or interest assessed. Under this process, the taxpayer continues to be protected from domestic double taxation.

When is a GAAR not a GAAR: when it's a GAA(b)R?

The lexicon of anti-avoidance varies by country.

Sometimes the acronym "GAAR" means "general anti-avoidance rule." Other times it means "general anti-abuse rule." While this may seem of little consequence, the difference in phrasing can be intended to suggest that the abuse version (a "GAA(b)R") covers a narrower range of situations than its broader sibling the GAAR.

The United Kingdom, for example, has proposed a GAA(b)R that is intended to apply only to "egregious" cases. By including a "double reasonableness test" under which a GAAR would apply only to arrangements "which cannot reasonably be regarded as a reasonable course of action," the government hopes to give comfort to taxpayers that common transactions will not be targeted by the GAA(b)R.

However, country approaches that start off as a GAA(b)R may eventually morph into more of a GAAR. Ongoing developments in Australia would appear to be moving in this direction. Australia's GAAR was originally directed toward arrangements that were regarded as "blatant, artificial or contrived." Today, the ATO regularly seeks to apply it more broadly, and legislative changes to widen the regime have been announced.

Such experience demonstrates that, even when such rules are initially intended to have limited application, in practice, the extent to which tax authorities seek to apply them may stretch over time, a process known as "administrative creep."

So perhaps the question "When is a GAAR not a GAAR?" is not answered with "when it is a GAA(b)R," but rather "when it is young."



4

GAAR and SAAR: what's the difference, and when do they intersect?

Our analysis of 24 countries shows that while many have introduced GAAR, all have more SAARs that are focused on particular types of transactions and business structures. Moreover, some countries have put in place measures that have the general characteristics of a GAAR but that are in fact more closely targeted TAARs. The proposed United Kingdom regime may well fall into this latter category.

While some governments view the introduction of a GAAR as a way to simplify the tax law, our survey shows the opposite to be true. Regardless of whether they have a GAAR regime, virtually all countries have multiple SAAR provisions, and few of these have been abolished with the introduction of a GAAR.

A TAAR approach provides something of a middle ground between the two approaches. It may share many (if not all) of the characteristics of a GAAR regime but is limited to a specific set or type of transactions. TAAR approaches also typically do not replace existing SAAR provisions, however.

How GAAR and SAAR can intersect

The introduction of a GAAR regime poses the significant question of whether the GAAR will apply to an arrangement or transaction that has already been subject to one or more of the SAAR measures that are in place in the local jurisdiction.

Perhaps not surprisingly, there seems to be little or no consistency among countries on this question. Germany, for example, provides that GAAR is not to be applied to any arrangement or transaction that has passed muster under an applicable SAAR test. Canada, by contrast, is an example of a country where the GAAR regime may apply in spite of and in addition to an applicable SAAR provision. Indeed, this is a common characteristic of the regimes of many common-law countries.

A key concern of tax professionals regarding countries' development of new or strengthened regimes is the risk of introducing a GAAR that is hastily designed and prone to scope creep. Such a GAAR could encroach upon (and in some cases subsume) existing SAAR provisions that may be long-standing, thus creating additional uncertainty and greater compliance burdens for multinational companies. Some countries have begun to recognize this risk, including, for example, India, which has backed off its original proposal for immediate implementation of a GAAR and has formed an expert committee that has advised that implementation of the proposed GAAR should be deferred several years.

A SAAR to watch: treatment of indirect transfers of assets

One area of SAARs that has generated much global attention in the last few years is the practice in some countries of looking through holding company structures and attempting to tax the indirect transfer of assets. This trend began with the position taken by India in the Vodafone case, a position that ultimately was rejected by the highest Indian court.

China in recent years has also begun to tax indirect transfers of assets. In a well-publicized audit case, the Chongqing Municipal Tax Bureau sought to impose tax on an indirect stock sale by disregarding the existence of (or looking through) a Singapore investment in a Chinese company. In this case, the tax authority in Chongqing challenged what it viewed as the avoidance of Chinese tax upon an indirect disposal of an investment in a China tax resident entity and looked through the most immediate holding company, imposing tax on the Singapore parent of the Singapore SPV as if it had directly disposed of the Chinese company.

The tax authority reclassified the transaction as a direct transfer of the shares by disregarding the existence of the Singapore SPV. The case was reviewed and approved by the SAT centrally and may have had an influence on the SAT's subsequent issuance of Circular 698 in 2010. With Circular 698 now in place, it is clear that dispositions by foreign investors of the stock of intermediate holding companies that hold equity interests in a Chinese company are under scrutiny in China. Moreover, under Circular 698, in situations where the jurisdiction of the intermediate holding company imposes little or no tax on foreign source income, the transferor is required to make significant disclosures to the local China in-charge tax bureau regarding the details of the transfer.

Chile recently became the latest country seeking to widen its tax net in this way. A new law addresses indirect transfers of Chilean assets and will have a potentially significant effect on foreign investors in Chile, with the legislation targeting gains on an indirect disposal of assets in Chile if the buyer acquires a 10% or greater interest in such assets. Under the new law, the tax could be collected from the seller, the buyer or their agents in Chile or from the transferred Chilean assets.

“To me, the GAAR panel ... should be advisory.”

– Dr. Tizhong Liao

China's Circular 601 – interpreting beneficial ownership

On 27 October 2009, the SAT issued *Guoshuihan* (2009) No. 601 (Circular 601), setting out guidelines on the interpretation and determination of the term “beneficial owner” under China’s tax treaties. This interpretation of beneficial ownership is intended to apply to determine whether nonresident recipients are entitled to the reduced rates of withholding tax provided under the dividend, interest and royalty articles of the tax treaties that China has entered into with other tax jurisdictions, including the agreements with the Hong Kong and Macau Special Administrative Regions of China. Circular 601 provides guidance for the tax authorities to follow when processing applications from nonresident taxpayers for such benefits under an applicable tax treaty.

Although the treatment in Circular 601 of pure conduit (i.e., holding company) situations generally follows the mainstream international tax practice and the OECD’s definition of beneficial ownership, the approach set forth in Circular 601 goes much further in denying beneficial ownership status. The SAT thus seems to be expanding the beneficial ownership concept beyond its original meaning and using it instead as an anti-treaty shopping/anti-abuse test, which risks creating significant uncertainty for nonresident taxpayers with respect to qualification for treaty benefits.

The SAT has recently issued a supplement to Circular 601, which provides some important clarifications. So-called “Notice 30” provides that the specified factors should be considered “collectively” when assessing beneficial ownership status, with the presence or absence of any one of the seven negative factors identified in Circular 698 not alone determinative. Two other important features of Notice 30 are a safe harbor for certain dividends received by a treaty-jurisdiction resident company that either is itself a listed company in the treaty jurisdiction or is wholly owned directly or indirectly by such a listed company (which is somewhat similar to the public company test under the Limitation of Benefits articles in US tax treaties), and a look-through provision for situations where the income in question is collected by an agent.

Where next for China's GAAR?

The application of GAAR is not coherent in China: in one province you have one standard; in a second province you may have another. We hope to achieve more coherence by establishing a GAAR supervision committee in SAT’s headquarters. China doesn’t want to use the GAAR article as a policy instrument to encourage tax collection. The article is regarded as a last resort in terms of combatting abusive and aggressive tax planning.

In terms of reforming GAAR, at the beginning of this year (2012), I was instructed by the board of directors of the SAT to draft new procedural guidance on the application of GAAR. We are open to introducing more international practice into our procedures, while also taking into account the needs of China.

To me, the GAAR panel I mentioned should be advisory. Thinking about the legal issues behind it, if the panel is advisory as opposed to binding, the taxpayer has a chance to apply for administrative reconsideration at a higher level in the tax administration. It also allows the panel to be more flexible generally.

Dr. Tizhong Liao, Deputy Director General of International Taxation of the State Administration of Taxation, China, in an October 2012 interview with Ernst & Young

5

GAAR and tax treaties

The use of GAAR or SAAR is not limited to domestic law tax benefits but also extends to benefits provided by tax treaties. Tax treaties frequently include their own anti-avoidance provisions, both targeted provisions focused on a specific benefit provided by the treaty or more general provisions aimed at overall qualification for benefits under the treaty. These are bilateral provisions negotiated by the treaty partners.

However, we are also seeing countries attempt to apply anti-avoidance measures to tax treaties on a unilateral basis, through pronouncements regarding the interpretation of their existing treaties or through application of domestic-law GAAR provisions to treaty benefits. These latter situations raise serious concerns about the instability created by the override of tax treaty obligations.

Recent developments around the world show an increasing focus on including in tax treaties explicit provisions aimed at curtailing the benefits provided in the agreement. While detailed limitation on benefits provisions have long been a feature unique to US tax treaties, similar approaches designed to prevent “treaty shopping” have now begun to find their way into some treaties to which the United States is not a party. In addition, countries increasingly are including in their tax treaties explicit authorization of the application of domestic-law anti-avoidance provisions.

Table 3 on page 19 provides some examples of 2011 and 2012 tax treaties that contain specific reference to the application of domestic anti-avoidance rules. This list is not exhaustive but is illustrative of a growing trend.



Even where application of domestic law GAAR measures is not explicitly provided for in tax treaties, some countries are unilaterally applying anti-avoidance measures to their existing treaties.

The approach that has been taken by China provides an example of this phenomenon. The 2010 protocol amending the 2000 China-Barbados tax treaty includes a provision that allows the Chinese tax authority to apply its GAAR regime to restrict the benefits of the treaty in certain cases. Article 4 of the protocol provides: "The provisions of this Agreement shall in no case prevent a Contracting State from the application of the provisions of its domestic laws aiming at the prevention of fiscal evasion and avoidance, provided that the taxation in that State on the income concerned is not contrary to this Agreement."

About half of the tax treaties that have been signed by China subsequent to this agreement with Barbados have included a similar provision allowing the application of domestic GAAR provisions.

Even where application of domestic law GAAR measures is not explicitly provided for in tax treaties, some countries are unilaterally applying anti-avoidance measures to their existing treaties. The position taken by India in the Vodafone case is an example of such an approach. The interpretation of the concept of beneficial ownership in China's Circular 601 is another example.

Our survey of 24 countries shows that approximately half allow their GAAR provisions to override existing tax treaties, either by overriding the treaty unilaterally or by agreeing in the treaty to allow application of domestic GAAR. The potential application of domestic anti-avoidance rules in the tax treaty context creates a particularly high degree of uncertainty for multinationals and can have implications for their tax treatment not just in the source jurisdiction that is applying its GAAR provisions but also in the residence jurisdiction.

Businesses that are operating in multiple countries would benefit from a common understanding of GAAR, which could be advanced through multilateral organizations such as the European Commission, the OECD and the United Nations Tax Committee. The operation of GAAR in the treaty context should be agreed bilaterally and reflected in the treaty itself.

Table 3: Examples of 2011-12 tax treaties containing specific reference to the application of domestic anti-avoidance rules in the treaty context

2011 – Barbados* – Czech Republic tax treaty
2011 – Ethiopia – Egypt tax treaty
2011 – United Arab Emirates – Estonia tax treaty
2011 – India – Ethiopia tax treaty
2011 – Cyprus – Germany tax treaty
2011 – Hungary – Germany tax treaty
2011 – Mauritius – Germany tax treaty
2011 – Spain – Germany tax treaty
2011 – Turkey – Germany tax treaty
2011 – Taiwan – Germany tax treaty
2011 – Malta – Hong Kong tax treaty
2011 – Portugal – Hong Kong tax treaty
2011 – Spain – Hong Kong tax treaty
2011 – Switzerland – Hong Kong tax treaty
2011 – Estonia – India tax treaty
2011 – Tanzania – India tax treaty
2011 – Malta – Israel tax treaty
2011 – Spain – Singapore tax treaty
2012 – Colombia* – Czech Republic tax treaty
2012 – Ireland – Germany tax treaty
2012 – The Netherlands – Germany tax treaty
2012 – Czech Republic – Hong Kong tax treaty
2012 – Jersey – Hong Kong tax treaty

**In addition to preserving the application of domestic GAAR, these treaties contain a general treaty anti-abuse rule.*

6

GAAR design and administration: the balancing act

The challenge – some would say a near impossibility – for any GAAR regime is to target tax avoidance without hampering taxpayers' ability to engage in legitimate business activity. The very nature of a GAAR involves substantial subjective judgment on the part of tax administrators. As such, there is a critical need for clear guidance as to the scope and application of a GAAR, including detailed examples of what is and is not permitted. Moreover, the need for such guidance is ongoing as both tax law and the GAAR regime evolve and develop.

With this in mind, what are the key elements in this balancing act aimed at achieving a GAAR that appropriately targets arrangements and transactions that are inappropriately artificial and contrived and that is clear, consistent and constrained in its application?

Policy design

The following are important considerations in the design of a GAAR regime:

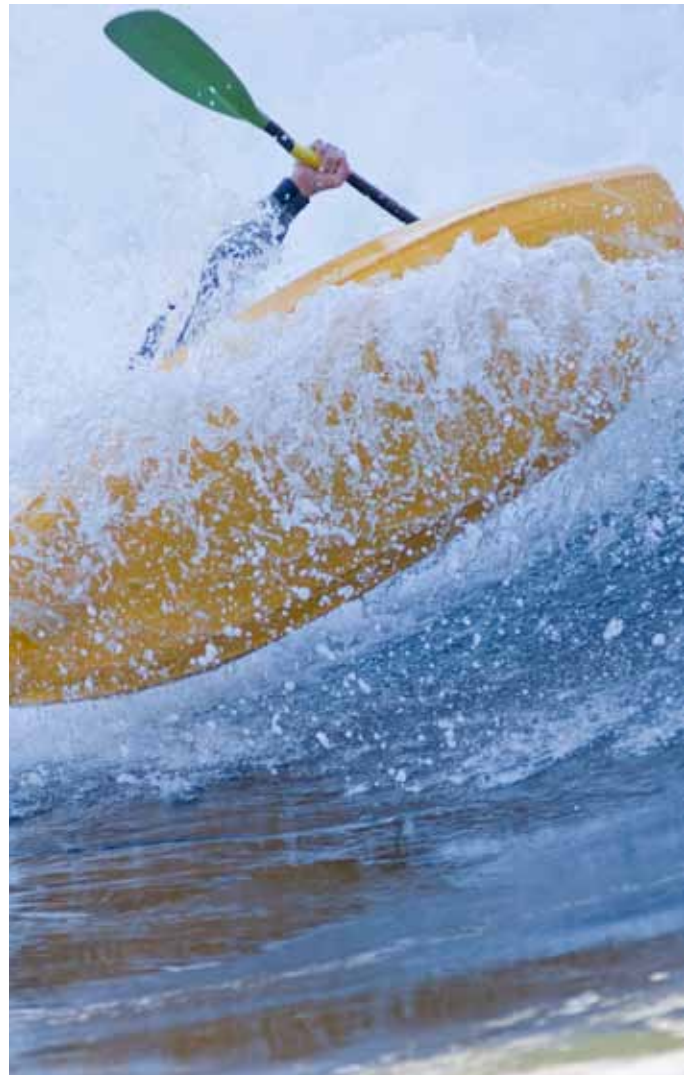
- ▶ **Engage with all stakeholders:** countries with the most stable, consistent and clear tax laws are those that engage actively with business during the development phase.
- ▶ **Clearly defined language under the statute:** some of the greatest uncertainties in tax laws around the world are driven by the use of words that are loose in their meaning and open to significantly varied interpretations. Provisions should be clear in their meaning and their application.
- ▶ **Dominant purpose test:** GAAR should only apply in scenarios where it is clear that the relevant transaction (or arrangement or scheme) has a dominant purpose of obtaining a tax benefit. It should not, as was originally proposed under the Indian GAAR for example, be used to strike down an arrangement even where there is an incidental (but not dominant) purpose of obtaining a tax benefit.
- ▶ **Exclusions:** there are some situations and areas that legislators will want to specifically exclude; for instance, clear tax-motivated choices that are intended to motivate taxpayer behavior and/or certain business activity (such as targeted tax incentives or credits) should not be caught under the GAAR legislation. The exclusions should be clearly delineated within the statute.
- ▶ **Retroactivity:** there have been proposals to apply new or revised GAAR legislation retroactively, and these proposals have been understandably criticized. A retrospective GAAR creates unnecessary uncertainty and therefore should be avoided.
- ▶ **Penalty regime:** penalties are a necessary deterrence in some situations, and there are frequently separate penalty regimes for violations of a GAAR provision. Care should be exercised in applying penalties where the law is uncertain, however, and the use of strict liability penalties should be avoided.

Some of the greatest uncertainties in tax laws around the world are driven by the use of words that are loose in their meaning and open to significantly varied interpretations. Provisions should be clear in their meaning and their application.

Administration

A poorly or inappropriately administered GAAR regime can lead to excessive controversy and litigation with the result that administrators and taxpayers waste limited time and resources. The following three suggestions may help reduce these inefficiencies:

- ▶ **GAAR panel:** because the administration of a GAAR requires a significant amount of judgment, the decision to apply a GAAR must be made by a carefully balanced GAAR panel. In this sense, it is important that the composition of a GAAR panel include people who have a significant amount of business knowledge and experience. This experience should be balanced with the appropriate (but not dominant) representation by tax administrators as well as independent tax professionals.
- ▶ **Provision of last resort:** GAAR should only be applied as a matter of last resort. In practical terms, this means that a GAAR regime should not be considered during an audit or examination without first applying all other appropriate substantive tax provisions. Procedurally, it is very important that taxpayers are made aware at the earliest possible time that the administrator is even considering the application of a GAAR provision.
- ▶ **Alternative dispute resolution:** there are a number of alternative dispute resolution (ADR) techniques that can bring certainty earlier in the tax compliance process, including rulings or other pre-filing mechanisms. At the same time, there are a number of post-filing options, including administrative appeals processes and various forms of mediation and/or arbitration. One or more ADR processes should be considered a basic building block of a GAAR regime.



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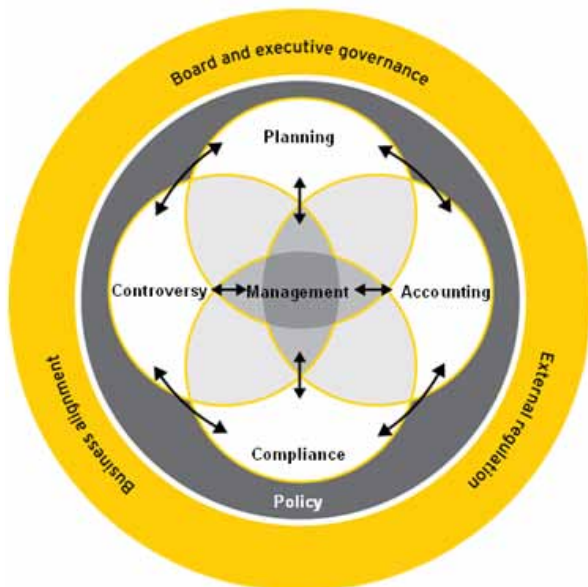
Living with GAAR: leading practices for tax life cycle management

In an increasingly complex and constantly evolving environment for tax, there is a growing recognition of the close linkage between the tax planning, tax provision, tax compliance and tax controversy processes. These processes and their interdependencies can be described as a tax “life cycle.”

Today, decisions are best made with the entire tax life cycle in mind, recognizing that its phases are interconnected. Through its different stages, the life cycle addresses tax in the context of the whole business.

The use of a model such as the tax life cycle is especially important when set against the context of the growing adoption of GAAR measures around the world. It provides a framework against which the tax department can assess and manage overall GAAR readiness.

Image 1: The tax life cycle



Board and executive governance

“The governance of a corporation’s business involves the administration of multifactorial issues of which tax is but one.”

Honorable Justice John Logan RFD,
*Mission Accomplished? A Perspective on Part IVA of the
Income Tax Assessment Act 1936*, 6 September 2012

In the words of Australia’s Justice Logan, tax is but one of many issues that boards of directors need to consider when carrying out their directorial duties. Making sure that the proper tax procedures are in place is critical to keeping the enterprise from being unnecessarily exposed to the application of GAAR and the significant penalty, interest or reputational ramifications that may follow.

How a corporation manages GAAR should be dictated by its overall risk appetite. That is, what level of risk is the corporation willing to accept in a transaction? That risk appetite should be decided at the board level, and it will determine the manner in which transactions are planned and executed.

Leading practice in this area – and something that tax administrators continue to encourage – is for the corporation to operate under a tax corporate governance framework that includes a documented process for significant transaction sign-off. At the highest level, this framework should outline the process for escalating transactions that are material or that have particular characteristics that may attract tax authority scrutiny.

With this in mind, C-suites and boards may consider asking themselves and their tax directors some key questions (as shown on page 23) regarding those transactions that could potentially result in the application of a GAAR regime.

The presence of a GAAR regime does not affect the need to plan appropriately taking into account tax consequences. Rather, it means that tax planning should continue in a thoughtful manner, with practical steps taken through all stages of the tax life cycle to protect the business from a GAAR challenge.

8 questions for the C-suite and board to ask in relation to GAAR

1 Does the transaction/structure have a valid commercial purpose?

2 Is the transaction/structure unique and complex?

3 Is the tax benefit material to the financial statement?

4 Could the transaction/structure be undertaken in a different manner, without attracting the potential application of GAAR?

5 Has an opinion been obtained that the transaction/structure will more likely than not withstand a GAAR challenge?

6 Is the transaction/structure defensible in the public eye?

7 What is the corporation's tax risk profile both globally and locally?

8 How comfortable is the corporation with litigation if it is required to defend the transaction/structure?

Monitoring

The global tax landscape continues to shift and change at an increasingly fast pace. This is apparent in the evolving approach to tax enforcement and the growing implementation of new or strengthened GAAR regimes. In that regard, making sure that new proposals for GAAR, SAAR and TAAR are continuously monitored and factored into the tax life cycle is an imperative for any multinational business. Having detailed, up-to-date and accurate information available is essential so that transactions are measured against the most current rules in each jurisdiction.


Planning

The presence of a GAAR regime does not affect the need to plan appropriately, including the consideration of potential tax consequences. Rather, it means that tax planning should continue in a thoughtful manner, with practical steps taken through all stages of the tax life cycle to protect the business from a GAAR challenge. In particular, all alternatives should continue to be considered as part of the planning approach, and sufficient documentation should be maintained to support the decisions taken.

Defense files

Contemporaneous documentation can be valuable in defending a company's position against a GAAR challenge. Making sure there are documents that set out the intended purpose of the overall transaction, as well as each step within the transaction, can significantly enhance a taxpayer's position in forestalling or defending against such a challenge.

Additionally, documentation outlining the consideration of alternative options in relation to the transaction settled upon is, in some jurisdictions, critical in demonstrating that the final position taken was the only one that could reasonably be carried out to obtain the commercial objectives sought, and that there were no transactional steps taken that were explicable only in the context of obtaining a tax benefit.



Taking advice on significant transactions is seen by many as good corporate governance. Receiving an opinion on GAAR should provide more than a mere reassurance that the position satisfies the technical requirements of the law.

Consultation

Taking advice on significant transactions is seen by many as good corporate governance. Receiving an opinion on GAAR should provide more than a mere reassurance that the position satisfies the technical requirements of the law. It can also affect the manner in which a position is disclosed in financial statements or to a revenue authority, as well as have a bearing on the imposition of penalties.

Provisioning and disclosure

Recent years have seen a significant increase in a broad range of new information reporting and disclosure requirements for business taxpayers.

Both the United States and Australia have recently put in place disclosure regimes for “uncertain tax positions.” In short, these regimes require the disclosure of tax positions where there is some level of uncertainty as to whether the taxpayer would prevail if challenged. While these two countries are the first to put in place requirements of this type, other countries might adopt similar approaches as they look to expand their own disclosure regimes.

In this regard, 99% of tax executive respondents to an Ernst & Young survey believe disclosure and transparency requirements will either stay the same or increase further in the coming two-year period. This view is also shared by tax policy-makers and tax administrators. In the same survey, 81% of tax administrators expect these requirements to grow in the next three years, while 94% of tax policy-makers expect there to be either some or significant growth in transparency requirements.⁷

United States: uncertain tax positions and Schedule UTP

Schedule UTP focuses on situations in which a business taxpayer has made a reserve in its financial statements. If a US company has made a reserve under ASC 740 (informally referred to as FIN 48) in relation to an uncertain tax position or has not made such a reserve because it intends to litigate the position, the company is required to file a Schedule UTP with the Internal Revenue Service. For the 2010 and 2011 tax years, this requirement applied to US companies with assets greater than US\$100 million. The threshold drops to US\$50 million for the 2012 and 2013 tax years and to US\$10 million thereafter.

Under ASC 740, a company must reserve a tax position where the level of opinion regarding the position is that it is more likely than not based on the technical merits that it will be sustained upon examination.⁸ “More likely than not” means a likelihood of more than 50%. Where a US company or one of its subsidiaries takes a position to which a GAAR in another country may be relevant, and the position affects an item on a US tax return, the position may have to be disclosed if the confidence level is not greater than a likelihood of more than 50% taking into account potential application of the GAAR rules.

⁷ Ernst & Young, *2011-12 Tax risk and controversy survey*, www.ey.com/taxrisksurvey.

⁸ ASC 740/FIN 48 definition – “recognition” paragraph 6.

When taking a position in relation to Part IVA in Australia, it is critical that advice has been sought to determine a “more likely to be correct than incorrect” position that Part IVA would not apply to the transaction.

Australia: reportable tax positions and Schedule RTP

The ATO introduced Schedule RTP for the year ended 30 June 2012, applicable to a select number of large business taxpayers. The uniqueness of Schedule RTP is that it was introduced by the ATO in the absence of an Australian equivalent accounting standard to FIN 48/ASC 740 in the United States.

Schedule RTP has three alternate categories, each of which requires a position to be reported:

- A. Tax uncertainty in your tax return. A position that is either as likely to be correct as incorrect or less likely to be correct than incorrect is taken in the tax return.
- B. Tax uncertainty in financial statements. A position in respect of which uncertainty about taxes payable or recoverable is recognized and or/disclosed in the taxpayer’s financial statements or a related party’s financial statements.
- C. Reportable transactions or events.

Under Category A, where a taxpayer has taken a position that Part IVA (Australia’s GAAR regime) would not apply and that position is considered to be reasonably arguable, such position would not be required to be disclosed. Additionally, the taxpayer must take reasonable care in determining that Part IVA did not apply. In this context, the taxpayer must consider all relevant matters under the relevant authorities (e.g., rulings and case law).

In a practical sense, where a taxpayer has undertaken a transaction and received advice that its Part IVA position is reasonably arguable, and where it did so in a manner which a court would view as taking “reasonable care,” then this would

not constitute a reportable transaction. To this end, when taking a position in relation to Part IVA in Australia, it is critical that advice has been sought to determine a “more likely to be correct than incorrect” position that Part IVA would not apply to the transaction.

One issue with Category A is that the application of Part IVA is based on a determination made by the Commissioner of Taxation. Putting oneself in the shoes of the Commissioner is a challenging proposition. Understanding how the Commissioner may come to a decision is, at best, difficult.

Category B requires disclosure where a reserve has been created in the taxpayer’s (or a related party’s) financial statements in accordance with Australia’s accounting principles. This is similar to the approach under IRS Schedule UTP and seeks to identify positions where reserves have been created that fall outside Category A.

Category C is related to events involving the disposal of assets. Disclosure is required where all of the following apply:

- ▶ There is a disposal of a capital asset.
- ▶ The capital proceeds exceed A\$200 million.
- ▶ There is significant disparity between the accounting and tax outcomes on the disposal of the asset.
- ▶ The difference between the accounting and tax outcomes is material.

Disclosure of a Part IVA position may be required under Category C, notwithstanding that there is a likelihood of greater than 50% that the position is correct (and so Category A does not apply) and no reserve/provision has been made in the financial statements (so Category B does not apply).

Some – but certainly not all – tax authorities provide clearance mechanisms to taxpayers at the pre-filing stage. These procedures may apply to questions regarding the potential application of GAAR.

Controversy

Defending a GAAR position is not merely a matter of technical argument. Rather, it is an objective analysis of the evidence and facts in relation to a particular transaction.

The manner in which a corporation engages with a tax authority seeking to invoke GAAR during an examination is therefore critical. If the process is not managed appropriately from the outset, the opportunity to strongly defend a position may be reduced or lost, which in turn could adversely affect future settlement negotiations or future litigation. With this in mind, it is important to determine an appropriate strategy from the outset, paying close regard to the process that is used by the tax authorities for invoking GAAR, as well as the corporation's rights and obligations as a taxpayer throughout the process.

A key consideration in today's environment is how and when the corporation discloses a position to a revenue authority. If the corporation is part of an enhanced relationship process – such as Horizontal Monitoring (the Netherlands), Compliance Assurance Process (United States), Annual Compliance Agreement (Australia) or something similar – it is likely that the transaction will be disclosed at an early stage of the process.

Many M&A-type transactions receive media attention prior to being fully executed, and revenue authorities may ask questions about form and substance of the transactions at this early stage. Therefore, robust defense files created at the time of the transaction, which contain contemporaneous documentation, will be critical in explaining and ultimately defending the position to a revenue authority.

Alternative dispute resolution

Some – but certainly not all – tax authorities provide clearance mechanisms to taxpayers at the pre-filing stage. These procedures may apply to questions regarding the potential application of GAAR. It may be wise to seek certainty up front, potentially eliminating the need to defend the position through an audit or to deal with complex issues such as provisioning and disclosure.

Table 4: Obtaining a pre-filing ruling or clearance on GAAR

Countries providing GAAR rulings/clearances	Australia, Belgium, Canada, France, Germany, India (proposed), Italy, the Netherlands, Poland, Singapore, Sweden, Switzerland, Turkey
Countries not providing GAAR rulings/clearances	Brazil, China, Indonesia, Ireland, Japan, South Africa, South Korea, United Kingdom (proposed)

Process for invoking GAAR

The process for invoking GAAR differs significantly from jurisdiction to jurisdiction.

In Australia, for example, the process for invoking GAAR requires significant dialogue between the ATO and the taxpayer. The process (pursuant to paragraphs 14 to 43 of PS LA 2005/24) typically follows these steps:

- ▶ An audit of the particular transaction occurs.
- ▶ The auditor is expected to raise the matter with the ATO's internal Tax Counsel Network (TCN).
- ▶ The TCN raises the matter with the Deputy Chief Tax Counsel, who then determines the ATO's position.
- ▶ A position paper is issued to the taxpayer outlining the ATO's position in relation to the application of GAAR, with a right of response by the taxpayer.
- ▶ The matter is then referred to the GAAR Panel, which has the final input before a Part IVA determination is made.

The process in many other countries is far simpler, with the taxing authority simply notifying the taxpayer that GAAR is being invoked. The country appendix to this report provides detailed information on how GAAR may be invoked.

In some jurisdictions, panels – generally either fully or semi-independent – have been established to oversee or provide advice as to the process for invoking GAAR.

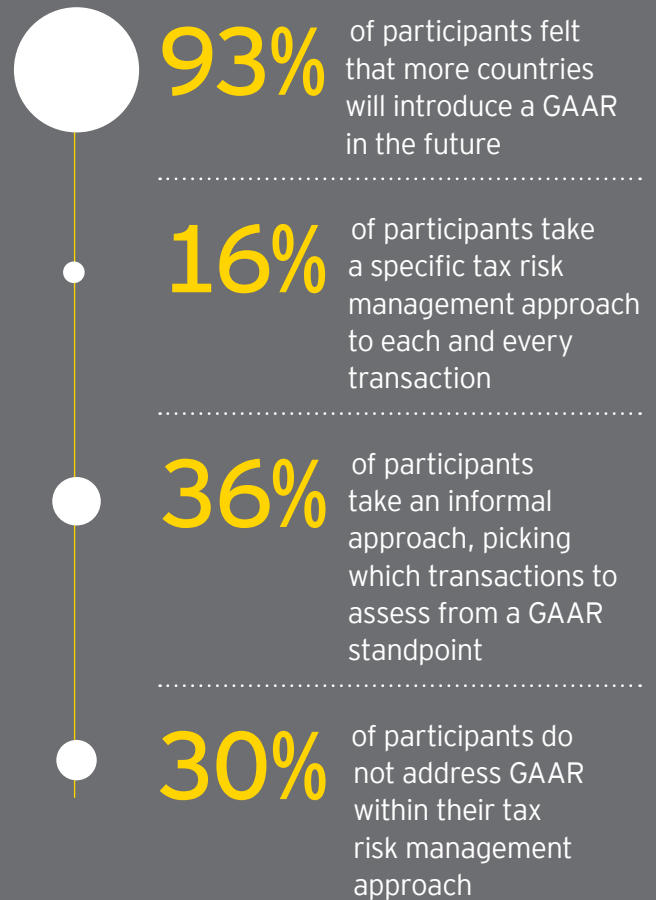
Role of a GAAR “panel”

In some jurisdictions, panels – generally either fully or semi-independent – have been established to oversee or provide advice as to the process for invoking GAAR. While the existence of a panel generally demonstrates that government takes the rights of taxpayers seriously, many commentators question whether such a panel can be of value if one (or more) of its members is from the taxing authority. Others argue that the taxing authority should be present.

In some countries the taxpayer is either invited to or permitted to attend a GAAR panel. In some circumstances, taxpayers may choose not to appear before a GAAR panel even if the taxpayer has been invited by the tax authority. In other cases, the taxpayer is not allowed to be present while the auditor presents its case to the panel even though the auditor is permitted to be present throughout the taxpayer’s submission.

Where a panel is in place, taxpayers will have to make decisions on how to engage with it and include this as part of their overall strategy for managing tax risk.

What businesses say



Polling responses from Ernst & Young webcast GAAR rising: the evolving tax enforcement landscape 24 October 2012.

8

Business as usual?

Tax is a cost of doing business – oftentimes a significant cost – that needs to be understood and managed effectively. It has long been acknowledged that taxpayers have the right (and arguably the obligation to their stakeholders) to manage their overall tax bill. An oft-quoted statement by the venerable Judge Learned Hand in the United States crystallized this basic sentiment more than 75 years ago: “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.”⁹

Arranging one’s affairs to manage tax liability, however, has never been a simple matter. Businesses are constantly changing, expanding into new markets and developing new business models. Indeed, a business might be considered ill-advised if it does not carefully consider tax consequences in structuring its business operations.

At the same time, broader attitudes around business taxes are undeniably shifting, with increased social activism and media attention capturing public and political interest around the world. As a result, there has been an unmistakable emphasis on ensuring that corporations pay a “fair share” of tax, however opaquely that may be defined. This has underscored the paradigm shift we see from many governments, moving beyond requiring technical compliance with the letter of the tax law to expecting cooperative adherence to its underlying spirit and intent.

The question is, what role should a GAAR play in this context? Should it be a rule with a broad-based and potentially sweeping application, or a more narrowly circumscribed rule with a more limited application? The answer is important to tax administrators and taxpayers, affecting businesses on a global scale and setting parameters that a tax administrator must manage effectively. This is especially important today, as countries around the globe carefully study the GAAR measures being proposed by their peers as they contemplate drafting one of their own.

Defining an appropriate scope for GAAR: two conflicting views of the world?

It is difficult to determine the impact of GAAR regimes given the thicket of complex statutes (including a wide range of specifically targeted anti-abuse rules), regulations, administrative rulings and treaties (for cross-border transactions) that must be navigated in the context of even the most mundane commercial transactions.

Perhaps the role of a GAAR is to fill in statutory gaps or, more precisely, to close the perceived “loopholes” in the governing statutes and regulatory regimes that might allow taxpayers to avoid taxes. The underlying policy rationale is that the statute’s intent or the legislature’s intention might not be realized without a robust and possibly expansive GAAR as a backstop. This assumes that a statute possesses a knowable intent or, less likely, that the intentions of a large legislative body could ever be understood. It also assumes, falsely, that varying views of individual legislators who voted for the statute could ever be fully comprehended, let alone reconciled.

A contrary view is that legislators and regulators should fill the role of statutory gap-filling and loophole-filling because they have the ability (and, perhaps, the obligation) to amend statutes and revise regulatory regimes.

⁹ *Gregory v. Helvering*, 69 F.2d 809 (2nd Cir. 1934).

Many taxpayers and tax practitioners believe the appropriate response to tax avoidance concerns is for tax authorities to amend (on a prospective basis) the relevant laws or treaties, rather than attempt to apply GAAR (or SAAR) to upset settled expectations under local laws.

This latter perspective would focus the GAAR on truly abusive transactions, those artificial and contrived schemes that have tax reduction (and perhaps even tax avoidance) as their sole or primary motivating purpose. A more narrowly tailored GAAR might apply to a narrower category of transactions (by design), but it would also provide taxpayers and tax administrators with much greater certainty, saving time and resources.

Many taxpayers and tax practitioners believe the appropriate response to tax avoidance concerns is for tax authorities to amend (on a prospective basis) the relevant laws or treaties, rather than attempt to apply GAAR (or SAAR) to upset settled expectations under local laws.

To work effectively together, taxpayers and governments need to find a workable balance between taxpayers' efforts to minimize tax costs and tax administrators' efforts to put in place anti-avoidance regimes that might affect commercial, substance-driven decisions.

Whichever way governments turn, taxpayers should be aware of the evolving landscape and build in the appropriate responses to the way they manage their tax life cycle.





Appendix

Countries

Australia
32

Brazil
36

Canada
38

China
42

France
44

Germany
48

India
50

Indonesia
52

Ireland
54

Italy
56

Japan
58

Mexico
60

Netherlands
62

Poland
64

Russia
66

Singapore
68

South Africa
70

South Korea
72

Sweden
74

Switzerland
76

Turkey
78

United
Kingdom
80

United States
84

Australia

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. Australia has a GAAR incorporated into its income tax law, contained in Part IVA of the Income Tax Assessment Act of 1936 (ITAA 1936). It applies to schemes entered into after 27 May 1981.

Can the GAAR be applied retrospectively?

No. Its application is limited by the general statute of limitations to amend a taxpayer's assessment. The Australian Taxation Office (ATO) generally has the power to issue amended assessments for a limited time after the original notice of assessment is issued to the taxpayer. For individual taxpayers and small businesses, the ATO has two years to issue an amended assessment. For all other classes of taxpayer, the ATO has four years to issue an amended assessment.

Do specific anti-abuse measures exist?

Australia currently has the following specific anti-abuse legislation:

- ▶ Direct and indirect value shifting rules under Division 725 and Division 727 of the Income Tax Assessment Act of 1997 (ITAA 1997)
- ▶ Sections 82KH, 82KJ, 82KK and 82KL of the ITAA 1936, which deal with restricting deductions that are in excess of the net expenditure incurred by a taxpayer and their associates (i.e., round-robin transactions)
- ▶ Streaming of dividend and capital benefits under section 45A of the ITAA 1936 and schemes to provide capital benefits and demerger benefits under section 45B of the ITAA 1936
- ▶ International transfer pricing provisions
- ▶ VAT/GST- and Stamp Duty-specific anti-avoidance provisions
- ▶ Non-income tax-specific legislation containing anti-avoidance provisions

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes.

What are the circumstances in which the GAAR can be invoked?

There are three key criteria that need to be satisfied in order for GAAR to be invoked:

1. There must be a scheme.
2. The taxpayer must have obtained a tax benefit in connection with the scheme.
3. The sole or dominant purpose of a person who entered into or carried out the scheme must have been to enable the taxpayer to obtain that benefit.

Scheme

The courts have decided that the relevant scheme can be defined as narrowly or as broadly as the commissioner considers appropriate provided:

- ▶ That the single step, or multiple steps, identified as the scheme are capable of having practical meaning.
- ▶ The relevant tax benefit and purposive elements of Part IVA are capable of being attributed to, or connected with, the scheme as particularized.

Tax benefit

- ▶ The identification of the tax benefit requires consideration of what would have, or might reasonably have been expected to have, occurred if the particularized scheme was not entered into.
- ▶ This "alternate postulate" must be something that can be reasonably expected to have occurred if the scheme was not entered into, rather than a mere possibility.
- ▶ The relevant tax benefit is then to be identified based on a comparison with what would have been the tax consequences if the alternate postulate had been implemented by the taxpayer.

Dominant purpose

- ▶ In determining whether the requisite sole or dominant purpose of obtaining the tax benefit exists, an objective assessment of the eight factors listed in the legislation must be carried out. These must then be weighed against each other to make a global assessment as to purpose.
- ▶ Substance over form is considered to determine objective purpose.
- ▶ A rational commercial transaction may still have the document purpose of obtaining a tax benefit.
- ▶ Factors tending to indicate that the requisite tax avoidance purpose will exist include:
 - ▶ If the nature of the scheme is elaborate
 - ▶ If the scheme, or certain steps in an overall arrangement, are only explicable by reference to the desire to obtain the tax benefit
 - ▶ If the quantum of the tax benefit is disproportionate to, or materially outweighs, the other commercial consequences of the arrangement

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof is on the taxpayer.

The general process for invoking a GAAR involves the commencement of an audit by the ATO. Once it has gathered all of the facts and evidence, it will then publish a position paper and issue it to the taxpayer for a response to the ATO's position.

The Panel signs off on the application of a determination to cancel the tax benefit. Once it cancels the tax benefit, it may then issue an amended assessment to reflect this alteration. This will not necessarily occur in all cases (for example, the cancelation of capital losses will not necessarily lead to an amended assessment being issued).

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For further information, refer to paragraph 25 of PS LA 2005/24, *Application of General Anti-Avoidance Rules*.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

Yes. However, this is an advisory body and the ATO is not bound by its decision.

The GAAR Panel consists of members from the ATO as well as external advisors. The ATO audit team and the taxpayer (or their representatives) have the opportunity to present their case to the GAAR Panel, but it is not compulsory for the taxpayer to present his or her case. While the ATO audit member can be present when the taxpayer presents its case, the taxpayer cannot be present when the ATO audit team member presents the ATO's case to the Panel.

The GAAR Panel does not generally consider operation of the GAAR. Its primary objective is to make sure that the GAAR has been properly applied to facts. Oral presentation is limited to matters raised in written submission. Generally, a taxpayer's oral presentation is limited by facts presented in written position, but this does not preclude further argument in disputing an assessment.

What is the general attitude of the tax authority toward invoking a GAAR?

The GAAR is a provision of last resort. However, it has become common practice of the ATO to apply the GAAR as an alternative to any substantive law arguments it raises in the first instance, particularly in a large business corporate environment.

Is a clearance/rulings mechanism available?

Taxpayers may seek to obtain a private ruling from the ATO as to whether the GAAR will apply to an arrangement.

Can the GAAR override treaties when invoked?

Yes.

What penalties may result from the GAAR being invoked?

Generally, where a GAAR is applied, penalties will be levied at 25% of the tax shortfall where the taxpayer has a "reasonably arguable position" that the GAAR does not apply. If a taxpayer does not have a reasonably arguable position, the penalty is then applied at 50% of the tax shortfall. Note that all tax adjustments (including the GAAR) are also subject to a general interest charge at penalty rates.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Key judicial decisions

Part IVA has been around for more than 30 years, so there are a number of key judicial decisions that relate to how it is interpreted. The major decisions are:

- ▶ *Federal Commissioner of Taxation v. Peabody (1994) HCA 43*
- ▶ *Federal Commissioner of Taxation v. Spotless Services Limited, 96 ATC 5201*
- ▶ *Federal Commissioner of Taxation v. Hart (2004) HCA 26*
- ▶ *RCI Pty Ltd v. Federal Commissioner of Taxation (2011) FCAFC 104*
- ▶ *Federal Commissioner of Taxation v. News Australia Holdings Pty Ltd (2010) FCAFC 78*
- ▶ *Federal Commissioner of Taxation v. Futuris Corporation Ltd (2012) FCAFC 32*
- ▶ *Macquarie Finance Limited v. Federal Commissioner of Taxation (2005) FCAFC 205*

Are there any legislative proposals or open consultations that may affect the future composition of a GAAR?

On 16 November 2012, Australia's Assistant Treasurer released for public comment the exposure draft legislation (ED) and explanatory materials (EM) for the changes to Australia's GAAR (Part IVA) announced on 1 March 2012.

Importantly, the start date of the proposed changes is now altered, to apply to arrangements carried out or commenced on or after 16 November 2012. The ED is intended to deal with perceived deficiencies in the operation of Section 177C of Part IVA (Income Tax Assessment Act 1936), which deals with the issue of "tax benefit." The EM states that the proposed amendments ... "are not intended to disturb the operation of Part IVA in any other respect."

Belgium

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. The current version for income tax purposes was introduced into law on 29 March 2012 and is applicable from tax year 2013 and on legal acts performed during the accounting period related to tax year 2012 and ending at the earliest on 6 April 2012.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The GAAR applies to individuals and corporations. The previous version of the GAAR applied only to "economic" acts (not to acts in the private sphere). The current version applies to private and economic acts.

Can the GAAR be applied retrospectively?

No, but application is possible on acts prior to date of entry into application in case of link with acts performed as from entry into application under step-by-step doctrine.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

For income tax purposes, the following specific anti-abuse provisions exist:

- ▶ Article 18, 4^o Belgian Income Tax Code 1992 (hereafter BITC 1992): reclassification of interest paid to certain shareholders and directors into dividends insofar the interest rate is abnormal or insofar a 1:1 debt/equity ratio is exceeded
- ▶ Article 26 BITC 1992: taxation of abnormal or benevolent advantages granted
- ▶ Article 32 BITC 1992: reclassification of immovable income into professional income insofar the immovable income exceeds a certain threshold
- ▶ Article 46 BITC 1992: tax-neutral contribution of branch of activity for personal income tax purposes is subject to the condition that tax avoidance/tax evasion is not the main aim or one of the main aims of the operation

- ▶ Article 54 BITC 1992: conditions for deductibility of certain payments (interest, certain royalties, services fees) to foreign beneficiaries who are either not subject to income tax, or are subject to a tax regime on that income that is "far more beneficial" than in Belgium
- ▶ Article 79 BITC 1992: non-deductibility in personal income taxation of professional losses from abnormal or benevolent advantages received from affiliated enterprises
- ▶ Article 80 BITC 1992: professional losses of a company without legal personality cannot be deducted from the profits of its partners unless and insofar the losses are imputed from profits related to a similar activity or unless the partners prove that the losses of the company without legal personality result from transactions which meet legitimate economic or financial needs
- ▶ Article 183bis BITC 1992/Article 211 BITC 1992: tax-neutral character of corporate restructurings for corporate income tax purposes is subject to the condition that tax avoidance/tax evasion is not the main aim or one of the main aims of the operation
- ▶ Article 185, §2 BITC 1992: arm's-length principle, allowing the tax authorities to make upward adjustments to the profits in case a company has forfeited profits (also to make downward adjustments in case of an upward adjustment by foreign tax authorities)
- ▶ Article 198, 10^o BITC 1992: non-deductibility of insufficiently reported payments to tax havens and low-tax jurisdictions and non-deductibility of sufficiently reported payments to tax havens and low-tax jurisdictions in case of a lack of legitimate economic or financial need
- ▶ Article 198, 11^o BITC 1992: thin capitalization rule
- ▶ Article 292bis BITC 1992: non-imputation of R&D tax credit carried forward in case of change of control unless proof of legitimate economic or financial need
- ▶ Article 207 BITC 1992: non-deductibility of losses in corporate income taxation from profits derived from certain items (e.g., abnormal or benevolent advantages received, certain non-reported expenses or benefits in kind, 17% of costs related to company cars)
- ▶ Article 207 BITC 1992: non-imputation of investment deduction carried forward, notional interest deduction carried forward and tax losses carried forward in case of change of control unless proof of legitimate economic or financial needs
- ▶ Article 344, §2 BITC 1992: CFC-like provision according to which the transfer of certain assets to a low-tax jurisdiction is not opposable to the tax authorities unless proof of legitimate economic or financial needs or proof of exchange for a sufficient asset or amount that constitutes income subject to a normal tax regime compared to the asset that was transferred

Does your country have specific legislation in place related to the indirect transfer of assets?

No.

What are the circumstances in which the GAAR can be invoked?

Application of GAAR in case of abuse of tax law, i.e.

- ▶ Avoidance of taxable situation according to provisions of BITC 1992 or royal decree to the BITC 1992, in a way that is not in line with the objectives of the tax provision and has income tax advantage as essential objective
- Or
- ▶ Obtaining a tax advantage through the application of provisions of BITC 1992 or royal decree to the BITC 1992, in a way that is not in line with the objectives of the tax provision and has income tax advantage as essential objective

The objectives of the provision must be found in the text of the provision and, if this text is not clear, in the parliamentary documents. The compatibility with the objectives of the tax provision is to be

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assessed in the light of the concept “wholly artificial arrangements,” as put forward in the case law of the Court of Justice of the European Union.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

Burden of proof of abuse of tax law is on the tax authorities. In case this proof is delivered, it is up to the taxpayer to prove the existence of motives for the act other than tax motives.

What is the administrative/audit process for invoking the GAAR?

Normal procedure:

- ▶ Notice of amendment of the tax return is issued by the tax authorities in which application of GAAR is announced – possibility for the taxpayer to comment
- ▶ Assessment with application of GAAR in case the tax authorities do not follow the position of the taxpayer

What is the general attitude of the tax authority toward invoking the GAAR?

Before tax year 2013 (i.e., under the previous version of the GAAR), the application of GAAR by the tax authorities was not widely accepted in case law, since the courts required that the new characterization adopted by the tax authorities had similar legal consequences as the characterization adopted by the taxpayer. This requirement was not often met in cases concerning the recharacterization of stand-alone legal acts. Most cases of successful recharacterization pertained to steps to transactions.

As of tax year 2013, (i.e., under the current GAAR), the existence of similar legal consequences is not required. The general attitude of the tax authorities is unknown, as the provision has not yet led to effective (reported) application by them.

The tax authorities have issued an administrative circular without information on the practical application of the GAAR for income tax purposes. They have issued a second administrative circular with practical examples for

inheritance tax and registration duties purposes.

Is a clearance/ruling mechanism available concerning the GAAR?

Yes, rulings can be requested on the existence of other motives than tax motives.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

According to the tax authorities, the GAAR can override tax treaties. Belgium also made no reservation to section 22 of the OECD Commentary to article 1 of the OECD Model Tax Convention, which allows the application of domestic anti-abuse provisions to situations to which a treaty applies. For treaties expressly allowing the application of domestic anti-avoidance measures, the GAAR will override the treaty. For treaties that do not expressly allow the application of domestic anti-avoidance measures, there is no clear-cut answer. A few judgments have been rendered on this issue in which the application of a domestic anti-abuse provision has been disallowed. However, case law on this issue at this time is not sufficiently substantive to consider the issue resolved.

What penalties may result from the GAAR being invoked?

The legal act to which the GAAR is effectively applied is considered not to constitute tax fraud. Although additional tax may be due, there are no specific penalties related to GAAR.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

There is not yet any case law on the current provision.

In principle, situations that led to case law allowing recharacterization under the previous GAAR regime, would also

lead to the successful application of the current GAAR.

Examples of case law relating to the old GAAR include:

- ▶ Transfer of profits to an intermediary company – Supreme Court decision of 10 June 2010: two profitable companies paid a substantial management fee to a related loss-making company. The latter outsourced its management task to a third related company for a much lower fee. The Belgian tax authorities considered that the interposition of the loss-making company was only designed to increase its tax base in order to allow it to offset its losses.
- ▶ The legal act is recharacterized into a combination of a direct payment by the two profitable companies of a management fee to the third related company and a gift to the loss-making company.
- ▶ Letting/subletting – Supreme Court decision of 21 April 2005: in case of the lease of real estate by a director to his company, income tax law provides for the recharacterization of the nature of the excessive part of rental income into professional income. In order to avoid this recharacterization, the director let the property to a third person, who in turn let the property to the company of the director. The Supreme Court allows the recharacterization into a direct rent of the property by the director to his company.
- ▶ Letting/subletting – Supreme Court decision of 11 December 2008: a direct lease of real estate (for which the taxable basis is based on the real rental income) is replaced with a lease-sublease (for which the taxable basis is based on a lower notional income). The legal act is recharacterized into a direct lease.

Are there any legislative proposals or open consultations that may affect the future composition of a GAAR?

No, the law has recently been changed.

Brazil

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. Based on Complementary Law 104/2001, Article 116, "The administrative authority may disregard legal acts or transactions that are effected with the purpose of dissimulating the occurrence of a taxable event or of [dissimulating] the nature of the elements that trigger the tax obligation, under procedures to be established by ordinary law" (freely translated).

However, there is a discussion as to whether this rule is in force to the extent that, by its own terms, the application of Article 116 will be determined "under procedures to be established by ordinary law" (the Regulatory Law). Therefore, any attempt by the Brazilian tax authorities to apply the law to the Brazilian reorganization prior to the issuance of the Regulatory Law that will clarify its application should be turned down.

It is important to note that the Brazilian Government attempted to enact the Regulatory Law; however, its provisions were widely criticized and it was not approved by the Brazilian Congress.

Despite the current situation, the Brazilian tax authorities are issuing tax assessments using the anti-avoidance rule as legal background. In assessing taxpayers, the tax inspectors are disregarding the rule's non-applicability due to the lack of the Regulatory Law.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

There are no specific targets, but large taxpayers are often the focus due to detailed transaction disclosure through massive electronic disclosure requirements.

Can the GAAR be applied retrospectively?

Yes, but limited to the statute of limitations.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

No.

Does your country have specific legislation in place related to the indirect transfer of assets?

No, Brazil does not have legislation to trigger capital gains taxation on the indirect transfer of assets. There is, however, one case in which the tax authorities challenged the indirect transfer, recharacterizing it as a direct transfer of Brazilian assets. Although the Brazilian tax authorities lost the case in the last level of administrative appeal, this demonstrates that they may challenge indirect transfer of Brazilian assets.

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What are the circumstances in which the GAAR can be invoked?

There is no specific procedure. GAAR is invoked by the inspector during the audit and presented to the taxpayer in the tax infraction notice.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

In practical terms, the burden of proof is with the taxpayer, who needs to provide evidence of other non-tax reasons embedded in the challenged transaction.

What is the administrative/audit process for invoking the GAAR?

There is no specific procedure. GAAR is invoked by the inspector during the audit and presented to the taxpayer in the tax infraction notice.

What is the general attitude of the tax authority toward invoking the GAAR?

The tax authority has demonstrated no particular attitude in this area.

Is a clearance or ruling mechanism available for a GAAR?

No.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

Such subject is under discussion in administrative courts.

What penalties may typically result from GAAR being invoked?

Usually tax authorities apply qualified penalties when the GAAR is invoked. Qualified penalties may reach 150% to 225% over the principal.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

The bulk of discussions have been at the administrative level, but some have reached the judicial level. We can comment on two cases of downstream mergers. In the Rexnord case, judges construed that the transaction's underlying intention was solely to reduce the tax burden. In the Josapar case, judges concluded that the merger was upstream instead of downstream as reported.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

The Regulatory Law has been discussed in several forums for 11 years, but it seems to be far from becoming enacted.

Canada

Does a GAAR exist? If so, please state year of introduction and date of applicability.

The GAAR was enacted in Canada in 1988. The resulting GAAR legislation came into force on 12 September 1988 and applies to transactions entered into on or after that date, although certain transactions were grandfathered.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The GAAR provisions are invoked at the corporate and individual levels.

Statistics recently released by the Canada Revenue Agency (CRA) state that for the year ended 31 March 2012, 83 new cases were referred to the GAAR Committee; the top three issues were surplus strips, loss creation via stock dividends and kiddie tax (income splitting).

Since the introduction of the GAAR provisions in 1988, the most contentious issues involve surplus stripping, tax losses, income splitting and kiddie tax, as well as various international issues.

Can the GAAR be applied retrospectively?

Yes, but only with respect to transactions undertaken in its period of application.

Do specific anti-abuse measures exist?

Yes. Some of the most regularly invoked measures include:

Amount owing by nonresident: loans to non-residents may have Canadian tax implications for both the lender and the borrower with respect to principal and interest. The principal amount of a loan that is outstanding for longer than a certain period may be deemed to be a dividend, and withholding tax will apply to it. If the amount is borrowed at zero or low interest, deeming rules may apply to treat the amount of interest paid as if it had been calculated according to a prescribed rate.

Benefit conferred on a shareholder: where a corporation confers a benefit on a shareholder, or on a person in contemplation of that person's becoming a shareholder, unless specifically excluded, the amount or value of the benefit is included in the shareholder's income for the year. The provision applies even if the corporation is a nonresident or does not carry on a business in Canada.

Capital gains stripping: directed toward transactions designed to unduly reduce the capital gain that, but for the payment of an inter-corporate dividend, would otherwise have been realized on the disposition of any share. Subject to the permitted exceptions, applies to re-characterize the full amount of the dividend as proceeds of disposition, where the corporation has disposed of the share or as a capital gain if the corporation has not disposed of the share.

Loss trading: general restriction on (i) use of a corporation's tax losses and certain other tax attributes following an acquisition of control, (ii) deemed realization of gain on transfer of property to an unaffiliated person as part of a loss utilization scheme, and (iii) other rules which suspend losses within an affiliated group until realization on sale to a non-affiliated person.

Surplus stripping: where shares of a corporation are directly transferred by a taxpayer to another non-arm's-length corporation as part of a surplus stripping scheme, the proceeds realized by the vendor may be recharacterized as a dividend. These rules apply to certain transfers by individuals and by nonresidents of Canada.

Thin capitalization: restricts the deductibility of interest payable by a Canadian-resident corporation on outstanding debts to specified nonresident shareholders, or to nonresident persons who do not deal at arm's length with such shareholders, if the ratio of these debts to the corporation's equity (as defined for this purpose) exceeds 2:1. Under proposed legislation, this ratio is reduced to 1.5:1 for taxation years beginning after 2012.

Thin capitalization, back-to-back loans: designed to prevent circumvention of the thin capitalization rules where a specified nonresident shareholder of a corporation resident in Canada lends money to an unrelated party on the condition that the unrelated party on-lends the funds to the Canadian company.

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Transfer pricing adjustments: where a taxpayer has participated in a non-arm's-length transaction or series of transactions the income of the taxpayer may be adjusted to the extent that "the terms or conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length."

The CRA is permitted to recharacterize a transaction if it would not have taken place at arm's length and there was no bona fide reason for the transaction other than to obtain a tax benefit (in other words, if the transaction did not have a substantial, valid business purpose).

What are the circumstances in which the GAAR can be invoked?

Where there is a "tax benefit" arising in an "avoidance transaction" (includes a series each element of which is judged on its own; a transaction not undertaken primarily for bona fide purposes other than to get the tax benefit) where an abuse of the Act or a misuse of its provisions results, even in the absence of a GAAR, the transaction is otherwise compliant with the Act.

Subsection 245(2) of the Act establishes the basic conditions for the application of the GAAR. The subsection is broadly worded, stating that the GAAR applies to any transaction that is an avoidance transaction. If it applies, the tax consequences "shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction."

There are two significant limitations to the application of GAAR.

The first is found in the definition of avoidance transaction. An *avoidance transaction* is defined, in subsection 245(3), as a transaction that alone or as part of a series of transactions results in a tax benefit of any kind. However, it does not include transactions arranged primarily for bona fide purposes other than obtaining a tax benefit.

The second limitation is that the GAAR applies only to transactions that result in

- ▶ A *misuse* of the provisions of the Act, Income Tax Regulations, *Income Tax Application Rules*, a tax treaty, or any other relevant legislation
- Or
- ▶ An *abuse* having regard to any of these provisions read as a whole.

In other words, if an avoidance transaction does not involve a misuse or abuse, the GAAR does not apply.

On 19 October 2005, the Supreme Court of Canada decided its first two GAAR cases: *The Queen v. Canada Trustco Mortgage Co.*,¹ and *Mathew v. The Queen*.² In *Canada Trustco*, the Supreme Court established a number of useful guidelines for applying the GAAR. The court decided another GAAR case, *Lipson et al. v. The Queen*,³ on 8 January 2009, and generally confirmed its approach as set out in *Canada Trustco*. These cases and the Tax Court of Canada and Federal Court of Appeal decisions that interpret them are now the main points of reference for interpreting GAAR. That being said, it is sometimes difficult to reconcile the recent Tax Court and Federal Court of Appeal decisions that purport to apply the Supreme Court guidelines. This may be explained by the fact that GAAR cases are usually fact driven.

It is now well established that the application of GAAR requires an answer for each of the following three questions:

1. Did the transaction (or series of transactions that includes the transaction) result in a tax benefit?
2. If so, is the transaction or any transaction in the series an avoidance transaction? A transaction is not an avoidance transaction if it can reasonably be considered to have been undertaken primarily for a bona fide purpose other than to obtain the tax benefit in question.
3. If a transaction is an avoidance transaction, did it result in a misuse of the provisions of the Act, Income Tax Regulations, Income Tax Application Rules, a tax treaty, or any other legislation relevant in computing tax or amounts payable or refundable under the Act, or an abuse having regard to these provisions (other than section 245 of the Act) read as a whole?

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The onus is on the taxpayer to prove no tax benefit or no avoidance transaction; the onus is on the tax authority to show abuse or misuse.

What is the administrative/audit process for invoking the GAAR?

The tax authority asserts it. In most cases the application is reviewed by a committee of senior CRA, Department of Finance and Justice officers (the "GAAR Committee"). The GAAR Committee has no legal authority as such and is an informal group established to ensure the consistent application of the GAAR.

¹ *The Queen v. Canada Trustco Mortgage Co.*, 2005 SCC 54.

² *Mathew v. The Queen*, 2005 SCC 55.

³ *Lipson et al. v. The Queen*, 2009 SCC 1.

Canada

What is the general attitude of the tax authority toward invoking the GAAR?

Canada's GAAR is commonly invoked with respect to transactions/arrangements thought not to be in accordance with legislative intent.

Is a rulings/clearance mechanism available?

If an advance income tax ruling is requested with respect to a transaction, the CRA will rule on the GAAR. Otherwise there is no approval or review mechanism.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

Yes, the CRA has a GAAR Committee. Usually, referrals to the GAAR Committee originate either from ordinary audits or from CRA's Income Tax Rulings Directorate.

The GAAR Committee is made up of representatives from various divisions of CRA, the Department of Finance, and the Department of Justice. Although it is not a statutory committee (i.e., it is not mandated under the Act or any other federal statute), the GAAR Committee advises on whether it is appropriate to apply GAAR in particular fact situations and whether the application is consistent with how GAAR has been applied in other cases.

While taxpayers cannot appear before the GAAR Committee, they can make written representations to it.

Can the GAAR override treaties when invoked?

This is a complex question. Some believe that customary international law would sustain treaty interpretation in a fashion that would be consistent with the GAAR. The GAAR does apply to tax treaties; the Act so applies. The limitation on benefits provision of Canada's most significant treaty, the Canada-United States Income Tax convention specifically envisages the application of the GAAR (Article XXIX – A(7) and possibly a more general treaty law-based anti-avoidance limitation.

What penalties may result from the GAAR being invoked?

There is broad authority to redetermine the tax consequences of a transaction according to what would have occurred in the absence of the abuse/misuse – essentially any adjustment considered reasonable in the circumstances to eliminate the aberrant tax benefit.

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Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

The key judicial decisions involving the GAAR are the Supreme Court of Canada decisions in:

- ▶ **Canada Trustco Mortgage Company** (2005 SCC 54): a tax deferral arrangement involving the claiming of substantial capital cost allowance (tax depreciation) following a sale-leaseback transaction. The Court concluded GAAR did not apply on the basis the transaction fell within the spirit and purpose of the capital cost allowance provisions of the *Income Tax Act*.
- ▶ **Kaulius/Mathew** (2005 SCC 55): an arrangement involving the acquisition of losses whereby the company transferred unrealized losses to arm's-length taxpayers through series of transactions involving partnerships. The Court concluded GAAR applied as Parliament could not have intended that the combined effect of the partnership rules and s. 18(13) would preserve and transfer a loss to be realized by a taxpayer who deals at arm's length with the transferor.
- ▶ **Lipson** (2009 SCC 1): an arrangement whereby the taxpayer restructured his financial affairs to obtain an interest deduction in respect of borrowed funds used indirectly to purchase a personal residence. The Court concluded GAAR applied as to allow the combining of these provisions to reduce the taxpayer's income tax from what it would have been without the transfer to his wife would frustrate the purpose of the attribution rules.
- ▶ **Copthorne Holdings Ltd.** (2011 SCC 63): a surplus stripping arrangement that involved the doubling-up of paid-up capital. The Court concluded GAAR applied as the object and spirit of the paid-up capital provisions of the Act preclude the preservation of paid-up capital where the preservation would allow for a tax-free withdrawal of an amount in excess of the investment made by shareholders with tax-paid funds.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

China

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. China's GAAR provisions were introduced under Article 47 of the prevailing Corporate Income Tax (CIT) Law, which came into effect on 1 January 2008. This is a General GAAR. China does have specific anti-abuse circulars such as Circular 601 regarding treaty application of beneficial ownership and Circular 698 regarding the indirect transfer of Chinese entities.

China's GAAR focuses on substance over form and uses a facts and circumstances test in addition to studying the legal form of a transaction.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The GAAR is more likely to be applied at the corporate level as opposed to individuals.

The current Individual Income Tax (IIT) Law does not have an equivalent GAAR section as the CIT law. The GAAR was introduced into China's CIT Law in the 2008 CIT Law Reform. The Ministry of Finance is currently considering reforming the IIT Law but will likely wait until the change of government is completed at the upcoming National People's Congress. The objective of reform is to make the IIT more closely aligned to the to the CIT Law in areas such as taxation of overseas activities and controlled foreign corporations (CFCs).

Can the GAAR be applied retrospectively?

No. The CIT Law itself is effective from 1 January 2008, the corresponding tax guidance and pronouncements regarding the CIT Law should, in general, only go as far back (or be applied retrospectively) as 1 January 2008. For example, Circular 698 specified the implementation date of 1 January 2008 even though it was issued in December 2009.

Do specific anti-abuse measures exist?

Other than the GAAR provisions stated in the CIT Law, China also implements thin capitalization, transfer pricing and CFC rules to curb abusive acts from a tax standpoint.

Specific GAAR include Circular 601 on denial of treaty benefits if the Beneficial ownership tests are not satisfied.

Guoshuihan [2009] No. 698 (Circular 698) is one of the more, if not the most, well-known tax circulars issued by the State Administration of Taxation (SAT) in recent years. Circular 698 aims to attack indirect transfers of Chinese company shares based on the GAAR provisions.

Circular 698 is not, however, an assessing regulation; it is merely a reporting circular. In-charge tax authorities would take the information submitted by the transferor who indirectly disposed of equity interest in a Chinese company per Circular 698 reporting requirements and make a determination based on the GAAR provisions. Technically, the in-charge tax authorities should submit the case to the SAT, specifying the key features of the transaction, whereby the SAT would conduct further assessment (as necessary) before the final decision of invoking the GAAR is made.

Guoshuifa [2009] No. 2 (Circular 2) also specifies that general anti-tax avoidance investigations would be launched if a company practices any of the following tax avoidance arrangements or features:

- ▶ The company misuses any tax preferential treatment.
- ▶ The company misapplies any tax treaty.
- ▶ The company misuses the form of corporate organization.
- ▶ The company avoids tax by using tax havens.
- ▶ The company enters into any other arrangements for non-reasonable commercial purposes.

Per Article 93 of Circular 2, tax authorities should adopt the substance-over-form doctrine when examining whether an arrangement entered into by a company is of a tax avoidance nature and take into account the following matters:

- ▶ The form and substance of the arrangement
- ▶ The time at which the arrangement is entered into and the period in which the arrangement is implemented
- ▶ The manner in which the arrangement is fulfilled
- ▶ All stages involved in the arrangement or relationship between the integral parts of the arrangements
- ▶ Changes in the financial conditions of all parties involved in the arrangement
- ▶ Tax results arising from the arrangement

What are the circumstances in which the GAAR can be invoked?

Article 47 of the CIT Law stipulates that when a company implements arrangements without reasonable business purposes to reduce the taxable revenue or taxable income, the tax authority has the right to make adjustments in accordance with reasonable methods.

The GAAR provision generally would be invoked under circumstances where a business arrangement's main purpose is to avoid, defer or reduce a company's tax payments.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof lies with the taxpayer.

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What is the administrative or audit process for invoking the GAAR?

In order to launch a general anti-tax avoidance investigation, the in-charge tax authority would need to issue a Notice of General Anti-tax Avoidance Investigation to the taxpayer; within 60 days of receipt of such Notice, the taxpayer should provide documents to prove that the arrangement in question is entered into for reasonable commercial purposes.

If the company fails to provide the documents within the specified period or the documents provided cannot prove that the arrangement is entered into for reasonable commercial purposes, the taxation authority may, on the basis of information acquired by it, make tax adjustments via the issuance of a Notice of Special Tax Investigation Adjustments.

Per Article 97 of Circular 2, general anti-tax avoidance investigations and adjustments shall be reported level by level to the SAT for approval.

What is the general attitude of the tax authority toward invoking the GAAR?

Based on our observations, the SAT tends to have an aggressive interpretation of the GAAR provision. They tend to focus more on operating substance (e.g., number of employees, office space) instead of reasonable commercial purpose when deciding whether to invoke the GAAR.

Is a ruling or clearance mechanism available?

There is no clearance mechanism available under the prevailing tax laws for the GAAR or generally for taxes in China.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

China does not currently have a GAAR Panel, but the formulation of such a Panel is under active debate. For substantial GAAR cases, the administration requires a consensus group determination based on an internal control guideline.

Can the GAAR override treaties when invoked?

According to Article 58 of the CIT Law, where agreements on taxation concluded by China and foreign governments contain different provisions, and is inconsistent with domestic provisions, such agreements shall prevail.

Therefore, technically speaking, the GAAR should not override a treaty if there is no abuse of the treaty. With this said, we have seen several cases where the GAAR provision is invoked and overridden treaties, but those were generally very special transactions or extreme cases that involve serious abusive acts or arrangements with a primary objective to avoid, defer or reduce tax. In other words, the tax authorities would invoke the GAAR on transactions entered into with a view toward obtaining unintended benefits under the treaty.

In addition, various tax treaties recently entered into by China also contain specific articles stating that the treaty shall not prejudice the right of each contracting party to apply its domestic laws and measures concerning tax avoidance insofar as they do not give rise to taxation contrary to the treaty.

What penalties may result from the GAAR being invoked?

The SAT may impose interest on the tax underpaid (if any) when the GAAR provision is invoked and tax adjustment is made. The media have reported that an interest charge has been levied in one case.

Article 48 of the CIT Law stipulates that when adjustments are made to taxable amounts under Chapter 6 of the CIT Law (including GAAR adjustments), interests would be levied. In such a situation, Articles 121 and 122 of the Implementation Rules of the CIT Law state that, in case the tax authority makes a special adjustment for enterprises pursuant to the provisions of the CIT Law and regulations, the tax authority shall impose interest charges for the unpaid tax computed on a

daily basis from 1 June following the tax year to which the tax is attributed through the date of tax payment. Interest shall be charged at a rate of 5% above the benchmark lending interest rate published by the People's Bank of China for the year in which the tax payment occurs per Article 122 of the Implementation Rules of the CIT Law.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Tax court cases are very rare in China. We have seen several Circular 698 cases being widely published on tax authorities' websites or reported in the news. However, these cases do not carry the same meaning as tax court cases do in other case law countries. These cases, which detail how the SAT have successfully enforced or collected taxes from taxpayers, are published for use as learning materials.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

China's tax authorities, including the SAT, are open to listening to the experience of tax practitioners, as well as any concerns or difficulties their clients, i.e., taxpayers, may have regarding the GAAR provision. We do not believe the existing GAAR provision would change in any significant way. However, the implementation of the GAAR provision may change based on comments or feedback received from taxpayers and practitioners.

The SAT is drafting new detailed implementation rules for the GAAR, projected to be released during late 2012.

France

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. According to the provisions of section L 64, Book of Tax Procedures, the French Tax Authorities (FTA) may disregard as constituting an abuse of law (i) any fictitious transaction or (ii) any transaction that “by looking for the benefit of a literal application of provisions or decisions, against the initial objective pursued by their authors, were inspired by no other reason than to avoid or reduce the tax burden which would have normally been borne by the taxpayers, due to their situation or to their real activities, if those transactions had not been entered into.”

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

GAAR applies to individual and corporate taxpayers.

Can the GAAR be applied retrospectively?

GAAR cannot apply before its entry into force, but it can apply retrospectively within the limitation period (3 years, 6 years or 10 years depending on proceedings and tax).

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

France also has other anti-abuse measures aimed at fighting tax evasion by companies:

- ▶ **Anti-abuse mechanism for withholding tax purposes:** under the EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive, passive income (i.e., dividends, interest and royalties) paid by a French subsidiary to its EU parent company is exempt from withholding tax in France. However, pursuant to sections 119-ter and 119-quater of the Book of Tax Procedures, this favorable regime does not apply where the recipient company is controlled directly or indirectly by companies with their place of effective

management located outside the EU. The taxpayer may still benefit from the exemption if it can prove that the main purpose for interposing an EU company in the shareholding chain does not have as its sole purpose the avoidance of withholding tax taxation.

- ▶ **Payments made to nonresidents located in a low-tax jurisdiction:** section 238 A of the Book of Tax Procedures provides that certain types of payments (i.e., interest, royalties and remuneration paid in consideration for services) made to entities established in a territory designated “privileged” are not deductible for purposes of French corporate income tax (CIT) unless the French taxpayer proves that the payment (i) is related to an effective operation and (ii) is not related to an “abnormal” or “exaggerated” act of management. Please note that a taxpayer is deemed to benefit from a privileged tax status when taxes paid abroad represent less than 50% of what the taxpayer would have paid in France.
- ▶ In addition, as from 1 January 2011, payments made to nonresidents located in a non-cooperative state or territory (NCST) are not tax deductible. However, the deduction is allowed when the paying French company (i) proves that the transaction’s main purpose and effect is not to shift income outside France (i.e., both the purpose and the effect may not be driven mainly by tax avoidance) and (ii) records the expense on a detailed tax return (section 54-quater of the FTC). Please note that failure to comply with this filing requirement gives rise to a 5% penalty.
- ▶ **Controlled foreign corporation (CFC) rules:** under section 209 B of the French Tax Code (FTC), if a French company holds more than 50% in another company benefiting from a taxation of less than 50% of what it would have been in France, the profits are taxable in France. The participation threshold is reduced to 5% in situations where more than 50% of the shares in the foreign entity are owned by French

companies or by foreign companies directly or indirectly controlled by a French company.

- ▶ **Profits indirectly transferred to related companies abroad:** under section 57 of the FTC, the FTA is entitled to add back to the taxable income of French companies (or branches of foreign companies) profits indirectly transferred to related companies abroad (i.e., through either an increase or reduction of the purchase price or the sale price, or by any other means). There is no limit to the types of transactions that can be challenged under this provision: transfer of assets or remuneration for services, use of intangibles, participation in cost funding or sharing arrangements, etc. To include profits transferred abroad in French taxable income, the FTA (i) must show that the transaction is taking place within a context of subordination (i.e., the FTA is not required to demonstrate the control or dependency relationship when the non-French company benefits from privileged tax treatment within the meaning of section 238 A of the FTC) and (ii) must also show that the transaction is not at arm’s length.
- ▶ **General disclosure requirements:** section L13 B of the Book of Tax Procedures enables the FTA to order, during a tax audit, the audited company to provide all relevant information and documents regarding any transaction with related companies situated abroad. The requested information must be provided within three months. Failure to provide such information gives right to the FTA to adjust the transfer pricing methods on the basis of information available, and the company must pay a fine of €10,000 per tax year concerned. Moreover, under section L 13 AA, as from 1 January 2010, large companies have to provide further documentation on their transfer pricing policy within 30 days upon request of the FTA.

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- ▶ **Transfer of assets abroad:** the provisions of section 238-bis-0 I of the Book of Tax Procedures apply to transfer of assets to a grouping or a fiduciary arrangement (such as a trust) established abroad. Under this provision, annual profits derived from this corporate entity, grouping or fiduciary arrangement are included in its French taxable income.
 - ▶ **Limitation of the deduction of interests:** the Amended Finance Bill for 2011 created an anti-abuse mechanism (under section 209 IX of the FTC) that aims to limit the deduction of interest related to the acquisition of qualifying participations (i.e., shares considered to be "titres de participation" – a specific class of shares for accounting purposes that enables the shareholder to have a controlling interest, or shares that are eligible for the dividend participation exemption regime). According to the new rules, as from 1 January 2012, the interest related to the acquisition of qualifying participation is not tax deductible if the company does not show that (i) it effectively makes the decisions concerning these investments, and (ii) if applicable, it has an effective control or influence over the acquired company.
- France also has anti-abuse measures aimed at fighting tax evasion by individuals:
- ▶ **Payments to entity established abroad in consideration for services:** under section 155 A of the Book of Tax Procedures, amounts paid to a person domiciled or an entity established abroad in consideration for services rendered by a person domiciled or established in France are taxable in France if (i) the person domiciled in France directly or indirectly controls the foreign person or entity which receives the payment, or (ii) the supplier does not prove that the foreign person or entity principally carries on an industrial or commercial business other than the performance of services, or (iii) the foreign person or entity is established in a country with a privileged tax regime.
 - ▶ **CFC rules:** under section 123-bis of the Book of Tax Procedures, when an individual having his tax domicile in France holds directly or indirectly at least 10% of the financial rights or voting rights in a corporate entity, a grouping or a fiduciary arrangement (such as a trust) established or created abroad and subject to a privileged tax regime, the profits derived from this corporate entity, grouping or fiduciary arrangement are treated as a deemed distribution, taxable as such up to the level of interest or participation held by the taxpayer in the entity.
 - ▶ **Restrictions of deduction payments to tax havens entities:** under section 238 A of the Book of Tax Procedures, the deduction of interests, royalties, remuneration for services and other amounts paid by a person domiciled in France to a person domiciled or established in a country with a privileged tax status is prohibited unless the taxpayer proves that (i) the transaction is genuine and (ii) the payment is not excessive or unreasonable.
 - ▶ **Undisclosed transfers of funds from and to third countries:** pursuant to section 1649-quater A of the Book of tax procedures, transfers of funds by French resident individuals without the intermediary of a financial institution can be made from or to EU Member States on the condition that individuals make disclosure to the Customs Authorities when the amount of the transfer exceeds €10,000. If they do not undertake this formality, this transfer is considered as taxable income, unless the taxpayers prove that income has already been taxed or was not taxable in France. Failure to comply with this formality implies a penalty of €1,500 (i.e., €10,000 when the account is located in a NCST).
 - ▶ **Obligation to disclose accounts opened, used or closed abroad:** section 1649 A of the Book of Tax Procedures.
 - ▶ **Obligation to disclose a life insurance policy contracted with entities located abroad:** section 1649 AA of the FTC.
 - ▶ **The 3% real estate tax:** under section 990 D of the Book of Tax Procedures, legal entities that directly or indirectly own one or more real property assets in France or rights over such assets are liable to an annual tax assessed at the rate of 3% on the fair market value (as at 1 January of each year) of such real property assets or rights unless they fall outside the scope of this tax or benefit from an exemption.
 - ▶ **Exit tax:** under section 167-bis of the Book of Tax Procedures, as from 3 March 2011, taxpayers who become resident in another country and who hold substantial shareholdings (i.e., a shareholding exceeding 1% of the share capital of a company, or a shareholding with a value that exceeds €1.3 million) must upon departure pay income tax and social contributions (exit tax) on the unrealized capital gains. Also, in situations where shareholdings of less than 1% exist in multiple companies and the total value of those shareholdings exceeds €1.3 million, the exit tax is due. The tax paid is credited against the capital gains tax effectively payable at the time the shares are actually disposed of, with the excess being refunded. The exit tax is refunded after eight years from the date it was collected if the shares have not been disposed of or if the taxpayer becomes resident in France before that date. The social contributions are not refundable. The exit tax is not levied if the taxpayer becomes a resident of another EU Member State.

France

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes, if the indirect transfer relates to French real estate assets. (Please see prior section.)

What are the circumstances in which the GAAR can be invoked?

(Please see prior section.)

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

In France, the FTA bears the burden of proof except in the circumstance of jeopardy assessment.

Jeopardy assessment implies that all taxable income of a company is assessed by the FTA in case of (i) failure to file a return or to file a late return, (ii) failure to provide the information required by the FTA and (iii) opposition to tax inspection.

Disputes involving the GAAR must be endorsed by a local chief inspector. In addition, the case may be submitted to a pre-judicial litigation Consultative Committee, either on the initiative of the FTA or at the request of the taxpayer. The burden of proof must be discharged by the party that received the negative opinion of the Committee or, where the case has not been referred to the Committee, by the FTA.

What is the administrative or audit process for invoking the GAAR?

During a tax audit, the tax inspector is empowered to disregard any legal arrangement that is either "artificial" or "seeks to benefit from a literal application of legal provisions or decisions in contradiction with the objective set forth by the author." Thus, the specific procedure (section L64) is invoked to preserve taxpayers' rights.

What is the general attitude of the tax authority toward invoking the GAAR?

The GAAR is rarely invoked; the FTA only invokes the GAAR when it cannot apply one of the many anti-abuse measures at its disposal.

Is a clearance or ruling mechanism available for a GAAR?

Yes.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

Yes, the Consultative Committee. A tax reassessment grounded on section L. 64 of the Book of Tax Procedures can be submitted to the Consultative Committee on either the taxpayer's or the FTA's initiative before the tax collection notice is issued. As a pure internal tax administration proceeding, the ruling mechanism is outside the jurisdiction of the Consultative Committee.

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Can the GAAR override treaties when invoked?

Yes, it could (for example, see case CE, 29 December 2006, n°283314, Min c/ Société Bank of Scotland).

What penalties may result from the GAAR being invoked?

If the FTA successfully demonstrate that the abuse of law procedure may apply, such reassessments trigger, in addition to the late payment interest, an 80% penalty, which may be reduced to 40% if the FTA cannot demonstrate that the taxpayer was either the main initiator of the transactions constituting the abuse of law or the main beneficiary of the transactions.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Key judicial decisions involving the GAAR:

- ▶ CE, 27 September 2006, n°260050, Sté Janfin.
- ▶ CE, 29 December 2006, n°283314, Min c/ Sté Bank of Scotland.
- ▶ CE, 18 February 2004, n°247729, SA Pléiade: the Administrative Supreme Court dealt with the application of the GAAR in respect of a Luxembourg 1929 holding company by a French resident company.
- ▶ CE, 18 May 2005, n°267087, Sté Sagal: the GAAR was challenged by a taxpayer in respect of its compatibility with EU law (i.e., the freedom of establishment).
- ▶ CE, 10 December 2008, n°295977, Sté Andros et Cie.
- ▶ CE, 27 July 2009, n°295358, Caisse interfédérale du Crédit Mutuel and n°295805, Sté Conforama Holding.
- ▶ CE, 27 January 2011, n°320312, Bourdon: the GAAR does not prevent the taxpayer from using LBO structures to alleviate the tax liability as long as a minimum dose of economic substance exists.

Key judicial decisions involving other anti-abuse legislation:

- ▶ CE, 30 December 2003, n° 249047, SARL Coréal Gestion c/ Min and, n° 233894, SA Andritz c/ Min.
- ▶ CE, 10 November 2004, n° 211341, M. de Lasteyrie du Saillant c/ Min (CJCE, 11 March 2004, aff. 9/02): Exit tax.
- ▶ Cass.com, 8 April 2008, n°02-10.359, Elisa (CJCE, 11 October 2007, aff. C451/05): 3% real estate tax.
- ▶ CE, 28 March 2008, n°271366, Aznavour: section 155 A of the Book of Tax Procedures.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No. However, some adjustments to other specific measures, such as deduction of interest and burden of proof reversal for transfer pricing matters, are under scrutiny within the scope of the second amended Finance Bill for 2012 (due to the change of majority after France's elections).

Germany

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. Pursuant to sec. 42 of the German General Tax Code (AO), any legal arrangement implying a treaty benefit can be disregarded for tax purposes if a taxpayer achieves such benefit through an “inappropriate” legal structure tax benefits that (i) would not have been achieved when using an “appropriate” structure, and (ii) the structure cannot be justified with significant non-tax (i.e., commercial) reasons.

Sec. 42 AO was implemented in 1977 with the creation of the AO 1977 (Abgabenordnung 1977, German Fiscal Code). A tightening of the rule was introduced with the JStG 2008 (Jahressteuergesetz 2008, Annual Tax Act 2008). The new regulation became effective from 1 January 2008.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

Sec. 42 AO does not distinguish between the class of taxpayer, but typically in practice GAAR is targeted at corporate entities.

Can the GAAR be applied retrospectively?

No, the new regulation is only applicable from 1 January 2008. Arrangements created before have to be examined according to the former version.

Do specific anti-abuse measures exist?

Yes, there are several specific anti-abuse rules (e.g., sec. 1 para. 2a S. 1 GrdEStG; sec. 8 para. 3 AStG; sec. 50d para. 1a EStG; sec. 8c para. 1 KStG; sec. 160 AO; sec. 162 para. 3 und 4 AO). They have priority over the general rule.

Anti-treaty shopping rule – withholding tax

With regard to withholding tax exemptions under Double Tax Treaty/ EC Directive, the following tests have to be performed for the shareholder and the receiving intermediary company for FY12 onward:

Shareholder test

- ▶ The new anti-treaty shopping rules are not applicable if the intermediary company is owned by shareholders that would be entitled to a corresponding benefit under a tax treaty or an EU directive had they received the income directly (Shareholder test).
- ▶ Exception for listed companies: if a foreign holding company is held directly or indirectly by a company that is a listed company or a qualifying investment vehicle, the additional tests regarding business income, business purpose and substance would not need to be tested at each level.
- ▶ Limited look-through approach: it is possible to look through intermediary companies that do not meet the anti-treaty shopping test, provided the higher-tier company is personally entitled to the same level of relief. If one of the intermediary companies is personally entitled only to lower or no relief, the lower relief will be decisive.

Business income test

- ▶ On the basis of the own business income test, gross receipts of the intermediary company will be separated into active income and passive income, which will determine whether a company will be entitled to full or partial withholding tax relief.
- ▶ Income from its subsidiaries (dividend, interest and royalty income) is only deemed active income if the intermediary company is a qualified management holding company. The management holding qualification is met if a foreign holding company actively manages two or more subsidiaries. The management holding company should exercise a certain degree of influence over the subsidiaries, and long-term strategic decisions and certain fundamental decisions regarding the subsidiaries will be made at the level of the management holding company.
- ▶ In case the subsidiary is active in the same line of business as its foreign parent company (functional link), any dividend, interest and royalty income of this subsidiary qualifies as active income.

Business purpose test (only for passive income)

- ▶ A valid business purpose has to be presented with regard to the passive income.
- ▶ A business purpose is absent if the foreign company serves mainly to safeguard domestic assets in times of crisis, or the company is to be used for future succession arrangements or for securing the retirement assets of the shareholders.
- ▶ There is no statement available on which date the business reason must have existed.

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Substance test (only for passive income)

The required substance is indicated in case of:

- ▶ Existence of sufficient management and other staff personnel
- ▶ The personnel having sufficient qualifications to engage in the business of the company in a competent and independent manner
- ▶ Transactions between related parties based on the arm's-length principle

Substance that exists at the level of other group companies cannot be taken into account.

Timing aspects

- ▶ For an application for refund, the tests outlined before have to be performed for the year the respective dividends, etc., were received by the respective interposed company.
- ▶ For an application for a tax exemption certificate, the tests outlined before have to be performed for the year of the application. Certain changes in future circumstances have to be reported to the tax authorities.

Apportionment rule

On the basis of the tests to be performed (shareholder test, business income test, business reason test and substance test), the company will be entitled to full or partial withholding tax relief (apportionment rule).

What are the circumstances in which the GAAR can be invoked?

An inadequate arrangement leads to a tax benefit the law does not provide for.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

There is a partial sharing of the burden of proof. The authorities have to prove malpractice, but the taxpayer has to invalidate the charge.

What is the administrative or audit process for invoking the GAAR?

Typically, the tax authorities discover malpractice during a tax audit. As a consequence, the tax assessment will be revised.

What is the general attitude of the tax authority toward invoking the GAAR?

The general attitude of the tax authority is regulated in the Circular on Application of the German Fiscal Code to sec. 42 AO (Anwendungserlass zur AO, AEAO).

Is a ruling or clearance mechanism available?

Yes, there is the possibility of a clearance mechanism. The taxpayer can check the proposed transaction by requesting an advance ruling from the German tax authority. The decision binds the tax authority.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

Yes. Although some treaties include a special anti-avoidance rule that was in effect prior to the GAAR (sec. 42 AO) and the German special anti-avoidance rules. However, the German Federal Fiscal Court (Bundesfinanzhof, BFH) still applies sec. 42 AO.

What penalties may result from the GAAR being invoked?

Penalties may only result from GAAR when the taxpayer gives incorrect information to the tax authorities (tax fraud/tax evasion).

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

BFH, Urteil vom 13.10.2010, I R 61/09, BStBl. II 2011, 249 – "Dublin Docks"

BFH, Urteil vom 15.12.1999, I R 29/97, BStBl. II 2000, 527 – "Dividendenstripping," confirmed by decision of 20.11.2007, I R 85/05, BFH/NV 2009, 289.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

There are no pending legislative proposals or consultations that may affect the GAAR.

In 2012, the green party (opposition party in Parliament) failed in an attempt to tighten the GAAR.

Can GAAR be applied to a transaction in spite of an existing specific anti-abuse rule?

Basically, yes. But when the matter of facts [Tatbestand] of a specific anti-abuse rule are fulfilled, sec. 42 AO is not applicable. Sec. 42 AO is a blanket clause [Generalklausel]. If there is a specific anti-abuse rule for the transaction, but the matter of facts are not fulfilled, sec. 42 AO is not applicable either.

India

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Although Finance Act, 2012 introduced a GAAR in India with effect from 1 April 2014, the Government has announced that its implementation has been deferred until 1 April 2016.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The GAAR is proposed to be invoked in any arrangement entered into by a taxpayer that may be declared to be an impermissible avoidance arrangement.

However, in a recent statement, the Ministry of Finance has stated that:

- ▶ Where a foreign institutional investor (FII) chooses not to take any double tax avoidance agreement (DTAA) benefit and subjects itself to tax in accordance with the domestic law provisions, then the provisions of a GAAR shall not apply to such FII or to the nonresident investors of the FII.
- ▶ Where an FII chooses to take DTAA benefit, GAAR provisions may be invoked in the case of the FII, but they would not be invoked in the case of the nonresident investors of the FII.

Can the GAAR be applied retrospectively?

The provisions of the GAAR will apply to any arrangement entered into by the taxpayers on or after 1 April 2016.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Specific anti-abuse measures include:

- ▶ Deeming certain payments by closely held companies by way of loans and advances to specified shareholders and other specified entities as dividends
- ▶ Value of any benefit or perquisite, whether convertible in money or not, arising from that business or profession to be taxed as income from business or profession
- ▶ Disallowance of excessive and unreasonable payments to an associated person

- ▶ Provision to consider valuation determined by stamp valuation authority on transfer of land or building or both if the consideration mentioned while calculating capital gain is less than the valuation as determined by stamp valuation authority
- ▶ Provisions meant to curb tax avoidance by transferring property at nil or inadequate consideration
- ▶ Provision applicable to fresh issue by closely held companies of shares at a premium to residents; difference between issue price and fair value will be considered as deemed income of the issuer company
- ▶ Provision authorizing assessing officer to tax unexplained credits in the books of account
- ▶ Provision authorizing assessing officer to tax unexplained investments
- ▶ Provisions relating to computation of income from an international transaction in regard to arm's-length price

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes, it has been inserted by Finance Act 2012, with retrospective effect from 1 April 1962. This measure is currently under review by the Indian Government.

The Expert Committee on GAAR chaired by Dr. Parthasarathi Shome has issued its second report which makes a series of recommendations in relation to the Indian Government's proposal for a 50-year retroactive measure in relation to the taxation of indirect transfers of assets.

The Committee recommends that retrospective application of tax laws should occur only in exceptional or rare cases and with particular objectives, namely, first to correct apparent mistakes or anomalies in the statute, second to remove technical procedural defects that have vitiated the substantive laws and third to protect the tax base from highly abusive tax avoidance schemes. However, retrospective application of tax laws should never be used to expand the tax base as is the case in respect of taxation of indirect transfers.

The Committee has noted the objective of maintaining certainty, predictability and stability of tax laws in India so as to remove uncertainty in the minds of investors about shifting interpretations of the Indian Revenue seriously impacting the perception of safety of investing in India.

The Committee has further proceeded to consider the possibility of the Indian Government retaining the retrospective amendments and has made some specific suggestions vis-a-vis concerning the purchaser of the foreign shares and also the seller thereof. The committee has recommended that the purchaser should never be treated as a taxpayer in default in respect of retrospective amendment as this would amount to imposition of burden of impossibility of performance. In other words, government could apply the retrospective provisions only on the taxpayers who earns capital gains from indirect transfers. Moreover, even for the seller, who earns capital gains there should be no levy of interest and penalties on such back taxes.

The Committee has also fully incorporated the recommendations made by the Parliamentary Standing Committee on Finance to clarify "substantial value" as 50% or more value derived from assets located in India and carve-out exceptions for internal reorganizations.

What are the circumstances in which the GAAR can be invoked?

A GAAR may be invoked (as proposed) if the following three conditions are satisfied:

1. The taxpayer has entered into an arrangement, which includes a transaction, operation, scheme, agreement or understanding as well as a step or part of these.
2. The main purpose of the arrangement is to obtain a tax benefit (this will be presumed to be the case if the arrangement "results" in a tax benefit, unless the taxpayer proves otherwise).
3. The arrangement either:
 - ▶ Creates rights and obligations that are not normally created between persons dealing at arm's length

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- ▶ Results in misuse or abuse of the provisions of the Act
- ▶ Lacks commercial substance or is deemed to lack commercial substance
- ▶ Is carried out in a manner not normally employed for bona fide purposes

A monetary threshold of Rs. 3 core of tax benefit (about US\$550,000) in the arrangement will be provided in order to attract the provisions of GAAR.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

The Approving Panel shall consist of a Chairperson who is or has been a Judge of a High Court; one Member of the Indian Revenue Service not below the rank of Chief Commissioner of Income-tax; and one Member who shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and international trade practices. The current provision that the Approving Panel shall consist of not less than three members being Income-tax authorities or officers of the Indian Legal Service will be substituted. The Approving Panel may have regard to the period or time for which the arrangement had existed; the fact of payment of taxes by the assessee; and the fact that an exit route was provided by the arrangement. Such factors may be relevant but not sufficient to determine whether the arrangement is an impermissible avoidance arrangement.

The directions issued by the Approving Panel shall be binding on the assessee as well as the Income-tax authorities. The current provision that it shall be binding only on the Income-tax authorities will be modified accordingly.

Since the GAAR is newly introduced and its implementation will be from 1 April 2013, whether the taxpayers carry out strategic decision-making or appear before the Panel has yet to be determined.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The primary onus is on the tax authority to provide the burden of proof.

What is the process for invoking the GAAR?

1. The Lower Tax Authority refers to the Higher Tax Authority if during assessment or reassessment it is considered necessary to invoke the GAAR based on evidence or material.
2. The Higher Tax Authority hears the taxpayer. The assessing officer **will be required to issue a show cause notice, containing reasons**, to the assessee before invoking the provisions.
3. If the Higher Tax Authority is of the opinion that GAAR provisions are to be invoked, the matter will be referred to Approving Panel.
4. The Approving Panel will determine consequences of IAA, including years affected.
5. After inquiries and further reports, the Approving Panel will decide if the arrangement is an IAA. The order is to be given within six months of Higher Tax Authority reference.

What is the general attitude of the tax authority toward invoking the GAAR?

Although the GAAR has yet to be implemented, it will have a far-reaching impact and would affect every taxpayer including investors, multinationals and Indian business houses.

Its implications need to be considered, particularly for all structuring and transactions being undertaken, as well as in respect of existing arrangements, structures and business models.

Is a clearance or ruling mechanism available for the GAAR?

- ▶ A resident or a nonresident can file an application to AAR to determine whether the arrangement proposed to be undertaken by them would fall under the purview of an IAA as per the GAAR provisions.
- ▶ The final order of the tax officer is appealable directly to the Tribunal, the second level of appellate authority in India. It consists of two senior judges called Tribunal members.

Can the GAAR override treaties when invoked?

The newly introduced provisions explicitly state that the provisions of a DTAA would not be available to a taxpayer when the GAAR is invoked.

What penalties may result from the GAAR being invoked?

In situations where a GAAR is invoked (as proposed), the income tax authorities will be empowered to declare such arrangement as an IAA and to determine the appropriate tax consequences, including by:

- ▶ Disregarding, combining or recharacterizing any step or part or whole of the arrangement
- ▶ Treating the arrangement as if it had not been entered into or carried out
- ▶ Disregarding any party to the arrangement
- ▶ Reallocating income and expenses between the parties to the arrangement
- ▶ Relocating the place of residence of a party, or the location of a transaction or situs of an asset, to a place other than provided in the arrangement
- ▶ Looking through the arrangement by disregarding any corporate structure
- ▶ Recharacterizing equity into debt, capital into revenue and vice versa

A penalty of 100% to 300% of the tax amount will apply.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Not applicable.

Are there any legislative proposals or open consultations that may affect the future composition of a GAAR?

The Committee on GAAR recently circulated for public comment draft guidelines regarding the implementation of the GAAR provisions.

Indonesia

Does a GAAR exist? If so, please state year of introduction and date of applicability.

No.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The specific anti-avoidance rules listed below apply to any class of taxpayer; in practice, it is more likely to be applied to those at the corporate level.

Can the GAAR be applied retrospectively?

No. However, the tax office may take the view that the income tax law is essentially based on the principle of substance over form rule to avoid tax abuse.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Indonesia has several specific income tax provisions that are intended to avoid tax abuse:

- ▶ There is an anti-abuse rule on the application of tax treaty benefits (effective since 1 January 2010).
- ▶ The sale of shares in a conduit company or special purpose vehicle established or domiciled in a tax haven country that has a special relationship with a company established or domiciled in Indonesia or with permanent establishment in Indonesia is deemed to be the seller of the shares in the company established or domiciled in Indonesia or the sale of the permanent establishment in Indonesia (effective since tax year 2009).

A taxpayer who purchases shares or assets of a company through another party or entity that is formed specifically for this purpose can be deemed to the actual buyer (effective since tax year 2009).

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes; see prior question. However, this should be limited to a conduit company or special purpose vehicle established in tax haven countries.

What are the circumstances in which the GAAR can be invoked?

There are no specific circumstances except as mentioned above.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof is generally shared. In the general tax audit procedures, the tax authority is required to base its tax adjustments on valid and sound ground. However, in tax court practices, both taxpayers and tax authorities should provide their own evidence to defend their respective positions.

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What is the process for invoking the GAAR?

In general, tax assessments are issued as a result of a tax audit or the tax office obtaining solid evidence for the issuance of a tax assessment. If the tax office considers that there is sufficient grounds, they can carry out a special investigation, which can result in the case being brought to the criminal court.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

What is the general attitude of the tax authority toward invoking a GAAR?

The attitude is quite aggressive, especially on the application of tax treaty benefits and the indirect sale of Indonesian shares.

What is the administrative or audit process for invoking a GAAR?

There are two types of tax audits in Indonesia: field audit and office audit. A field audit allows the tax office to enter the premises of the taxpayers and obtain any documents deemed necessary. An office audit is a simpler process where the tax audit is carried out at the tax office's premises. In both types of tax audit, the tax authorities can invoke one of the specific anti-avoidance rules.

Can the GAAR override treaties when invoked?

No. Tax treaties should override the domestic tax laws.

What penalties may result from the GAAR being invoked?

There are no specific penalties for GAAR. The general penalty rules apply. For instance, short payment of income tax is subject to an interest penalty of 2% per month with a maximum of 48%.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Not applicable.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Ireland

Does a GAAR exist? If so, please state year of introduction and date of applicability.

A GAAR was introduced in 1989 in section 811 of the Taxes Consolidation Act 1997.

It applies to transactions carried out wholly or partly on or after 25 January 1989. It also applies to a transaction carried out wholly before that date where the transaction is used to reduce a tax charge first arising by reason of activities carried out or events taking place on or after that date or to create a repayment that could only arise on or after that date.

Can the GAAR be applied retrospectively?

The GAAR provisions apply to transactions carried out wholly or partly on or after 25 January 1989. It also applies to a transaction carried out wholly before that date where the transaction is used to reduce a tax charge first arising by reason of activities carried out or events taking place on or after that date or to create a repayment which could only arise on or after that date.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Numerous specific anti-avoidance provisions are contained within the Tax Acts.

These measures generally introduce amendments to existing statutory provisions to close off perceived loopholes.

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes.

What are the circumstances in which the GAAR can be invoked?

The Revenue Commissioners (or a nominated officer) can form an opinion that a transaction is a tax avoidance transaction.

Per section 811(2) TCA 1997:

"A transaction shall be a 'tax avoidance transaction' if having regard to any one or more of the following:

- (a) The results of the transaction
- (b) Its use as a means of achieving those results
- (c) Any other means by which the results or any part of the results could have been achieved, the Revenue Commissioners form the opinion that:
 - (i) The transaction gives rise to, or but for this section would give rise to, a tax advantage
 - (ii) The transaction was not undertaken or arranged primarily for purposes other than to give rise to a tax advantage ... "

What is the frequency for the GAAR to be invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

As of April 2012, 28 schemes have been identified and 585 notices have issued regarding schemes. However, no notices were issued in the first 10 years of the provision's existence.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

In the first tax avoidance case heard in the Irish High Court, *The Revenue Commissioners v. O'Flynn Construction Co. Ltd*, the Court determined that the burden of proof lay with the taxpayer to demonstrate that the transaction was not a tax avoidance transaction. In the majority decision of the Supreme Court, no reference was made to burden of proof; however, the dissenting judge concluded that the onus of proof should be on the taxpayer.

What is the administrative or audit process for invoking the GAAR?

The Revenue Commissioners (or a nominated officer) can form an opinion that a transaction is a tax avoidance transaction and give notice to that effect to each person affected by the opinion. The notice describes the transaction, the tax that is intended to be avoided or the refund that is intended to be generated by the transaction, and the steps the Revenue Commissioners propose to take in order to make sure the tax is not avoided or refunded. The person receiving a notice has 30 days within which to contest the Revenue Commissioners' opinion through the tax appeal procedures.

The Revenue Commissioners will not regard a transaction as a tax avoidance transaction if it was made with a view to the realization of profits in the course of business and was not primarily to avoid tax, or if the transaction was undertaken to obtain the benefit of a tax incentive, provided that the transaction would not result in a misuse or abuse of the incentive.

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Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

What is the general attitude of the tax authority toward invoking the GAAR?

Section 811 is perceived to have had mixed results since its introduction in 1989. A number of further initiatives have also been introduced, including a protective notification process with reportedly disappointing support. In 2011, a mandatory reporting regime was introduced requiring the mandatory reporting of certain transactions (namely transactions with characteristics perceived to point to tax avoidance) to the Revenue Commissioners.

Is a clearance or ruling mechanism available for the GAAR?

No.

Can the GAAR override treaties when invoked?

No.

What penalties may result from the GAAR being invoked?

Where the opinion of the Revenue Commissioners that a transaction is a tax avoidance transaction becomes final, interest and a 20% surcharge will be payable on the tax that the taxpayer unsuccessfully attempted to avoid paying.

It is provided that, by making a protective notification to Revenue in respect of a transaction within 90 days of beginning a transaction, the taxpayer can, on a wholly non-prejudicial basis, obtain protection from the possibility of such interest or surcharge arising in the event of Revenue successfully challenging the transaction.

An appeal against Revenue's opinion that a transaction is a tax avoidance transaction will be deemed to be finally determined where it is settled by agreement between the taxpayer and Revenue.

Refunds by a taxpayer of tax repayments received as a result of avoidance will be treated as additional tax payable for the purposes of the surcharge.

Interest will be applied by reference to when the tax would have been payable if there had been no avoidance.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.**Key judicial decisions**

In December 2011, the Irish Supreme Court delivered its first decision in relation to Ireland's GAAR (*Revenue Commissioners v O'Flynn Construction Co. Ltd*). The decision upheld the earlier High Court decision that had found in favor of Revenue.

The case concerned the application of the GAAR to a transaction designed to obtain the benefit of export sales relief dividends (since abolished). The transaction was implemented through a series of predefined steps over a two-month period. The resulting tax benefit was challenged by Revenue under the GAAR.

The majority decision of the Supreme Court decided that the transaction was a tax avoidance transaction and that none of the exceptions applied.

Are there any legislative proposals or open consultations that may affect the future composition of a GAAR?

No.

Italy

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Yes. Article 37-bis Presidential Decree n. 600/3 was introduced in 1997 as Italy's GAAR. According to Article 37-bis, the effects of all main corporate transactions (including mergers, demergers and sales of an interest in an Italian company) may be disregarded or recharacterized – from a corporate tax perspective – if it can be demonstrated that they were artificial and finalized for no other valid justification than to obtain a tax benefit.

The law's provision requires three conditions for its application:

1. The achievement of an "undue" tax reimbursement or an "undue" tax reduction
2. The circumstance that deeds, facts or agreements referring to the relevant transaction are aimed to circumvent obligations or prohibitions provided by tax law
3. The lack of valid business reasons

These conditions should be jointly present to apply Article 37-bis.

In addition, Italy has an abuse of law principle, created through the jurisprudence of the Supreme Court, that can be applied to every circumstance and in relation to every fiscal year.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

GAAR is more likely to be applied at the corporate level.

Can the GAAR be applied retrospectively?

No, see prior for the abuse of law principle.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Italy has additional anti-abuse legislation:

- ▶ Net operating loss carryforward in relation to mergers, demergers and change of ownership may be precluded if specific tests are not met.
- ▶ Interest expense carryforward in relation to mergers and demergers may be precluded if specific tests are not met.
- ▶ Tax residency test: a foreign company that controls Italian subsidiaries may be deemed to be tax resident in Italy if either (i) it is controlled, even indirectly, by an Italian company, or (ii) it is managed by people which reside in Italy for tax purposes.

Does your country have specific legislation in place related to the indirect transfer of assets?

Per Article 20 Presidential decree n. 131 of 1986 concerning registration tax, the deed to be registered is interpreted according to its proper nature regardless of its juridical title.

What are the circumstances in which the GAAR can be invoked?

Article 37-bis can be applied only when the taxpayer performs specific operations, such as (in particular) a merger, demerger or sale of an interest in an Italian company.

With the abuse of law principle, every situation can in principle be challenged by Italian tax authorities.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof for the application of the Italian anti-avoidance provision relies on the Italian tax authorities.

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What is the process for invoking the GAAR?

Before the tax authorities can issue a notice of assessment based upon the anti-avoidance provision, the law requires compliance with specific prelitigation procedures. The tax office needs to issue a preliminary request challenging the reasons why the operation is deemed to be “elusive” and requesting the taxpayer to offer comments within 60 days of the notification.

If, for whatever reason, the prelitigation procedure is not respected by Italian tax authorities, the tax assessment based upon Article 37-bis Presidential Decree n. 600/73 is null and void. In addition, the motivation expressed in the tax assessment should clearly indicate the reasons why the taxpayer’s arguments were not considered relevant and therefore disregarded by the tax office.

What is the general attitude of the tax authority toward invoking the GAAR?

Italian tax authorities are now more likely than before to apply Article 37-bis or the abuse of law principle. Note that when the abuse of law principle is used, the specific procedure mentioned earlier does not apply.

Is a clearance or ruling mechanism available for a GAAR?

Yes, the taxpayer can request the opinion of Italian tax authorities about a specific operation in advance.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

In principle, no.

What penalties may result from the GAAR being invoked?

The normal penalty when a tax return is considered unfaithful, from 100% to 200% of additional taxes due, applies.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Reference is made only to Supreme Court decisions:

- ▶ Supreme Court decision n. 30055 of 2008 concerning the abuse of law as general principle deriving from the Constitution and therefore always applicable
- ▶ Supreme Court decision n. 25537 of 2011 concerning the applicability of normal administrative penalties in case of application of Article 37-bis
- ▶ Supreme Court decision n. 7393 of 2012 concerning the relation between Article 37-bis and the abuse of law principle (the abuse of law always prevails)

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

There is an active reform project to modify Article 37-bis by merging the old anti-avoidance rule with the abuse of law principle. This has not yet been approved by Parliament.

Japan

Does a GAAR exist? If so, please state year of introduction and date of applicability.

No. Japan has no comprehensive GAAR, but Japanese tax law does provide some GAAR-like provisions that apply under certain conditions.

Article 132 of Japanese corporate tax law (CTL) provides a general tax avoidance rule for closely held corporations (e.g., a corporation whose stock or contributed capital is more than 50% owned by not more than three shareholder groups). Under the rule, the Japanese National Tax Agency (NTA) can recalculate the taxpayer's taxable income or corporate tax due if the NTA determines a transaction results in a reasonable reduction of corporate tax due. A similar general tax avoidance rule (under Articles 132-2 and 132-3 of CTL) applies to corporate reorganizations or transactions within a consolidated tax group.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The provisions described prior are more likely to be applied to corporate-level taxpayers than individual taxpayers.

Can the GAAR be applied retrospectively?

The provisions mentioned prior maybe applied within the statute of limitations (normally five years) under which other tax law may also be applied.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Yes. Japan has other specific anti-abuse legislation, such as:

- ▶ Non-deductible treatment for unreasonably high amount of directors' salaries
- ▶ Japanese controlled foreign corporation (CFC) rules (tax haven rules)

Does your country have specific legislation in place related to the indirect transfer of assets?

If a nonresident sells shares in a non-Japanese corporation that is treated as a real property holding corporation (RPHC), the capital gains will typically be taxed in Japan. The definition is as follows:

When a nonresident shareholder sells shares in an RPHC, at least 50% of which total assets consist of real properties located in Japan, including the shares in such a corporation, the gains will typically be taxable in Japan. This capital gain taxation is not applied for a minority shareholder who owns 5% or fewer shares in listed RPHCs or 2% or fewer of shares in non-listed RPHCs.

What are the circumstances in which the GAAR can be invoked?

The above provisions can be invoked when there is an improper decrease of the tax burden due to an unreasonable transaction.

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Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof is primarily on the tax authority.

What is the administrative or audit process for invoking the GAAR?

It is the same as the normal tax examination process.

What is the general attitude of the tax authority toward invoking the GAAR?

To date, the tax authority has demonstrated no specific attitude in their application of anti-abuse provisions.

Recently there have been some cases where the tax authorities challenge the tax benefit of transactions and arrangements by taxpayers because they believe that such transactions do not have any commercial substance or consideration other than to generate a tax benefit. In such cases, the tax authorities may apply Article 132, 132-2, or 132-3 of the CTL to the relevant cross-border transaction(s) or reorganization arrangements that are executed by corporate taxpayers.

Is a clearance or ruling mechanism available for a GAAR?

No.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

Not applicable.

What penalties may result from the GAAR being invoked?

Not applicable.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

There is a disallowance of taking foreign tax credits, which was regarded as an abuse.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

There is currently an active debate in Japan regarding the introduction of a comprehensive GAAR to Japanese tax law.

Mexico

Does a GAAR exist? If so, please state year of introduction and date of applicability.

No. However, Mexican Income Tax Law (MITL) establishes a range of specific anti-abuse rules.

The Mexican Tax Administration Service annually publishes non-binding guidelines (criterios no vinculativos) that set some examples of what it thinks may be considered as illegal tax practices.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

Anti-abuse rules are more likely to be applied at a corporate level. Nevertheless, some anti-abuse rules may also be applied to individuals.

Can the GAAR be applied retrospectively?

No. The Federal Constitution prohibits prejudicial retroactive application of law.

Moreover, the Federal Tax Code establishes that taxes are triggered according to the tax law in force during the time the actions or facts that triggered them occurred.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Simulation: although Mexico is a formalistic country, the tax authorities may determine through review that a transaction or event corresponds to a simulation for tax purposes – to the extent the transactions are carried out between related parties. However, the scope may be broader due to the wording of Article 213 of the MITL that makes reference to the “assessment of Mexican source income.”

To simulate one or more acts or contracts obtaining an undue tax benefit to the detriment of the federal tax authorities is considered tax fraud.

Deemed dividends: interest derived from loans granted to legal entities or to permanent establishments (PEs) in Mexico, by residents in Mexico or residents abroad that are considered as related parties of the person who pays the loan, will be deemed dividends if the taxpayer falls within the scope of certain provisions (for example, back-to-back loans).

Transfer pricing provisions: all transactions between related parties should follow the arm’s-length principle and have supporting documentation to prove it. Taxpayers must file an information return on transactions with foreign related parties.

Tax authorities are allowed to modify taxpayer-determined tax profit (or loss) by adjusting the sales price of a transaction (or consideration, if different from a sale) if, in general terms, the agreed value differs from the market value.

Payments made to tax haven residents: subject to 40% withholding tax and specific disclosure requirements.

Anti-treaty shopping rules: no general rules or guidelines have been issued by Mexico. Depending on the treaty, different provisions may apply.

Thin capitalization: companies may not deduct interest derived from loans with related-party residents abroad that result in indebtedness exceeding a ratio to their shareholders’ equity of 3 to 1.

Controlled foreign corporation rules: Mexican tax residents and residents abroad with a PE in Mexico are subject to a special tax treatment when (i) income is generated indirectly through foreign legal entities or legal figures in which they participate directly or indirectly, in the proportion of their participation, as long as said income is subject to a preferential tax regime, or (ii) income is obtained through fiscally transparent foreign entities or legal figures. In general terms, income under this special tax treatment is subject to tax in the fiscal year in which such income is generated abroad, even though the income has not yet been distributed.

Others: Capital reductions may be deemed as dividends if they enclose profit distribution; there are effective beneficiary provisions regarding interests paid to foreign residents.

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Does your country have specific legislation in place related to the indirect transfer of assets?

As a general rule, MITL provisions establish that when transferring shares, income shall be deemed to have Mexican source when more than 50% of such shares' "book value" comes directly or indirectly from real estate located in Mexico. Different interpretations exist on how to determine the value of the immovable property in relation to the book value of the shares, but the most common is to consider the value shown on the financial statements. Certain exceptions may exist if the taxpayer is a resident of a country that entered into a tax treaty with Mexico.

Net operating losses and change of ownership: if there is a change in controlling partners or shareholders of a company that has tax losses available for carryforward, and the sum of the income in the three prior tax years is less than the amount of the tax losses adjusted for inflation, the tax losses may be used only to offset income from the same business activity that generated the losses. For this purpose, income is measured based on the income included in the financial statements of the company.

A change in controlling partner or shareholder is deemed to occur when there is a change of holders, directly or indirectly, of more than 50% of the company's shares or social parts with voting rights, in one or more acts over a period of three years. Certain exceptions apply in the case of mergers, spin-offs or reorganizations.

What are the circumstances in which the GAAR can be invoked?

Not applicable.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The burden of proof is on the Mexican tax authority. However, tax authorities may base their case on presumptions regarding simulation.

What is the administrative or audit process for invoking the GAAR?

In general, tax authorities must exercise their review and enforcement powers in a formal procedure to invoke an anti-abuse rule.

What is the general attitude of the tax authority toward invoking the GAAR?

The Mexican tax authority has not demonstrated any particular attitude in invoking anti-abuse measures.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Is a clearance or ruling mechanism available for a GAAR?

In general, taxpayers can request a ruling to confirm the applicable tax regime of a transaction (the transaction must be real and concrete). In addition, a transfer pricing methodology ruling may be requested. Regarding the thin capitalization 3-to-1 ratio, a ruling may be requested in order to be authorized to apply a higher leverage.

Can the GAAR override treaties when invoked?

No. In terms of a Supreme Court precedent, international treaties are hierarchically higher than federal legislation.

The Mexican Federal Tax Code establishes that the tax laws apply without prejudice to the provisions of international treaties.

What penalties may result from the GAAR being invoked?

There are no qualified penalties. In general, there could be a penalty of 55% of the unpaid taxes as determined by the tax authorities as a result of the exercise of their review and enforcement powers.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

The Mexican Supreme Court ruled (in a non-binding precedent) that those transactions carried out by taxpayers that are not legally prohibited have the presumption of legality, to the extent that they are not done outside normal commercial practice.

Therefore, when it is alleged that a particular transaction has a speculative purpose intended solely for tax avoidance, the party proposing such an argument must provide the information indicating the absence of legal substance.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Netherlands

Does a GAAR exist? If so, please state year of introduction and date of applicability.

GAAR legislation was introduced in 1924 (the so-called *richtige heffing*) and came into force in 1925. Since 1959, it has been codified in Article 31 of the State Taxes Act (*Algemene wet inzake rijksbelastingen*).

In 1926, the Dutch Supreme Court also introduced a separate GAAR (*fraus legis*). Over the course of time, this GAAR developed in case law. *Fraus legis* or “judge defined” is a legal principle that prevents a person from relying on a right in law where such reliance would constitute an abuse of that right. Both the legislation and the judge-defined GAAR can be invoked by the Dutch tax authorities in cases where the taxpayer entered into a transaction that was (i) contrary to the purpose of Dutch tax legislation and (ii) with the predominant aim of avoiding taxation. These are cumulative requirements.

Judge-defined *fraus legis* also can be invoked separately, without reference to Article 31 of the State Taxes Act. Today, all cases are decided based on *fraus legis*.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

GAAR can be invoked on all taxpayers, either corporate or individual. Until recently, an unanswered question was whether GAAR could be invoked against a taxpayer who was trying to avoid VAT. However, in 2012 the Dutch Supreme Court explicitly applied *fraus legis* (judge-defined GAAR) in a VAT case.

Can the GAAR be applied retrospectively?

GAAR can be applied in any case where the tax authorities are allowed to impose an (additional) tax assessment.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Dutch tax law also contains the following specific anti-abuse legislation that may be relevant to corporate taxpayers (not exhaustive):

- ▶ Anti-dividend stripping rules: the Dutch tax authorities may deny application of a beneficial dividend withholding tax under domestic law, tax treaties or the EU parent-subsidiary directive if, in a series of transactions, a company entitled to such beneficial rate has been interposed between a Dutch entity and an entity that would not be entitled to such beneficial rate, while the latter entity has maintained an (indirect) interest in the Dutch entity that is comparable to its interest in that Dutch entities prior to the series of transactions. This provision disallows a recipient “beneficial ownership” status required to gain access to the favorable dividend withholding tax rates generally available under a tax treaty.
- ▶ Anti-base erosion rules: interest used to finance certain transactions may not be deductible.
- ▶ Provisions that aim to counteract abuse of the Dutch fiscal unity regime.
- ▶ Provisions under which distributions of profit by a Dutch co-op can become subject to Dutch dividend withholding tax or corporate income tax in abusive situations.
- ▶ Provisions under which a capital gain realized by a nonresident taxpayer with the disposal of a (share) interest in a Dutch company can become subject to Dutch corporate income tax in abusive situations.

- ▶ Denial of tax free merger/demerger facilities if the transaction is entered into with the predominant aim to avoid or defer taxation.
- ▶ Limitation of possibilities to utilize tax net operating losses if (i) these losses originate from holding and financing activities and future profits originate from other activities or the net receivable position of the company has increased or (ii) if the ultimate ownership in the Dutch taxpayer having the losses changes, subject to certain thresholds being met.

Does your country have specific legislation in place related to the indirect transfer of assets?

The Netherlands do not have specific (anti-abuse) regulations in place related to the indirect transfer of assets. Basically, when a company sells an asset, the book profit (fair value selling price minus book value for tax purposes) is subject to taxation. If the asset is not sold directly but indirectly by selling the shares of the company owning the asset, then this company is not subject to specific (anti-abuse) regulations leading to immediate taxation. However, the book profit will be taxed if the office/management of the company is transferred abroad as well. An indirect sale might trigger taxation at the level of the Dutch holding company (i) if the participating interest of the holding is deemed to be an investment interest or (ii) if the asset has been transferred within a fiscal unity prior to the sale of the shares.

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What are the circumstances in which the GAAR can be invoked?

GAAR can be invoked if a taxpayer entered into a transaction that was (i) contrary to the purpose of Dutch tax legislation and (ii) with the predominant aim of avoiding taxation.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The onus of proof is on the tax inspector claiming applicability of the GAAR.

What is the administrative or audit process for invoking a GAAR?

Typically, the tax inspector discovers a transaction meeting the previously mentioned conditions. If so, the tax inspector corrects the tax return filed by the taxpayer (generally by imposing an additional tax assessment). There are no specific GAAR formalities.

What is the general attitude of the tax authority toward invoking a GAAR?

Consensus is that GAAR is an *ultimum remedium*. It can be invoked only if other methods of finding law (such as interpretation of a legal provision or the facts) do not provide the necessary means to reach a reasonable outcome. There are no signs that the tax authorities are frivolous in using GAAR against taxpayers.

Is a clearance or ruling mechanism available for a GAAR?

A clearance mechanism is available. A taxpayer can check the potential tax consequences of a contemplated transaction with the tax authorities. Commitments made by the tax inspector will be binding for the tax authorities (unless evidently contrary to tax legislation).

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

No. Please note that in the absence of provisions in treaties or notes to treaties that explicitly demonstrate the treaty partners have agreed to provide for the possibility for the Dutch tax authorities to "disregard" the treaty on the basis of a domestic GAAR doctrine, the Dutch Supreme Court has to date refused application of the domestic GAAR doctrine in treaty contexts.

What penalties may result from the GAAR being invoked?

If GAAR is applicable, the amount of tax due by the taxpayer will increase compared to the original tax return filed by the taxpayer. Taxation will not be based on the facts presented by the taxpayer. Instead, these facts will be substituted (for tax purposes only) by facts that are within the reach of the legal provision that the taxpayer was trying to avoid.

In theory, when the tax authorities apply Dutch GAAR, they are entitled to impose an administrative penalty. However, in order to be able to impose an administrative penalty, the tax inspector has to prove gross negligence or the intention of the taxpayer to avoid taxation. No such gross negligence or intention will be deemed to have occurred if the taxpayer has a defensible point of view regarding his or her tax position. In situations where *fraus legis* is applicable, the taxpayer generally has a defensible point of view regarding his tax position. This point of view is overruled by *fraus legis* in order to establish the right taxable amount, but nevertheless still stands when assessing if an administrative penalty is in place. For this reason, administrative penalties are unlikely to be imposed next to *fraus legis*.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

In previous decades, the GAAR was applied in several different situations. Most noticeable are situations where taxpayers tried to erode to corporate income tax base by creating (allegedly deductible) interest payments.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Poland

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Currently, there is no GAAR in Polish tax law. The provisions of the Tax Ordinance Act (29 August 1997) that made the GAAR valid in Poland was abolished by the 11 May 2004 judgment of the Constitutional Court. Recently, the reintroduction of a GAAR has been under discussion.

Despite the lack of a GAAR in Poland, the idea of tax avoidance is sometimes used by the tax authorities in order to refuse to grant some rights to the taxpayer (e.g., in connection with a VAT refund). At times, the court's rulings on tax cases use arguments related to the GAAR, referring to the jurisprudence of the Court of Justice of the European Union and the general rules of VAT (e.g., claiming that the rule of anti-avoidance is included in the Sixth VAT Directive – Directive of the Council of the European Communities of 17 May 1977).

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

Not applicable.

Can the GAAR be applied retrospectively?

Not applicable. Under Polish constitutional standards, it is unlikely that GAAR could be applied retroactively, if introduced.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Anti-abuse measures exist in the Polish tax law.

According to Article 199a of the Tax Ordinance Act, the tax authority shall take into account both the congruent intention of the parties and the purpose of such acts – not just the literal wording of declarations of intent filed by the parties to such acts. Furthermore, when one legal act is performed but disguised as another legal act, tax consequences shall result from the disguised legal act. Moreover, if the evidence collected in the course of proceedings casts doubts on the existence or non-existence of a legal relationship or right having tax consequences, the tax authority shall apply to a common court for ascertaining the existence or non-existence of such legal relationship or right.

Another example of anti-abuse measures is the provision in the Corporate Income Tax Act of 15 February 1992. Following Article 10, paragraph 4, the general rule on stating revenues (income) of a legal person shall not apply in cases where merger or division of companies is not effected for justified economic reasons but instead with tax avoidance or tax evasion as its main or one of its main objectives.

Anti-avoidance rules can also be found in new double tax treaties. For instance, in the Protocol of 7 June 2012 amending the double tax convention between Poland and Luxembourg, Article 7 states that the benefits of this convention will not apply to the income received or achieved in connection with an artificial arrangement.

Does your country have specific legislation in place related to the indirect transfer of assets?

There is no specific Polish legislation related to the indirect transfer of assets, and there is no indication that any will be introduced in the near future. The practice of the courts in this respect does not constitute a risk for taxation.

Nevertheless, the indirect transfer of assets is regulated by certain double tax treaties to which Poland is a party. One of the typical regulations in this respect is the “real estate clause.”

What are the circumstances in which the GAAR can be invoked?

Not applicable.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

Not applicable. According to the general rule, the tax authorities are obliged to collect all the evidence required to assess tax. However, in certain circumstances it might be the taxpayer who should provide evidence supporting his rights or permissions.

What is the administrative or audit process for invoking a GAAR?

Not applicable. If the evidence collected in the course of the tax authorities' proceedings casts doubts on the existence or non-existence of a legal relationship or right having tax consequences, the tax authorities shall apply to a common court to ascertain the existence or non-existence of such legal relationship or right.

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What is the general attitude of the tax authority toward invoking a GAAR?

Not applicable. In certain cases, particularly related to the VAT, the tax authorities try to build their argumentation based on the GAAR. This attitude is more typical of the tax inspection authorities rather than regular tax authorities.

Is a clearance or ruling mechanism available for a GAAR?

Individual tax rulings are in place. They are not specifically designed to exclude applicability of GAAR. However, if all circumstances are disclosed to the tax authorities in the ruling application, the taxpayer is offered a protection against penalty interest and individual responsibility to the extent he or she follows the ruling. For events carried out after the issue of a tax ruling, the protection is also to be extended to unpaid tax.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

Not applicable.

What penalties may result from the GAAR being invoked?

Not applicable.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Judicial decisions in Poland are binding only in a given matter decided by the court. Past judicial decisions are relevant only while being used for strengthening the argumentation in another court case.

Exemplary key judicial decisions involving anti-abuse legislation in Poland are:

- ▶ Judgment of the Regional Administrative Court in Wroclaw of 21 April 2005 (ref. no. I SA/Wr 3065/03). According to the court's sentence, reducing the burden of taxation can occur in a legal manner, using the components of the specific tax (e.g., allowances, tax exemptions, deductions). This action of the taxpayer is called tax avoidance and is considered as acting by legal means, with the aim to reduce taxation or even to avoid it (tax savings).
- ▶ Judgment of the Regional Administrative Court in Warsaw of 21 June 2006 (ref. no. III SA/Wa 488/06). The court stated that after 2004 when the Constitutional Tribunal declared the previously existing GAAR provision unconstitutional, the tax authorities may not rely on the anti-abuse clause as a purely judicial concept with no grounds in legal provisions.
- ▶ Judgment of the Regional Administrative Court in Warsaw of 2 February 2012 (ref. no. III SA/Wa 1971/11). The court stated that tax authorities are entitled or even obligated to assess the agreements concluded between taxpayers and other acts in civil law, from the perspective of tax effects resulting from these agreements and acts. In particular, tax authorities may examine whether acts in civil law constitute actions aimed at full or partial tax avoidance. Acts in civil law may not be used to evade or avoid the tax law provisions.

- ▶ Judgment of the Supreme Administrative Court of 18 November 2009 (ref. no. I FSK 1133/08). According to the Article 58, paragraph 1, of the Civil Code, a legal action contrary to law or designed to evade the law is invalid. Considering the above, the court stated that the tax authority has the right to assess, for tax purposes, whether the act is valid in light of Article 58 and, consequently, effective. Following the court's sentence, civil contracts, forming mutual rights and obligations of the parties, cannot be used to avoid the tax law that belongs to the sphere of public law.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

In 2012, the Ministry of Finance commenced work toward the introduction of a GAAR. At several conferences, tax professors, tax authorities and tax professionals discussed the legitimacy of reintroducing anti-avoidance regulations.

Russia

Does a GAAR exist? If so, please state year of introduction and date of applicability.

The Russian Federation does not currently have a GAAR, but it does have a series of separate anti-avoidance principles (SAAR) in specific areas of legislation that aim to prevent tax avoidance.

In practice, the Russian tax authorities apply the so-called concept of “unjustified tax benefit,” introduced by Court Decree No. 53. Because the concept is effectively Russia’s sole systematic anti-abuse tool in the area of taxation, it has seen wide practical application.

An unjustified tax benefit is defined as a reduction of the amount of a tax liability resulting from a reduction of the tax base, the receipt of a tax deduction or tax concession (incentive) or the application of a lower tax rate, and the receipt of a right to a refund (offset) or reimbursement of tax from the budget. For example, a tax benefit may be considered unjustified when the form of a transaction does not match its substance or a transaction does not have a clear business purposes, i.e., it is tax-driven. On the other hand, the fact that the same economic result might have been obtained with a lesser tax benefit accruing to the taxpayer does not constitute grounds for declaring a tax benefit to be unjustified.

The ruling provides a number of examples of circumstances that do not in themselves constitute grounds for declaring a tax benefit to be unjustified. These include interdependence between participants in a transaction and tax violations by a contract partner of a taxpayer. Courts are to examine all of the relevant circumstances rather than presume that a tax benefit is unjustified based on one or two facts in isolation.

However, the concept of a GAAR has been primarily developed by the Russian courts, including the Decree of the Plenum of the Russian Supreme Arbitration Court No. 53 dated 12 October 2006 (Court Decree No. 53) that introduced the following:

- ▶ Substance-over-form principle
- ▶ “Mala fide taxpayer” concept
- ▶ “Unjustified tax benefit” concept

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

Russian anti-avoidance rules primarily apply to companies. In practice we do not see the application of such principles to individuals.

Can the GAAR be applied retrospectively?

The specific anti-avoidance measures set out below may be applied to transactions concluded within three years preceding the year in which the decision for conducting a tax audit is adopted by the authorized tax authority.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

The Russian Tax Code provides application of the following SAAR under certain conditions:

- ▶ Transfer pricing rules
- ▶ Thin capitalization rules
- ▶ Participation exemption limitations
- ▶ Requalification of the transaction

Does your country have specific legislation in place related to the indirect transfer of assets?

There are some special considerations relating to the taxation of foreign organizations that do not carry out activities through a permanent establishment in the Russian Federation and receive income from sources in the Russian Federation.

In particular, income received by a foreign legal entity that is not connected with activities in Russia shall be classified as an income of a foreign legal entity from Russian sources and shall be assessable to tax withheld at source. The rule applies if such income is received from the sale of Russian legal entities’ shares (share interests) and more than 50% of such Russian legal entities’ assets consists of Russian immovable property or of financial instruments derived from such shares circulated on the organized securities market.

What are the circumstances in which the GAAR can be invoked?

Not applicable. SAAR can be invoked when a taxpayer receives an unjustified tax benefit.

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Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

According to the Russian Tax Code, a person shall be deemed innocent of committing a tax offense until guilt has been proven in accordance with the procedure envisaged by federal law.

A person who is called to account shall not be obliged to prove his innocence of committing a tax offense. The obligation to prove the existence of circumstances that show that a tax offense has occurred and the person is guilty of committing it shall rest with the tax authorities. Any insurmountable doubts as to the guilt of the person who is called to account shall be interpreted in that person's favor. However, in practice taxpayers have to challenge the tax authorities' appliance of anti-abuse rules through judicial procedures even if the existence of circumstances is disputable.

What is the administrative or audit process for invoking a GAAR?

There are general provisions concerning tax control measures. Tax control refers to activities carried out by authorized bodies to check the compliance by taxpayers, tax agents and levy payers with tax and levy legislation.

Tax control shall be exercised by officials of tax authorities within the limits of their authority by means of carrying out tax audits, obtaining explanations and documents from taxpayers and tax agents, checking accounting and reporting data, inspecting premises and areas used to derive income (profit), engaging experts as well as translators and by other means provided for by the Russian Tax Code. Generally, the tax authorities have the right to collect any information from any taxpayer in relation to any transaction they are investigating.

What is the general attitude of the tax authority toward invoking a GAAR?

Not applicable.

Is a clearance or ruling mechanism available for a GAAR?

A clearance mechanism is provided only as mentioned above regarding Court Decree No. 53 for unjustified tax benefits.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

In certain cases the Russian tax authorities may challenge application of benefits provided by double tax treaties with reference to violation of the internal provisions of the tax legislation (particularly SAAR) by the taxpayer.

What penalties may result from the GAAR being invoked?

There are general penalties provided by the Russian Tax Code for commission of a tax offense (besides the additional tax assessment, the taxpayer may have to pay a fine and penalties).

There are no fines and penalties particularly specified by GAAR. Therefore general fines and penalties stipulated by the Russian tax legislation are applied. The Russian Tax Code establishes fines for non-payment or incomplete payment of tax at 20% of the unpaid amount of tax. Moreover in case the tax authorities are able to prove that the failure was committed deliberately the fine comprises to 40% of the unpaid amount of tax.

In addition to the fine assessment, the tax authorities used to charge penalties calculated based on the refinance Central Bank rate and the number of failed days.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

In November 2011, the Supreme Arbitrate Court (SAC) of the Russian Federation passed a precedent-setting decision concerning thin capitalization rules (Russian SAC Resolution of 15 November 2011 No. 8654/11 on Severny Kuzbass Coal Company's case). The Russian SAC adopted a position that differed fundamentally from the one that courts had previously adopted. Non-discrimination articles in double taxation treaties that had been successfully referred to by taxpayers no longer proved reliable protection against Russia's thin capitalization rules.

In the case of Naryanmarneftegaz LLC, which was decided in court on 5 August 2011, Lukoil and ConocoPhillips had a strategic agreement based on an economic partnership. The court carried out an investigation of financial and other documents and concluded that the loan given to Naryanmarneftegaz LLC was in fact made out by Lukoil and ConocoPhillips through a "financial company" called Phillips Petroleum International Investment. The judge said that in this situation the interest is characterized as a dividend under Russian law, so the loan transactions were controlled. Therefore thin capitalization rules should be applied.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Singapore

Does a GAAR exist? If so, please state year of introduction and date of applicability.

GAAR exists under section 33 of Singapore's Income Tax Act:

- 33.(1) Where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly.
- (a) To alter the incidence of any tax which is payable by or which would otherwise have been payable by any person
 - (b) To relieve any person from any liability to pay tax or to make a return under this Act
- Or
- (c) To reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act
- (2) In this section, "arrangement" means any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which it is carried into effect.
- (3) This section shall not apply to:
- (a) Any arrangement made or entered into before 29 January 1988
- Or
- (b) Any arrangement carried out for bona fide commercial reasons and had not as one of its main purposes the avoidance or reduction of tax

The prior was re-enacted by the Income Tax (Amendment) Act 1988 and took effect from 29 January 1988. Prior to 29 January 1988, Section 33 existed in a different form.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The Singapore GAAR applies to any person (includes companies and individuals).

Can the GAAR be applied retrospectively?

Yes, as long as the arrangement is made on or after 29 January 1988. However, if the application of the GAAR results in an assessment to collect the tax, the tax authority can only raise the assessment within four years after the end of tax year 2008 and after (or six years from the end of tax year 2007 and prior). If it involves fraud or willful default, there is no time limit during which the assessment may be raised.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Yes. They are provided in various sections of the Income Tax Act. An example is in the section 19B granting writing-down allowances for intellectual property rights (IPR). Sub-section (10A) denies the writing down allowance for IPR acquired from a related party in certain circumstance.

Does your country have specific legislation in place related to the indirect transfer of assets?

No.

What are the circumstances in which the GAAR can be invoked?

The tax authority can invoke GAAR if it is satisfied that the circumstances under which the arrangement was carried out was to avoid tax or reduce tax. The triggering events are outlined in section 33(1)(a) to (c).

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The onus is on the taxpayer to provide the burden of proof.

What is the administrative or audit process for invoking a GAAR?

GAAR is usually invoked as part of the tax return review by the tax authority.

What is the general attitude of the tax authority toward invoking a GAAR?

The tax authority will not hesitate to invoke GAAR if the situation calls for it.

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+65 6309 8452**Bee Tin Poh**bee-tin.poh@sg.ey.com
+65 6309 8017**Is a clearance or ruling mechanism available for a GAAR?**

Singapore has an advance ruling system whereby the taxpayer can obtain a binding tax ruling on how the tax law apply to a proposed arrangement seriously contemplated. However, there are certain situations where the tax authority will not rule, including:

- ▶ Where it requires the authority to determine any question of fact
- ▶ Where it involves an interpretation of foreign law
- ▶ Where the authority is undertaking an audit or investigation on the taxpayer or a similar arrangement

An application can be made for a binding tax ruling on the GAAR provided it involves a contemplated arrangement and does not involve a situation where the authority will not rule.

Can the GAAR override treaties when invoked?

The domestic legislation provides for treaty provisions to override the domestic law. Moreover, anti-abuse provisions are now included in the newer tax treaties that have been negotiated.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

What penalties may result from the GAAR being invoked?

Under section 33, the comptroller may disregard or vary the arrangement and make such adjustments as he or she considers appropriate, including the computation or recomputation of gains or profits or the imposition of liability to tax, so as to counteract any tax advantage obtained or made obtainable by that person from or under that arrangement.

There is no specific penalty provision in GAAR. However, it remains to be tested whether the general penalty regime (i.e., penalties ranging from 100% to 400% of tax undercharged and/or fine and imprisonment depending on whether this involves an incorrect return or tax evasion) could apply.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

So far, there are only three reported cases involving GAAR.

The first case was in 1971 and was largely decided on evidentiary grounds, but it was based on the old section 33 that was effective prior to 29 January 1988.

The second case concerned stamp duties where the court found that there was no "sound commercial basis" for 53 separate sale and purchase agreements when the true nature of the contract of sale was for the en bloc sale of the properties (i.e., involving only one agreement).

The third case involves a financing arrangement whereby the Singapore Board of Review found the arrangement to be structured in a contrived and artificial way in order to enable the appellant to obtain a tax refund. This case is currently under appeal to the Singapore High Court.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

We are not aware of any legislative proposals or open consultations that could affect the GAAR.

South Africa

Does a GAAR exist? If so, please state year of introduction and date of applicability.

South Africa's GAAR applies to impermissible avoidance arrangements entered into on or after 2 November 2006.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

GAAR is more likely to be invoked at the corporate level in South Africa.

Can the GAAR be applied retrospectively?

Retrospective application is highly unlikely and against established legal principles. The only situation where this is possible is when a subsequent step is introduced to a pre-existing arrangement, but even then it is doubtful whether there would be any retrospective effect.

Do specific anti-abuse measures exist?

There currently are numerous specific anti-avoidance measures, and the trend seems to be to introduce more going forward. Although the GAAR may now be applied explicitly as the alternative to any other grounds of assessment, the specific anti-avoidance measure is applied first as a rule first applied. If the abuse is still not addressed, the GAAR with its broader application will apply.

Existing anti-avoidance rules apply to specific situations such as controlled foreign corporation rules, thin capitalization rules, transfer pricing and exit taxes.

What are the circumstances in which the GAAR can be invoked?

The GAAR is invoked where an impermissible avoidance arrangement exists, where the sole or main purpose is to obtain a tax benefit and where one or more of the tainted elements are present. In a business context, there are four potential tainted elements, and in a context other than business there are three elements, any one of which must be present. Importantly, and deviating significantly from the previous general anti-avoidance provisions in the now repealed section 103 of the Income Tax Act 58 of 1962 as amended (the Act), a step to an arrangement may also be considered an impermissible avoidance arrangement.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The tax commissioner bears the onus of proving that a tax benefit was derived as a result of the arrangement being entered into or carried out, with regard to the assistance provided in terms of section 80G of the Act. In terms of this section, an avoidance arrangement is presumed to have been carried out or entered into for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement. It is also recognized that the purpose of a step may be different from the purpose of a holistic arrangement.

The commissioner does not have to define an alternative or comparable arrangement.

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What is the process for invoking the GAAR?

The taxpayer is first notified of the intention to apply the GAAR. The taxpayer is provided with the opportunity to respond before the actual GAAR assessment is raised. The GAAR is not a penal section, but where an assessment is raised on the grounds that the transaction is an impermissible avoidance arrangement, the commissioner may not waive the interest on the amount payable.

What is the general attitude of the tax authority toward invoking the GAAR?

At this stage it is difficult to gauge the attitude toward invoking the GAAR because there has been no case law on the new GAAR. Although it is conceivable that the GAAR had been applied in practice, what tends to happen is that, partly because of the reputational issues associated with a GAAR matter and partly because of the compulsory interest element, taxpayers tend to enter into settlement agreements on arrangements subject to the GAAR. The general attitude of the South African Revenue Service (SARS) is that the GAAR should serve as an effective deterrent for entering into aggressive tax planning arrangements.

Is a clearance or ruling mechanism available for a GAAR?

The advance tax ruling system generally precludes a ruling being obtained on an impermissible avoidance arrangement.

Can the GAAR override treaties when invoked?

As a rule, there is no conflict between domestic anti-abuse rules and provisions of a tax treaty. The GAAR will be applied in the same manner for purely domestic arrangements and arrangements involving an international component.

What penalties may result from the GAAR being invoked?

The GAAR is not a penal section. What has not been considered is whether the new Tax Administration Bill, which is expected to be enacted in June 2012, may have a penalty impact on arrangements assessed in terms of the GAAR.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Although there is substantial case law on the now-repealed section 103, which preceded the GAAR, there is no case law on the GAAR as such. However, some of the principles underlying section 103 still apply, so the relevant case law will still apply in relation to those principles.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

Although there are no current open consultations that we are aware of, the legislative process is of a consultative nature, and proposals can be made to the Treasury or SARS.

South Korea

Does a GAAR exist? If so, please state year of introduction and date of applicability.

South Korean tax law contains a general substance-over-form principle codified in tax legislation including the Basic National Tax Act, Corporate Income Tax Law and Law of the Coordination of International Tax Affairs.

A general substance-over-form principle was first codified in the Basic National Tax Act on 1 January 1990 and was revised on 31 December 2007 and 1 January 2010, respectively.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The substance-over-form test is invoked and applied equally to corporations and individuals. There is no correlation of its application to a taxpayer's status as a corporation or an individual.

Can the GAAR be applied retrospectively?

In accordance with Article 18 of the Basic National Tax Act, the tax authorities are not allowed to enforce tax acts retroactively. Article 18 (3) states that once the interpretation and practice of tax acts are generally accepted by taxpayers, tax authorities should not "retroactively" impose taxes using new interpretation or practice.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

South Korea provides other specific anti-abuse rules. For example, a specific law relating to cross-border transactions provides that if a person to which any income or activity is attributable in form is different from a person to which such income or activity is attributable in substance, the latter shall be the taxpayer with the tax treaties applied accordingly. Another provision applies special withholding tax procedures to residents of blacklisted jurisdictions. There also is a statute permitting the taxing authority to determine the proper income of a taxpayer that engages in a related-party transaction that is considered (under regulations) to abusively reduce tax.

Does your country have specific legislation in place related to the indirect transfer of assets?

Although there is no legislation regarding income tax, there is legislation in the transfer tax area regarding the indirect transfer of assets via a transfer of shares. The legislation concerns "deemed acquisition tax," which is a transfer tax imposed on the acquisition of certain tainted assets including real property and motor vehicles. A deemed acquisition tax is imposed on a person who becomes a greater than 50% shareholder in a company that owns certain tainted assets by acquiring shares in the company.

What are the circumstances in which the GAAR can be invoked?

Pursuant to the Basic National Tax Act, the general substance-over-form principle would be applied under the following circumstances:

- ▶ If any ownership of an income, profit, property, act or transaction that is subject to taxation is just nominal and there is another person to whom such income, etc., belongs, the latter person shall be liable for tax payment and related tax acts shall apply accordingly.
- ▶ The provision pertaining to the computation of the tax base of various tax acts shall be applied to a real (i.e., actual) income, profit, property, act or transaction, regardless of its title or form.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

Korean tax law does not clearly specify where the burden of proof lies with regard to challenging the arguments of the tax authorities. But if a taxpayer does not provide the tax authorities with proper account ledgers or supporting documentation, the burden of proof may fall on the taxpayer.

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What is the administrative or audit process for invoking the GAAR?

Based on the tax authorities' review of relevant information (such as account ledgers or contracts) during the tax audit, the tax authorities can invoke the GAAR for the tax assessment pursuant to a general substance-over-form principle pursuant to the Basic National Tax Act.

What is the general attitude of the tax authority toward invoking the GAAR?

The tax authorities are very aggressive in invoking the substance-over-form principle to deal with tax avoidance or aggressive tax planning.

Is a clearance or ruling mechanism available for a GAAR?

General and advance (pre-filing) tax rulings are available, but the tax authorities do not issue an opinion on the ruling inquiry if they find that the inquiry relates to deciding actual facts and circumstances. In this context, it could be reasonable to state that a clearance or ruling mechanism (GAAR) is not available.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

For international transactions, in cases where a taxpayer attempts to benefit unfairly by applying an indirect transaction through a third party or through two or more acts or transactions, then tax treaties, the Basic National Tax Act and other tax law would apply according to the economic substance of the transaction, assuming such a transaction has actually been made between the parties concerned or such acts or transactions are a single transaction in fact. In other words, GAAR would override treaties when invoked.

What penalties may result from the GAAR being invoked?

In general, when GAAR is invoked, it is more likely than not that the higher rate of penalty taxes (i.e., 40% of the under-reported tax amount) will be imposed.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

The controversial case of Lone Star in Korea, which has embroiled the US company in numerous legal and tax challenges, is a prime example involving GAAR. In one of Lone Star's tax disputes, the tax authorities argued that a Belgian holding company was a conduit lacking substance and established for tax purposes; it instead looked through to the US parent. These types of challenges are becoming more common in Korea.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

To combat offshore tax fraud, tax authorities recently strengthened the monitoring of overseas tax evasion. A new tax provision on the mandatory reporting requirements of foreign financial accounts held in overseas countries was incorporated on 27 December 2010. These measures are intended to prevent overseas tax evasion activities such as a resident or domestic corporation hiding its assets overseas by using a foreigner's name.

Sweden

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Sweden introduced a GAAR in 1981, but it was abolished on 1 January 1993. A new GAAR was reintroduced in 1995. With some changes, the rules are still in force and applied. Transactions carried out for the main purpose of avoiding tax can be disregarded if certain other requirements are fulfilled. One such requirement is that tax assessment based on the transactions would be contrary to the purpose of the legislation.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

Swedish GAAR applies to all taxpayers, both private individuals and corporations. GAAR has been invoked on both.

Can the GAAR be applied retrospectively?

GAAR can be applied retrospectively (up to five years after the assessment year). For example, in year 2012, the GAAR can be applied back to assessment year 2007 – fiscal year 2006 can be examined). The GAAR cannot be applied prior to the date of its introduction.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Sweden also has specific anti-abuse rules, e.g., relating to so-called “shell companies.” Under these rules, a gain on disposal of shares that would otherwise be tax-exempt under the participation exemption regime can be taxable. A company being disposed of may be considered a shell company if it has mainly liquid assets or high liabilities. Sweden also has controlled foreign corporation legislation where a Swedish parent can be taxable for the profit of a foreign subsidiary if the subsidiary has been subject to low taxation abroad.

Does your country have specific legislation in place related to the indirect transfer of assets?

There are no specific tax rules relating to capital gains on indirect transfers of shares or assets. However, such transfers may have other tax effects (e.g., relating to utilization of tax losses).

What are the circumstances in which the GAAR can be invoked?

GAAR can be invoked in situations where it can be established that:

In a tax assessment, a legal action or transaction shall not be considered if:

- ▶ The action or transaction, alone or together with other actions or transactions, forms part of method that provides the taxpayer with a material tax benefit.
- ▶ The taxpayer directly or indirectly is involved in the action or transaction.
- ▶ The tax benefit, with respect to the circumstances, can be assumed to be the overriding reason for the action or transaction.
- ▶ A taxation assessment based on the action or transaction would be contrary to the purpose and intention shown in the overall design of the tax rules and the rules that are directly applicable or have been circumvented by the action or transaction.

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Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

The taxpayer has a general obligation to provide the tax authority with sufficient information to make a correct assessment. Generally, it is assumed that the taxpayer must have the best knowledge of the reasons behind his or her actions, so the taxpayer has the onus of providing information that the actions or transactions were made for reasons other than receiving a significant tax benefit.

What is the administrative or audit process for invoking a GAAR?

Because of the nature of the GAAR, it can, as a first instance, only be applied by the first instance administrative court (i.e., the tax authority cannot apply the GAAR on a stand-alone basis). The GAAR is tried by the first instance court at the request of the tax authority, based on an assessment of a tax return or as a result of findings in a tax audit.

What is the general attitude of the tax authority toward invoking a GAAR?

Although the GAAR has not been used heavily in Sweden, it is not true to say that it is rarely used. Typically the tax authority would argue for GAAR to be used if it believes the requirements are met and the actions or transactions leading to the tax benefit cannot be questioned on other formal means.

Is a clearance or ruling mechanism available for a GAAR?

It is possible to ask the Tax Law Board for a preliminary ruling of a proposed transaction. In such a ruling also the question if a transaction could be subject to the GAAR or not is possible to get answered. The ruling can be appealed to highest administrative court, which may or may not take the case up for ruling.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

Yes, Swedish GAAR rules can override tax treaties.

What penalties may result from the GAAR being invoked?

There are no specific penalty rules attached to the GAAR regime, so there is no automatic penalty when GAAR has been successfully applied. But this does not mean that a penalty will not be invoked. However, such a penalty is normally due to the fact that the taxpayer has not provided the tax authority with sufficient information to make a correct assessment, with the penalty resulting from other applicable tax laws rather than as a direct result of the GAAR.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

- ▶ Cases where rules for closely held companies are circumvented
- ▶ Cases where restrictions on usage of net operating losses has been circumvented
- ▶ Cases where rules on tax beneficial restructuring has been exploited

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Switzerland

Does a GAAR exist? If so, please state year of introduction and date of applicability.

In Switzerland, the general principle of abuse of law or tax evasion applies. According to standing practice of the Federal Supreme Court, tax avoidance occurs if the following three cumulative conditions are met:

1. The legal structuring used by the parties is unusual and seems unusual from an economic perspective.
2. The structure has solely been chosen to avoid taxes that would have been due under normal circumstances.
3. The legal structure chosen would have resulted in substantial tax savings if tolerated by the tax authorities.

In cases where a double taxation treaty (DTT) is applied (or the application is requested), an ordinance of the Federal Council dated 14 December 1962 (so-called "BRB 62") is relevant. The ordinance was introduced to prevent abusive application of DTT and has been substantiated with several circular letters of the Swiss Federal Tax Administration (SFTA). According to BRB 62, the application of a DTT is abusive (and therefore not granted) if the tax relief would result – either directly or indirectly – in a substantial amount to the benefit of someone who is not eligible for the DTT (e.g., treaty shopping).

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The GAAR in general applies equally to corporations and individuals.

Can the GAAR be applied retrospectively?

Retrospective application of the GAAR is possible under certain conditions:

- ▶ The statute of limitation has not elapsed. Taxation is generally limited to five years after the respective tax period. This limitation is suspended in case any actions with respect to the taxation are undertaken. However, taxation may not be assessed later than 15 years after tax period (or corresponding to a longer period, if wrongful taxation was obtained due to a breach of penal law and penal law foresees a statute of limitation statute-barred prosecution later than 15 years).
- ▶ The reassessment is due to facts or evidence that were not known to the tax authorities at the time of the first assessment.
- ▶ The GAAR may not be applied prior to the date of its introduction.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

Specific anti-abuse measures include unilateral anti-treaty shopping rules, limitations on benefits provisions in treaties and the taxation of partial liquidation.

Does your country have specific legislation in place related to the indirect transfer of assets?

Yes, especially with respect to real estate companies and anti-abuse rules in cases of tax-neutral reorganizations.

What are the circumstances in which the GAAR can be invoked?

No specific circumstances are required.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

In general, the onus is on the party to derive a right from the law. Therefore, the respective tax administration has to prove circumstances that constitute taxation in Switzerland (e.g., the domicile of a person in Switzerland), whereas the taxpayer has to prove circumstances that impair the taxation in Switzerland (e.g., the substance requirements to benefit from a DTT).

What is the administrative or audit process for invoking a GAAR?

In general, the GAAR is invoked during the course of the ordinary tax assessment procedure.

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What is the general attitude of the tax authority toward invoking the GAAR?

Due to its federal organization, Switzerland has 27 competent authorities for corporate income tax (26 cantons and the SFTA). For withholding tax, share issuance and transfer tax, SFTA is the only competent authority.

As a result, the attitude depends on the competent tax authority as well as the specific case. A general attitude cannot be defined.

Is a clearance or ruling mechanism available for a GAAR?

Tax rulings may be obtained, they are granted only if filed prior to the realization of the facts of a case.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

In practice, a GAAR (especially BRB 62) generally overrides treaties. However, anti-abuse rules provided in treaties override the unilateral anti-abuse regulation.

What penalties may result from the GAAR being invoked?

The mere application of GAAR does not lead to penal measurements. The applicable penal rules depend on the tax concerned.

Corporate income tax

Voluntary or negligent tax evasion generally is punished with a penalty in the amount of the evaded tax. In severe cases, the penalty may amount up to the triple of the evaded tax, whereas in cases of slight negligence the penalty may be reduced down to one third of the evaded tax.

If falsified documents are used in order to commit a tax evasion (so-called tax fraud), the penalty applied may be up to CHF30,000. Furthermore, a custodial sentence may be imposed instead of a penalty.

Cantonal tax laws may apply their own penal rules in order to secure cantonal or communal taxes. Nevertheless, most cantons' rules are in line with the federal regulations.

Independent of the penal procedure, the ordinary tax remains due. Furthermore, interest on late payment applies, with an interest rate of about 3% (depending on the tax year and competent canton).

Withholding tax and anti-treaty-abuse rules

Voluntary or negligent tax evasion may be punished with a penalty of up to CHF30,000 or (if higher) triple the penalty tax.

The voluntary or negligent endangerment of the tax may be punished with a penalty of up to CHF20,000.

In any event, the tax remains due (i.e., it has to be paid in addition to any penalties). For the late payment an interest of 5% applies.

If further felonies are committed (e.g., falsification of documents or fraud), the penal code may apply in addition to the administrative criminal law outlined prior.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Not applicable.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No.

Turkey

Does a GAAR exist? If so, please state year of introduction and date of applicability.

Turkey has a GAAR that relies on the substance-over-form principle. This principle allows the tax authorities to disregard the form of a transaction when it is obvious that the taxpayer is attempting to avoid tax.

The substance-over-form principle was introduced and became effective in the tax legislation with the amendment made in the Tax Procedural Code No. 213 on 30 December 1980.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

All taxpayer classes are included in the scope of Turkish GAAR.

Can the GAAR be applied retrospectively?

Yes. In the Turkish legal discourse on taxation, the term “retroactivity” is used to define the application of laws to past events. However, a distinction has been established between “real retroactivity” and “unreal retroactivity” (retrospectivity) by the tax literature and in the jurisprudences of the Turkish Constitutional Court. Whereas real retroactivity in principle is not justifiable, retrospectivity is considered in principle to be justifiable in terms of the rule of law. Retrospectivity refers to the situations in which a new provision is introduced before the completion of a taxable event. In such cases, even though the taxable event commenced, the final legal effect of it has not occurred. The new law applies from the beginning of the current year but is introduced prior to the completion of the tax period. Thus, the actual tax obligation has not arisen at the time of the introduction of the new law.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

In addition to the GAAR, there are other specific anti-avoidance rules included in the Turkish Corporate Tax Code. For instance, Turkish resident taxpayers are subject to a 30% withholding tax on all payments made in cash or on account that relate to transactions with companies resident in countries that the Council of Ministers considers being in harmful tax competition. The Council of Ministers has not yet specified these countries.

Transfer pricing is another area containing anti-abuse rules that are applied when transactions between related parties are not determined to be in accordance with the arm’s-length principle. In such cases, profits returned will be subject to corporate income tax of 20% and dividend withholding tax of 15%.

The thin capitalization regime contains an anti-abuse rule that is applied when loans from shareholders or related parties debts exceed three times of the equity capital at any time in the relevant fiscal period. When the debt-to-equity ratio is exceeded, interest, foreign exchange losses and any relevant related expenses will be deemed to comprise a hidden profit distribution or a remittance of profits as of the last day of the fiscal period. Such expenses are non-deductible and subject to dividend withholding tax at the rate of 15%.

Controlled foreign corporation (CFC) rules are applied if resident individuals and corporate taxpayers jointly or severally have a direct or indirect participation of 50% or more in the shares, dividend rights or voting rights in a foreign entity that meets certain conditions. If the foreign company falls within the scope of the Turkish CFC measures, Turkish resident taxpayers declare the corporate income of the foreign company attributable to them.

Does your country have specific legislation in place related to the indirect transfer of assets?

No.

What are the circumstances in which the GAAR can be invoked?

There are no specific circumstances necessary for GAAR to be invoked.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

Within the GAAR provision, there is a general rule regarding the burden of proof. If either party claims the existence of a situation that is inconsistent with economic, commercial and technical norms or that is abnormal and unusual due to its nature, the burden of proof of such existence falls upon the party asserting such claim.

However, there is a special burden of proof rule for transfer pricing applications. According to this, taxpayers must prove that their transfer prices are arm’s length.

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What is the administrative or audit process for invoking a GAAR?

The tax authority initiates a tax inspection of a company and requires the legal books and accounts of the company. The initiation of the tax inspection should be recorded under the "tax inspection commencement minutes," a document that is signed by the taxpayer and the tax inspector. The tax inspector prepares a tax inspection report in which the detailed explanations and supportive arguments that have caused the tax authority to invoke the GAAR are presented to the taxpayer. The tax inspection report is then communicated to the taxpayer with the tax/penalty notification.

What is the general attitude of the tax authority toward invoking the GAAR?

The tax authority regularly invokes the GAAR.

Is a clearance or ruling mechanism available for a GAAR?

Yes.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

As a domestic tax rule, a GAAR cannot override treaties ratified by the Turkish Parliament, as there is a constitutional rule stipulating that international treaties cannot be overruled by a domestic law. However, the substance-over-form principle can be easily applied or considered when deciding tax issues in the scope of tax treaties.

What penalties may result from the GAAR being invoked?

The applicable penalty in the case of additional tax assessment is a tax loss penalty. In principle, the amount of tax penalty is equal to the tax principal to be assessed. However, in the case of a tax smuggling assertion, the tax loss penalty is applied at three times the tax principal to be assessed.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Tax replenishment funds contributed toward the equity of a company that has been incurring losses for many years should be recharacterized as service fees because having incurred losses for many years is abnormal and inconsistent with the general rules of commercial life.

It is abnormal for a company operating in Turkey to import goods from a sister company operating in a free trade zone with a buy/sell license at a higher fee than the purchase price said goods. The transfer price for the company operating in Turkey should be considered as the purchase price of the sister company operating in the free trade zone.

The tax assessment is made by the tax authority with an assumption that it is abnormal to print a single invoice without necessary permissions; therefore, it should be accepted that a series of invoices have been printed without necessary permissions until the serial number of the single invoice identified by the tax authority.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

No. There is a Draft Tax Procedural Code under discussion at the tax administration level. However, it contains the same GAAR with no differences.

United Kingdom

Does a GAAR exist? If so, please state year of introduction and date of applicability.

At present there is no GAAR in the United Kingdom. However, in the recent 2012 Budget the UK Government announced that it was currently consulting on the introduction of a GAAR with a view to enacting legislation in 2013.

The 2012 Budget announcement followed a study commissioned by the UK Government in 2010 to consider whether a GAAR should be introduced into the UK tax system. The study (known as the Aaronson Report), which was published in November 2011, concluded that a GAAR should be enacted in the United Kingdom (the UK GAAR Proposal). It also recommended a framework of principles that the GAAR should embody and proposed a draft GAAR based on these principles.

Details of the UK GAAR consultation

On 12 June 2012, the Government launched a formal consultation on a new GAAR to tackle artificial and abusive tax avoidance schemes.

The purpose of the proposed GAAR is in line with the Aaronson Report's recommendation to introduce a rule that is targeted only at artificial and abusive arrangements and not "the centre ground of tax planning."

In line with the report's recommendations, the proposed GAAR will apply to the main direct taxes (including bank levy) and national insurance. As announced at the budget, it will be expanded to cover stamp duty land tax. The consultation also proposes an extension of the GAAR to inheritance tax and makes it clear that the Government will consider including further taxes if appropriate but not VAT due to complexities in its interaction with the abuse of law doctrine.

Additional details include:

- ▶ The consultation proposes the establishment of a panel as recommended by the Aaronson Report. The Advisory Panel will advise on the application of the GAAR to a particular transaction and approve guidance produced by Her Majesty's Revenue & Customs (HMRC), the UK tax authority, that must be taken into account by a court in determining whether the GAAR applies in a particular scenario. This panel has significant influence over how the GAAR will apply in practice, and its composition and operational mechanics will be critical in determining whether the GAAR achieves its intended objectives and effect on UK competitiveness. That level of detail is not covered in the consultation document.
 - ▶ The Government has proposed that there will be further consultation on the draft legislation, adding that the guidance should be produced before the GAAR is enacted. It is suggested that HMRC would draft the guidance and the first act of the Advisory Panel will be to review and approve it. There is no suggestion that the guidance will be part of the consultation, although we consider this to be critical especially given that guidance must be taken into account by a court.
 - ▶ The consultation paper makes it clear that HMRC believes that targeted anti-avoidance rules are still likely to be required, particularly until such time as the GAAR has proved effective in countering abusive schemes.
- ▶ The Government acknowledges that the commencement rule for a GAAR will need careful consideration. A particular question is whether there should be a transitional rule dealing with arrangements straddling 1 April 2013. This means that the GAAR could potentially apply to transactions that began prior to the introduction of the legislation. The Government has invited representations on the issue.
 - ▶ The Government has proposed that the GAAR should apply to artificial and abusive arrangements where UK tax advantages have been obtained through rights or benefits under any double taxation agreements (DTAs). Despite concerns that if the GAAR were to negate the effect of DTAs, conflicting with the United Kingdom's duty to abide by the terms of its agreement with other countries, the Government believes that the GAAR would be consistent with the OECD commentary on the Model Tax Convention, which states that:
"States do not have to grant the benefits of a double tax convention where arrangement that constitute an abuse of the provision of the convention have been entered into."
 - ▶ The proposal is that the abusive tax advantage would be counteracted on a just and reasonable basis. However, the draft legislation does not contain the further provisions suggested by the study group that detail what factors should be taken into account in determining what is just and reasonable. This matter has been the subject of judicial debate in the past, and the study group's recommendations were intended to address this uncertainty.

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The GAAR study group, headed by Graham Aaronson, QC, has now issued a supplementary report in response to the consultation issued by HMRC. Overall the GAAR study group agreed that the consultation draft embodies all of the main principles that the study group considers need to be incorporated in, and to form the framework of, a GAAR that would be appropriate for the United Kingdom. The study group considers that the consultation GAAR is very well-drafted, and it does not recommend any amendments to the draft. The study group does comment on the differences between its suggestion and the consultation GAAR. In some cases it accepts the change, but in others it highlights the need for care. In particular, the study group views it as essential that the guidance should be as impartial and objective as possible.

The closing date for comments was 14 September 2012.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The proposed GAAR will apply to the main direct taxes (including bank levy) and national insurance. As announced at the Budget, it will be expanded to cover stamp duty land tax. Therefore, the proposed GAAR will cover both individuals and companies.

Can the GAAR be applied retrospectively?

The UK GAAR Proposal suggests the GAAR could be applied retrospectively to arrangements entered into but not yet completed given that the rule would only capture artificial and abusive tax schemes that are widely regarded as intolerable.

The general position of respect to retroactive legislation is that it is unusual even when it is counteracting highly aggressive tax avoidance. However, in limited circumstances HMRC has introduced retroactive legislation to counteract highly aggressive avoidance arrangements. While there has been some debate historically on whether retroactive legislation is in accordance with “human rights” under UK or EU law, as far as we are aware it has not been held to be unlawful.

The UK Government’s intention is that retroactive legislation should be used only in “wholly exceptional circumstances.” However, there is precedent for retroactive rules to have been back dated indefinitely. For example, Finance Act 2008 made amendments to certain income tax provisions to catch tax avoidance schemes. The statute stated that the amendments were to be “treated as always having had effect.” Retroactive tax legislation typically applies to target a specific piece of aggressive tax avoidance. However, as outlined prior, in most instances even where there is highly aggressive tax avoidance, legislative changes are not retroactive.

As a result, it is currently uncertain as to whether the GAAR will be able to be applied retrospectively.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Yes, the United Kingdom has a number of anti-avoidance measures targeted at specific areas. Commonly referred to in the United Kingdom as targeted anti-avoidance rules (TAARs), these specific rules are found across a wide variety of statutory provisions and generally within the legislation granting the relief.

It is estimated that there are more than 300 TAARs. Some of the key TAARs include rules around preventing:

- ▶ Groups acquiring companies that have losses in order to offset group profits or acquiring profit companies in order to utilize the group losses
- ▶ Groups acquiring companies that have capital losses to dispose of assets through in order to avoid capital gains tax
- ▶ Related parties from manipulating profits through the transacting at non-market rates
- ▶ Parties obtaining tax advantages generated by transactions in securities where it cannot be shown that the transaction was for a bona fide commercial reason and that the tax advantage was not one of, or the main objective of, the transaction
- ▶ Entities from avoiding income tax through the sale or transfer of income streams for lump sum consideration
- ▶ Losses arising through depreciatory transactions, e.g., dividend or asset stripping

United Kingdom

There are also a number of rules that prevent tax advantages from being obtained through artificial land transactions.

The United Kingdom also has a disclosure of tax avoidance schemes principle that requires early notification to HMRC of tax and VAT avoidance schemes that meet specific criteria. This disclosure is to enable HMRC to evaluate the schemes and, where it thinks appropriate, enact specific legislation to counter them.

What are the circumstances in which the GAAR can be invoked?

The UK GAAR Proposal recommends the GAAR should be invoked only when the nature of the taxpayer's arrangement is clearly artificial and contrived. It has been proposed that this will be where:

1. The arrangement is an abnormal arrangement in that an identified abnormal feature in the arrangement is included for the sole or main purpose of achieving an abusive tax result.
2. The arrangement cannot reasonably be regarded as a reasonable exercise of choices of conduct afforded by the legislation.

It has also been proposed that, at least initially, the GAAR should be invoked only in respect of the main direct taxes – income tax, capital gains tax, corporate tax and petroleum revenue tax – and national insurance contributions.

Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

It is likely that HMRC will have the burden of proving a taxpayer has entered into an arrangement that falls within the scope of the GAAR. This is the general position taken in respect of this type of legislation and is the position recommended in the UK GAAR Proposal.

What is the administrative or audit process for invoking a GAAR?

It has been proposed that there will be a panel to advise HMRC on whether there are reasonable grounds for invoking the GAAR in respect of a particular arrangement. It is envisioned that the majority of the members on the panel would be non-HMRC officials.

Once it has been determined that a taxpayer has entered into an abnormal arrangement that falls within the GAAR, the abusive tax result achieved by the arrangement would be counteracted.

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What is the general attitude of the tax authority toward invoking a GAAR?

It is too early to determine. However, the UK GAAR Proposal suggests HMRC's attitude to the GAAR should be to use it as a "shield" to protect the revenue base and enterprises that do conduct responsible tax planning, rather than wield it aggressively.

Is a ruling or clearance mechanism available?

It has been proposed that there should be no general clearance mechanism. This is because a GAAR that targets contrived and artificial arrangements, and not responsible tax planning, should by its very nature render a clearance mechanism unnecessary.

However, the UK GAAR Proposal suggests a simple option, such as an independent advisory panel, could be an efficient mechanism to help taxpayers and HMRC identify the outer limits of responsible tax planning.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No, but as noted prior, the GAAR consultation proposes the establishment of an Advisory Panel as recommended by Aaronson. The Advisory Panel will advise on the application of the GAAR to a particular transaction and approve guidance produced by HMRC that must be taken into account by a court in determining whether the GAAR applies in a particular scenario.

Can the GAAR override treaties when invoked?

The Government has proposed that the GAAR should apply to artificial and abusive arrangements where UK tax advantages have been obtained through rights or benefits under any DTAs. Despite concerns that if the GAAR were to negate the effect of DTAs, it would conflict with the United Kingdom's duty to abide by the terms of its agreement with other countries, the Government believes that the GAAR would be consistent with the OECD commentary on the Model Tax Convention.

What penalties may result from the GAAR being invoked?

The UK GAAR Proposal suggests that no penalties (separate from counteraction) should be imposed.

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

Not applicable.

Are there any legislative proposals or open consultations that may affect the future composition of the GAAR?

The UK GAAR consultation process has been described previously.

United States

Does a GAAR exist? If so, please state year of introduction and date of applicability.

The United States does not have a GAAR, but it has several common-law doctrines that are similar to many GAAR regimes. These doctrines include the substance-over-form doctrine, the step transaction doctrine, the sham transaction doctrine, the business purpose doctrine and the economic substance doctrine. Many of these doctrines are overlapping and some have been applied differently by the courts.

In 2010, Congress codified one of these common-law doctrines, the economic substance doctrine. The Health Care and Education Reconciliation Act created section 7701(o), which defined the economic substance doctrine as the common law doctrine under which certain tax benefits are not allowable if the transaction does not have economic substance or lacks a business purpose, i.e., a conjunctive test. Under this test, a transaction will be treated as having economic substance only if the taxpayer can demonstrate that (1) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position and (2) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction. Whether a transaction is subject to this economic substance analysis will be made under common law standards, as if section 7701 (o) had not been enacted.

On what class of taxpayer is the GAAR typically invoked? Is it more likely to be applied at the corporate level as opposed to individuals?

The common-law doctrines are potentially applicable to all taxpayers.

Can the GAAR be applied retrospectively?

Because the United States derives many of its anti-abuse measures from long-standing common-law doctrines, retroactivity generally is not an issue.

Do specific anti-abuse measures exist? If yes, please describe the measures and the issues they focus on.

In the United States, in addition to judicial doctrines such as substance over form, business purpose, sham transaction, step transaction and the recently codified economic substance doctrine, a number of provisions in the Internal Revenue Code, Treasury Regulations and tax practitioner rules refer to a tax avoidance purpose on the part of the taxpayer, including the following examples:

Corporations

- ▶ Acquisitions made to evade or avoid income tax – section 269
- ▶ Unreasonable accumulation of earnings – section 533
- ▶ Controlled foreign corporation rules – section 956
- ▶ Transfer pricing rules – section 482

Partnerships

- ▶ Passive loss limitation rules – section 469
- ▶ Abusive partnership transactions – sections 1.701-2, 1.704-4(f), 1.752-2(j)

Individuals

- ▶ Disqualified leaseback or long-term arrangement – section 467(b)(4)
- ▶ Related-party rules – section 267

Tax practitioners

- ▶ Cir. 230 rules
- ▶ Understatement of taxpayer's liability by tax return preparer – section 6694

Penalties

- ▶ Reportable transactions rules – sections 6011, 6111, 6112
- ▶ Accuracy-related penalties – section 6662

What are the circumstances in which the GAAR can be invoked?

Following the codification of the economic substance doctrine, the Commissioner of the Internal Revenue Service's (IRS) Large Business & International (LB&I) Division issued a Directive, LB&I-4-0711-015 (15 July 2011), providing examiners with a comprehensive set of guidelines examiners must follow to determine whether asserting the doctrine and imposing the associated penalty may be appropriate. The Directive also prescribes a series of "inquiries" that the examiner must develop, analyze and document in writing before seeking approval from the Director of Field Operations (DFO) for the ultimate application of the doctrine and penalty in the examination. In general, the new Directive mandates a four-step procedure that requires significant analysis and due diligence by the examiner to determine whether it is appropriate to seek approval from the DFO to assert the doctrine and the corresponding penalty. The four-step procedure provides a framework for examiners to consider the elements of the transaction and narrows the potential breadth of the economic substance doctrine.

Regarding the assertion of other anti-abuse judicial doctrines, the general exam process governs the assertion of a particular judicial doctrine.

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Is the onus on the taxpayer or the taxing authority to provide the burden of proof?

Generally, the burden of proof for sustaining a tax position lies with the taxpayers. Generally, the burden of proof for asserting a penalty lies with the government. There are exceptions to both of these rules.

What is the administrative/audit process for invoking the GAAR?

LB&I Directive, LB&I-4-0711-015 (15 July 2011), lays out when the economic substance doctrine can be asserted in an audit. There are no special rules for the assertion of the other anti-abuse judicial doctrines. Rather, the normal rules for the exam process under the Internal Revenue Manual apply.

What is the general attitude of the tax authority toward invoking a GAAR?

It is IRS policy to only assert anti-avoidance judicial doctrines where appropriate.

Is a clearance or ruling mechanism available for a GAAR?

Generally, the IRS will not grant advance rulings as to whether anti-avoidance doctrines such as the economic substance doctrine apply to a transaction. It is possible, in some circumstances, to obtain advance rulings as to whether certain anti-avoidance rules found in the Internal Revenue Code apply to a transaction.

Does your country have a GAAR Panel? If yes, do taxpayers carry out strategic decision-making as to whether they appear before the Panel or not?

No.

Can the GAAR override treaties when invoked?

The United States does not have a GAAR; therefore, no conflict can occur with any treaty provisions. Additionally, the US Model Income Tax Convention does not have a specific provision dealing with tax avoidance actions with respect to US income tax treaties. Finally, there are several IRC provisions that the IRS can invoke for specific transactions or entities. However, it is unlikely that any of those provisions would directly conflict with a provision in a US income tax treaty. If there is a conflict between a provision of domestic law and a provision in a US income tax treaty, a "later in time" rule applies if the two provisions cannot otherwise be reconciled. Under this rule, the last one to become law will prevail.

What penalties may result from the GAAR being invoked?

While there are no actual GAAR penalties in the United States, Sections 6011, 6111 and 6112 and the accompanying regulations are designed to combat specific types of tax abuse by requiring taxpayers and their advisors to disclose particular transactions. There are also code sections providing penalties for failing to meet these disclosure requirements.

The accuracy penalty may also apply to understatements resulting from avoidance transactions.

In particular, codification of the economic substance doctrine created section 6662(i), which contained a new 20% penalty on an underpayment attributable to a disallowance of claimed tax benefits because a transaction lacked economic substance. (This penalty is increased to 40% if the taxpayer does not provide adequate disclosure of the relevant facts affecting the tax treatment in the return or a statement attached to the return.)

Please provide a summary of key judicial decisions involving the GAAR or other anti-abuse legislation.

As the United States does not have a GAAR, there is no case law involving GAAR; however, there are key judicial decisions involving the common law doctrines that are designed to combat abusive tax avoidance actions by taxpayers, including:

Economic substance – section 7701(o)

- ▶ *Gregory v. Helvering* (1935)
- ▶ *Rice's Toyota World v. Commissioner* (1985)

Substance over form

- ▶ *Frank Lyon Co. v. United States* (1978)
- ▶ *Saviano v. Commissioner* (1985)

Sham transaction

- ▶ *Goodstein v. Commissioner* (1959)

Step transaction

- ▶ *McDonald's Restaurants of Illinois v. Commissioner* (1982)

Are there any legislative proposals or open consultations that may affect the future composition of a GAAR?

No.



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EYG no. DL0690
1301-1004695

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ED 0614