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Table of Contents

Feature

Case Summaries

Switzerland

United States

Legislative Developments

Argentina

Colombia

European Union

France

Italy

Malaysia

Feature

Civil Court of Paris, 32nd criminal chamber, 12 January 2017 - W Case

by Eric Meier, Malvina Puzenat and Arnaud Tailfer (Paris)

On 12 January 2017, the 32nd Criminal Chamber of the Civil Court of Paris rendered a decision in a highly publicized case discharging defendants who were prosecuted for tax fraud, characterized by "the use of trusts in order to conceal assets of the estate of the decedent", for complicity of tax fraud, and laundering of tax fraud proceeds.

The "W case" refers to a number of judicial proceedings in France, one of which is the settlement of the estate of the famous art dealer, Daniel W, who died in France in 2001.

Daniel W's heirs included his spouse, Sylvia Roth, and his two sons, Guy and Alec. While Sylvia Roth initially waived her share in the estate, she later obtained a judicial annulment of the waiver. From the judicial decisions it appears that Guy and Alec had initially persuaded Sylvia that a waiver would discharge her of certain tax liabilities incurred prior to her husband's death.

In reviewing the estate and gathering the information necessary to prepare the required inheritance tax returns, Sylvia Roth would have determined the existence of various irrevocable and discretionary trusts in which her late spouse had an interest. However, the Criminal Chamber's decision shows that the successive inheritance tax returns filed with the French Tax Authorities by Daniel W's heirs did not include any such trusts.

When Alec W, Daniel's son, died shortly thereafter, no trusts were reported on the inheritance tax return filed by his heirs.

The French tax authorities first challenged the inheritance tax returns filed by Daniel's heirs in 2011. Daniel W's heirs were notified of the tax reassessment concerning inheritance tax. The reassessment related to the undervaluation and omission of the assets held in trust. At the same time, French tax authorities filed a complaint for tax fraud against Daniel W's heirs.

At the end of 2012, a second complaint was filed for tax fraud against Alec W's heirs. The French tax authorities notified the heirs of the reassessment concerning inheritance tax based on the same grounds as the reassessment made on Daniel's estate.

After a judicial investigation, eight individuals were referred to the Criminal Chamber on charges of tax fraud, complicity in tax fraud, and laundering of tax fraud proceeds. The charges were brought against the heirs of both estates, as well as the notary and two lawyers. The trustee and the trusts' protectors were also involved in the criminal proceedings.

It is worth highlighting that the criminal judge delivered a verdict while the case before the tax court was still ongoing. In France, the courts and their jurisdiction are independent of one another, allowing a plurality of procedures, verdicts, penal sanctions, and tax penalties.

One of the major issues in this case was the fact that both Daniel and Alec died before the entry into force of the Amending Finance Law for 2011 of 29 July 2011 (n°2011-99), which created a set of rules regarding the treatment of trusts for French tax purposes. However, for taxable events which took place before 30 July 2011, the French tax authorities and the Tax Courts' judges have to analogize the trust to a known legal concept under French law, such as an indirect gift or inheritance.

For example, if the trust was liquidated and the assets held in trust were transferred to the beneficiaries of the trust upon the death of the settlor, the assets must be included in the inheritance tax return filed by the beneficiaries.

However, in this particular case, the various trusts of the W family were not liquidated upon the death of the settlor and continued to exist. As the assets remained held in trust with no transfer to the beneficiaries, the analogy to French civil succession law was not possible. Criminal judges are not authorized to extend taxation principles of trusts to a situation that has never been judged by French Tax Courts in order to overcome the silence of the law. As such, the Criminal Court was not in a position to characterize the legal element of the tax fraud offence.

The alternative was for the Court to determine whether the trusts were shams, in which case their purpose would not have been to complete any transfer of legal ownership from the settlor to the trusts but to conceal the assets from the French tax authorities.

Thereupon, the judges questioned whether the trusts were genuinely discretionary and irrevocable. The assets were held through holding companies in which the trustees' powers were limited if not non-existent. The W family retained important powers over the assets, which was made possible by the interposition of the holding companies.

In this particular case, the judges determined that they did not have sufficient evidence to conclude that the trusts were shams, which would have required the inclusion of the assets held in trust as part of the estates of Daniel and Alec W.

As such, the Court discharged every defendant in the case. It appears to us that this decision is the result of a thorough legal reasoning and the Court took time to carefully substantiate and explain their decision. Yet, the Court did note that "*its decision is likely to be seen as defying common sense and to be poorly understood by the French people on whose behalf justice is rendered" and reminds us that "the purpose of criminal law and criminal procedure law, is of course to protect society, but along with this purpose it is also to protect the defendant. To ignore this aspect would be to fall into an arbitrary repression. In this respect, we are all concerned, and each and every one understands that by moving away the protection of the law for some people, who are powerful or destitute, it is agreeing to move it away for every one*".

The W case is far from being closed as the public prosecutor appealed the Criminal Chamber's decision and the tax proceedings are still pending before the Civil Court of Paris. Still, while remaining cautious regarding its progress, we can at this time only pay tribute to the rigorous legal reasoning, which we believe is useful and also good to have in a case concerning trusts in France.

Case Summaries

Switzerland

AC Treuhand: Deductibility of fines for Swiss tax purposes and other implications to the tax sector

by Marnin Michaels, Kevin Keen and Herbert Wohlmann (Zurich)

In its decision of 26 September 2016, the Supreme Court of Switzerland resolved a long-outstanding issue of Swiss tax law: the deductibility of punitive fines by companies for corporate tax purposes. The decision is broadly applicable to both fines under criminal law and administrative penalties of a criminal or punitive nature, regardless of whether imposed by Swiss or foreign authorities. Historically, the deductibility of these fines was a mostly uncertain matter and was left largely to the discretion of the cantonal tax authorities.

Following a historic multi-year US Department of Justice Program for Non-Prosecution Agreements or Non-Target letters for Swiss Banks (the "Swiss Bank Program"), the decision holds particular relevance to the banking industry. Of potentially greater significance, however, is the relevance to any other industry where corporate fines may be imposed. As the breadth of fines covered by the decision include those imposed by criminal courts, antitrust bodies, financial services authorities, environmental commissions and health authorities, the potential application to other industries is noteworthy.

Background of the AC Treuhand Case

AC Treuhand was the subject of a 2009 European Commission decision (the "2009 Decision") by which numerous companies were fined for their participation in alleged price fixing and anti-competitive schemes within the chemical sector. For its role in aiding the cartelists by arranging and participating in meetings, gathering and circulating data and facilitating payments between them in exchange for remuneration, AC Treuhand was fined EUR348,000.

In its 2009 financial statements, the company accounted for this amount, made reserves (*Rückstellungen*) for the payment of the fine, and then claimed it as a deduction on its corporate tax return. The Zurich Tax Authority denied the deduction on the basis that the payment was not a commercially justified expense. Upon appeal to the Zurich Tax Appeal Court, the denial of the deduction was found to be improper. This pro-deduction decision of the appellate court was subsequently confirmed on appeal to the Zurich Administrative Court, after which the Zurich Tax Authority appealed to the Supreme Court of Switzerland.

The Supreme Court ruled that fines and financial sanctions with a penal character are not deductible, as these are not costs based on business (*geschäftsmässig begründeter Aufwand*). However, if the sanction is only to draw back illegally received profit (*unrechtmässig erlangter Gewinn*), then a deduction is acceptable. The court reasoned that allowing punitive fines to be tax deductible by companies would effectively cause the community to indirectly bear the costs of such fine, thereby circumventing the penal effect of the sanction.

Federal law on the tax treatment of financial sanctions

The decision of the Supreme Court was made before the *Bundesrat* published its draft of a law addressing the deductibility issue (*Bundesgesetz über die steuerliche Behandlung finanzieller Sanktionen*). The draft law provides, *inter alia*, that companies should not be able to deduct financial criminal penalties and bribes for tax purposes. The court's decision and the proposed law are nearly identical. Thus, as a practical matter, the law upon its enactment will be valid retroactively to the date of the court's decision.

Other implications to the tax sector and Swiss industries

The applicability of the court's decision is broad in scope. As the fine imposed on AC Treuhand was not from a Swiss legal body, it naturally follows that the decision applies to both Swiss fines and non-Swiss fines. These fines could therefore be imposed by criminal courts, antitrust bodies, financial services authorities, environmental commissions and health authorities of Switzerland, another state or a collective body of states.

A key consideration is whether tax fines fall within the scope of the decision. There is one essay that has been published in *Jusletter*, February 2014, by Peter Hongler and Fabienne Limacher. They argue that Swiss "*Steuerbussen*" are not deductible because Article 59 (1) lit. A of the DBG ("but not tax penalties"), but this does not distinguish Swiss from foreign tax fines.

Query whether the fines imposed on Swiss banks as part of the Swiss Bank Program would actually qualify as tax fines. The fines were imposed upon the banks not because of their failure to pay taxes, but because they helped their clients hide their accounts from a non-Swiss tax authority. These facts seem to parallel the "facilitator" role of AC Treuhand in the anti-competition context that gave rise to the 2009 Decision. Indeed, the Swiss Bank Program fines imposed are derived from the revenue of the banks, so a deduction for Swiss tax purposes should be appropriate.

Furthermore the amount of each fine was proportional in two ways: (1) temporally, in that the fine was linked to the point in time that the wrongdoing occurred (what seems to be a penal factor), and (2) the magnitude of the accounts on which the fine was based (what seems to be a revenue-based factor). Insofar as fines imposed are reached by settlement, this may support the basis for deductibility.

In the "*Sonntagszeitung*" of 18 December 2016, a new law in France was detailed. The law allows taxpayers to settle with the authorities without an admission of guilt. If one can negotiate and resolve a conflict without an admission of guilt, the penal character of the sanction may at least be questionable.

It is important to note that some Swiss Bank Program banks may have paid a small fine that was rivalled by the collective legal, accounting and administrative costs borne by the bank in respect of the Swiss Bank Program. If the competent tax authorities ultimately deem a particular Swiss Bank Program fine to be non-deductible, it is likely that a deduction for any costs related to such fine that do not otherwise have an independent business basis would similarly be disallowed.

Although the Supreme Court decision does not set forth specific, measurable factors for determining the deductibility of fines for Swiss corporate tax purposes, further guidance may be forthcoming from the cantonal courts and tax authorities. The specific framework for analyzing the deductibility of fines will vary depending on the particular type of fine imposed and is highly fact-specific. In the case of the Swiss Bank Program and its related fines, for example, relevant factors include the revenue earned by the banks involved, the lost tax revenue to the United States on its taxpayers' undisclosed accounts, amounts paid in lieu of an admission of wrongdoing and additional amounts imposed for "aggravating" factors.

Conclusion

The tax treatment of fines, penalties and penal sanctions was, until recently, an unclear area of Swiss law that varied between cantons. Now that Switzerland's highest court has ruled on the issue, and with the forthcoming enactment of the Federal Law on the Tax Treatment of Financial Sanctions, these legal uncertainties are now resolved. Fines and financial sanctions with a penal character are not deductible; profit-taking sanctions without a penalty are still deductible.

Not only is the decision relevant in light of the Swiss Bank Program, but it also holds significance for any other Swiss corporate taxpayer that might be subject to a criminal or administrative fine by Swiss or non-Swiss authorities. A key takeaway from the decision is that proper planning can and should be undertaken where possible prior to the imposition of a penalty (e.g., during settlement discussions or negotiation with the authorities) to influence the characterization of the fine imposed.

United States

15 West 17th Street LLC v. Commissioner

by Paul DePasquale and Adam Brownstone (New York)

In *15 West 17th Street LLC v. Commissioner* (147 T.C. No. 19) (2016), the Tax Court held for the IRS in a case involving a USD64.5 million charitable deduction. *15 West 17th Street LLC* is a reminder that deductions are a matter of legislative grace and taxpayers ordinarily must be able to prove entitlement to a deduction. The case is also noteworthy because of the Tax Court's analysis of non-self-executing tax statutes.

Summary of the facts

The LLC owned a building in Manhattan, New York. The LLC donated a conservation easement on the property to an organization described in Section 501(c)(3) of the US Internal Revenue Code that was also a "qualified organization" for qualified conservation contribution purposes (the "Donee"). The LLC claimed a deduction of around USD64.5 million as a charitable contribution on its 2007 partnership return. The Donee did not refer to the conservation easement on its originally filed 2007 Form 990 (Return of Organization Exempt from Income Tax). The IRS denied the LLC's charitable deduction and imposed penalties. The Donee filed an amended Form 990 in 2014 on which it described the 2007 easement.

Substantiating charitable contributions

A taxpayer can deduct a charitable contribution subject to certain limitations and requirements. One of those requirements is that the taxpayer must substantiate any contribution of USD250 or more by contemporaneous written acknowledgment from the donee. The acknowledgement must specify the amount of cash and a description of non-cash property contributed and state whether the donee provided any goods or services for the contribution (and additional information regarding any such goods or services). To be "contemporaneous", the donee must provide the acknowledgement before the donor files its tax return for the year of the contribution (or the due date including extensions, if earlier than the filing date).

The substantiation rules require the donor to substantiate the contribution. However, these rules also provide that "[the donor substantiation requirement] shall not apply to a contribution if the donee organization files a return, *on such form and in accordance with such regulations as the Secretary may prescribe* . . ." (emphasis added). The IRS has not issued forms or promulgated regulations implementing donee substantiation as an alternative to donor substantiation. The IRS issued proposed regulations addressing this issue in 2015 and then withdrew the proposed regulations. A key issue in *15 West 17th Street LLC* is whether the LLC could rely on alternative donee substantiation.

The take away

The Tax Court held that the general donor substantiation requirement applies to the easement in the case and that the donee substantiation alternative was not available because the donee substantiation alternative was not self-executing under the Code. The Tax Court found that Congress authorized Treasury to issue forms and regulations to implement alternative donee substantiation but that Congress did not direct or mandate that Treasury do so. As a result, the language providing for alternative donee substantiation was inoperative.

Reporting offshore corporations and the lasting effects of noncompliance

by Sophia Han and Paul DePasquale (New York)

Failure to comply with reporting requirements can attract penalties and have lasting consequences for taxpayers. In *Flume v. Comm'r* (T.C. Memo 2017-21), the US Tax Court upheld IRS penalties for the Taxpayer's failure to file Form 5471 to report his interest non-US corporations. The Tax Court denied the Taxpayer's request for relief from the penalties.

A US person who controls a non-US corporation must file Form 5471. This reporting obligation applies if the US person falls within one of four categories that trigger reporting. US persons file Form 5471 with their timely filed US federal income tax return. Aside from the penalties, failure to file Form 5471 can adversely affect the taxpayer's foreign tax credit position. A critical reason to ensure that the Form 5471 is filed when required is that the statute of limitations on the taxpayer's entire tax return stays open if Form 5471 is not filed when required - this means that the IRS can audit the entire return indefinitely.

In *Flume*, the Taxpayer was a US citizen residing in Mexico. In 2001 and 2002, he owned 50% of a Mexican Sociedad Anónima de Capital Variable (the "Mexican SA"). Another US citizen owned the remaining 50% of the Mexican SA. The Mexican SA was a controlled foreign corporation ("CFC") for 2001 and 2002. The Taxpayer reduced his interest in the Mexican SA to 9% in 2002.

The Taxpayer and his wife incorporated a Belizean international business company ("Belizean IBC") in 2001. The Belizean IBC issued two bearer shares, one to the Taxpayer and one to his wife. The Taxpayer was the president and director of the Belizean IBC. The Belizean IBC was a CFC in 2001 through 2009. The Belizean IBC opened a Swiss bank account in 2005 and the Taxpayer and his wife had signature authority over the account.

A US shareholder of a CFC that meets an ownership threshold (generally 10% by vote) must file Form 5471. The Taxpayer timely filed his tax returns but did not attach Form 5471. He argued that he actually owned less than 10% of the Belizean IBC but the Tax Court found that he did not prove his position. The Taxpayer did not have reasonable cause for noncompliance because he did not inform his advisor of his interest in the Mexican SA and the Belizean IBC. Accordingly, the Tax Court rejected his request for relief from the penalties.

US persons that have interests in non-US corporations should analyze their arrangements to ensure they comply with applicable reporting obligations. US persons should speak with their advisors if there is any question about when an international reporting obligation may or may not apply. Providing the advisor with sufficient information about a structure can maintain the possibility of reasonable cause relief.

Izen v. Commissioner, 148 T.C. No. 5 (1 March 2017)

by Elliott Murray (Geneva) and David Gershel (Zurich)

In 2007, Taxpayer purchased a 50% interest in a 1969 private jet for USD21,000. The airplane remained in storage until Taxpayer allegedly donated his interest[1] to the Houston Aeronautical Heritage Society ("Society"), a tax-exempt organization. US taxpayers are entitled to a tax deduction for charitable contributions. However, special rules must be followed to substantiate a charitable contribution of an automobile, boat, or airplane; otherwise the deduction will be disallowed.[2]

Taxpayer's 2009 and 2010 income tax returns were under examination, and Taxpayer previously petitioned the Tax Court challenging the disallowance of unrelated deductions. During the proceedings,

[1] The other 50% interest in the airplane was donated by Taxpayer's co-owner at the same time.
[2] The Internal Revenue Code of 1986, as amended ("IRC"), § 170(f)(12).

the Tax Court granted Taxpayer's motion to file an amended 2010 tax return, which was filed in 2016 claiming for the first time a deduction for the airplane contribution. Taxpayer included with his amended return: (1) an acknowledgment letter from Society; (2) a Form 8283, *Noncash Charitable Contributions*, executed by the managing director of Society dated April 13, 2016; (3) a copy of an "Aircraft Donation Agreement" allegedly executed on December 31, 2010, signed only by the president of Society; and (4) a 2011 appraisal valuing Taxpayer's interest in the aircraft, as of 30 December 2010, at USD 338,080. The IRS did not accept the amended return.

On motion for summary judgment, the IRS argued that Taxpayer's charitable deduction should be denied because he failed to satisfy the substantiation requirements for contributions of vehicles. Taxpayer argued that all defects had been cured on his 2010 amended return.

The US Internal Revenue Code specifically disallows deductions for contributions of "qualified vehicles"[3] unless the taxpayer obtains a "contemporaneous written acknowledgment" from the donee and attaches it to the taxpayer's tax return.[4] The acknowledgment must contain the donor's name and taxpayer identification number ("TIN"), the vehicle identification number, a certification of the intended use or material improvement, and a certification that the vehicle would not be transferred for money, other property, or services.[5] In addition, the acknowledgment must be contemporaneous—meaning provided by the donee within 30 days of the contribution.[6]

Upon review, the Tax Court held that the donation agreement could not be considered a de facto contemporaneous written acknowledgment. Specifically, the agreement lacked both Taxpayer's TIN and a certification of Society's intended use. Taxpayer argued that the court should read the amended return together with the donation agreement to find that the agreement met the requirements; however, the Tax Court reasoned that Taxpayer could not rely on the amended return filed in 2016 to supplement the 2010 donation agreement, which was lacking the required information.[7]

The Tax Court noted that Congress enacted the strict substantiation requirements to address serious tax compliance issues relating to charitable contributions of used vehicles. The Tax Court also cited past jurisprudence holding that the "doctrine of substantial compliance" will not cure noncompliance with the "statute's specific demands." *Izen* is, thus, an important reminder that many forms of charitable contributions require taxpayers to meet substantiation and filing requirements to receive deductions, and these requirements are often heightened for contributions of property including vehicles. Further, taxpayers would be well advised to consider the requirements in the year of the donation and not wait until a tax return is required to be filed.

The DOJ acts to foreclose against widow's home in Wyly Tax fraud case

By Caleb Sainsbury (Zurich)

On 9 February 2017, the United States Department of Justice filed a complaint in federal court to foreclose on the home of Caroline Dee Wyly, the widow of Charles Wyly (*United States v. Miller, N.D. Tex., No. 3:17-cv-00384-M, complaint dated February 9, 2017*). This is the latest step in a drawn-out saga caused by brothers Charles and Sam Wyly's use of off-shore trusts to commit tax and securities fraud. The home is located in Dallas and worth reportedly USD8 million.

[3] Qualified vehicles are defined as any "(i) motor vehicle manufactured primarily for use on public streets, roads, and highways, (ii) boat, or (iii) airplane." IRC § 170(f)(12)(E).
[4] IRC § 170(f)(12)(A)(i). In addition, if the done organization does not put the vehicle to "significant intervening use or material improvement" prior to a sale, the deduction is limited to the gross proceeds from the sale. IRC § 170(f)(12)(A)(ii).
[5] IRC § 170(f)(12)(B).
[6] IRC § 170(f)(12)(C)(ii).
[7] The Tax Court also noted that Taxpayer's argument "would be more compelling if the Society had filed … a Form 1098-C." However, the Society did not file a Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes*, with the IRS as required of donee organizations issuing acknowledgements. IRC § 170(f)(12)(D); Instructions to Form 1098-C.

By way of background and as reported in a previous edition of this newsletter, in May 2016, a US bankruptcy court judge in Texas ruled that billionaire Texas business moguls Charles and Samuel Wyly committed tax fraud in using offshore nongrantor trusts to hide income from the US Internal Revenue Service. (*In Re: Samuel E. Wyly, et al. (Bankr. N.D. Tex. 2016*)). In connection with the ruling, the IRS filed a lawsuit against the estate of Charles Wyly to collect USD 249 million in penalties for failure to file certain forms to report the offshore trusts (*United States v. Miller, N.D. Tex., No. 3:16-cv-02643, complaint dated September 15, 2016*). Charles Wyly had passed away in the meantime and the burden of the lawsuit fell on his estate and his widow, Caroline Wyly. Even though the court found that Caroline Wyly was an "innocent spouse" with respect to much of the fraud, it determined she still needed to pay approximately USD37 million for unpaid gift taxes and failing to file the necessary reporting forms on the offshore assets.

Prior to the ruling in the tax fraud case, the Wylys were ordered to pay the United States Securities and Exchange Commission nearly USD300 million in 2014 for engaging in securities fraud. Shortly after this order, Caroline Wyly filed for Chapter 11 Bankruptcy protection. However, the bankruptcy proceeding was converted to a Chapter 7 Bankruptcy on 26 October 2016 after Caroline Wyly's reorganization plan under Chapter 11 Bankruptcy was denied (*In Re: Samuel E. Wyly, et al. (Bankr. N.D. Tex. 2016*), *order dated October 26, 2016*). The primary difference between a Chapter 11 and Chapter 7 bankruptcy proceeding is a Chapter 11 proceeding involves the reorganization of debts whereas a Chapter 7 proceeding involves a liquidation of assets to pay debts. The practical result of this order was that now Caroline Wyly's assets were at risk of being liquidated to pay her debt.

Up until last month, an automatic stay had been granted preventing the sale of Caroline Wyly's home in Dallas. However, on 7 February 2017, the bankruptcy court entered an order lifting the automatic stay and specifically granted the United States the ability to file a tax lien against the property and sue to foreclose on that lien (see *United States v. Miller, N.D. Tex., No. 3:16-cv-02643, complaint dated February 9, 2017)*. Once that stay was lifted, the United States government moved quickly to exercise its rights and begin the foreclosure proceeding.

Thus, the important takeaway factor in this ongoing saga is the United State government will pursue individuals who have committed fraud and use the legal system to collect on taxes owed. In addition, as this case proves, one cannot assume their home will be exempted from the list of assets the United States government will attempt to seize and sell.

Legislative Developments

Argentina

Tax Information Exchange Agreement between Argentina and the United States of America

by Martín Barreiro and Juan Pablo Menna (Buenos Aires)

On 23 December 2016, Argentina and the United States of America entered into a Tax Information Exchange Agreement (the "Agreement").

I. Exchange of tax information

The Agreement sets forth mechanisms for upon request, automatic and spontaneous exchanges of tax information between Argentina and the United States, being applicable to all matters related to any kind of federal taxes established by both countries.

Notwithstanding the above, the request can be denied when the applicant party would not be able to obtain the information under its internal regulations, the request is not made in conformity with the Agreement or when the applicant party has not pursued all means available in its own territory to obtain the information.

II. Exchange of information upon request

The Agreement requires a justified cause and a defined purpose for a request of information.

In this regard, the Agreement establishes that when the exchange is made upon request, the interested party will have to send a request indicating with the greatest level of detail the following information: (i) identity of the person under investigation, (ii) a statement of the information sought, (iii) fiscal years, (iv) tax matter to which it relates, (v) grounds for the request, (vi) name and address of the person or entity believed to be in possession of the information (if known) and (vii) a statement that the request is made in conformity with the law of the applicant Party, and that such Party has pursued all means available in its own territory to obtain the information.

The Agreement also establishes that the parties must have the capacity to obtain and provide information held by banks and information related to the ownership of companies, trusts and foundations, including information about the entities that comprise the chain ownership.

The party that receives the request will have 90 days to obtain and provide the information, having the obligation of notifying any deficiencies within 60 days of the receipt of the request.

III. Automatic and spontaneous exchange of information

The Agreement subjects the automatic and the spontaneous exchange of information to the execution of additional agreements that regulate such possibilities.

IV. Entry into force

The Agreement has already been published on the website of the US Treasury Department on 24 January 2017, and will enter into force one month from the date of receipt of Argentina's written notification to the United States that it has completed its necessary internal procedures for entry into force of this Agreement, as set forth by its Article 14.

The Agreement shall have effect for requests made on or after the date of entry into force, concerning information for taxes relating to taxable periods beginning or charges to tax arising on or after 1 January 2018, or, where there is no taxable period, for all on or after 1 January 2018.

It should be noted that the Agreement can not be characterized as a Double Taxation Treaty.

Tax Information Exchange Agreement executed between Argentina and the United Arab Emirates

by Martín Barreiro and Juan Pablo Menna (Buenos Aires)

On 3 February 2017, the Tax Information Exchange Agreement entered into Argentina and the United Arab Emirates (the "Agreement") was published on the Official Gazette.

I. Tax Information Exchange Agreement

The Agreement sets forth mechanisms for the exchange of tax information between Argentina and the United Arab Emirates, being applicable in Argentina to matters related to Income Tax, Value Added Tax, Personal Assets Tax and Minimum Deemed Presumed Income and to other similar taxes established by the United Arab Emirates.

The exchange of information will take place upon request, and can be denied when the applicant party would not be able to obtain the information under its own laws for purposes of the administration or enforcement of its own tax laws and if the request is not made in conformity with the Agreement.

II. Entry into force

The Agreement entered into force on 17 January 2017.

Release of repatriation and settlement obligations as regards the payment of services

by Gabriel Gómez-Giglio and Francisco José Fernández-Rostello (Buenos Aires)

The Argentine Central Bank ("ACB") issued Communication "A" 6137 (the "Communication") removing the obligation to repatriate and settle in the local foreign exchange market the funds originated in the provision of services to non-residents as well as the disposal of non-produced non-financial assets.

In addition the Communication reversed the requirement that transactions involving the purchase of foreign currency in excess of USD2,500 could only be debited to an account opened with a local financial institution.

Draft bill to establish corporate criminal liability

by Fernando Goldaracena, Vanina Caniza and Luis Dates (Buenos Aires)

During the recent opening of the ordinary sessions of the National Congress, President Macri promised substantial amendments to criminal legislation, in particular the draft bill introduced to Congress in October 2016, that establishes corporate criminal liability on corruption crimes (the "Draft Bill").

The Draft Bill establishes penalties for legal entities who have participated in any offense against the public administration and/or transnational corruption. Thus, the Draft Bill would finally adapt our legal system to international standards.

Furthermore, the Draft Bill intends to prevent cases of corruption and accelerate the existing investigations on corruption offences, in order to improve effectiveness of punishment on those responsible for such offences.

In this sense, such Draft Bill also provides penalties that includes fines of up to 20% of the annual gross income of the year prior to the alleged offence for which the company would be sanctioned.

As a general guideline for the penalties, judges shall take into consideration, among other aspects, the level and consistency of the measures taken to control and supervise any such corruption offence by an "*adequate*" compliance program ("*programa de integridad adecuado"*).

If the Draft Bill becomes into Law, decisions within a company would consider the implementation of the adequate measures to prevent, detect and alert the authorities to any criminal offences, such as codes of ethics, periodic training, *hot-lines* available, and any other procedure that would allow the company to obtain information related to third parties' and/or regular and/or occasional business partners.

Colombia

Colombia new developments: UBO's and CFC's rules

by Rodrigo Castillo, Alejandra Becerra and Ana María López (Bogota)

Through the tax reform approved by the Colombian Congress on 29 December 2016 (Law 1819 of 2016) numerous anti-avoidance rules were approved with the aim of tackling tax evasion. Among others, these anti-avoidance mechanisms include a definition of *Ultimate Beneficial Owner* - UBO - and the establishment of a Controlled Foreign Corporations regime - CFC - for tax purposes.

1. Ultimate beneficial owner

1.1. Pursuant to new article 631-5 of the Colombian Tax Code ("CTC"), an ultimate beneficial owner is an individual who complies with any of the following conditions:

(a) Has effective control, directly or indirectly, on a resident entity, a mandatary, a local trust, a mutual fund or a permanent establishment of a foreign company.

(b) Benefits, directly or indirectly, from the operations and activities carried out by a national entity, a mandatary, a trust, a mutual fund or a permanent establishment of a foreign company.

(c) Has 25% or more of the capital or voting rights of a resident entity, a mandatary, a trust, a mutual fund or a permanent establishment of a foreign company.

1.2. The identification of the UBO is a mandatory regime and it is necessary for the Colombian Tax Office to comply with the automatic exchange of information commitment, in accordance with the Common Reporting Standard - CRS. Breaches in complying with the identification of the UBO may result in fines for taxpayers.

2. CFC rules

2.1. Any entity[8] (i) controlled by one or more Colombian tax residents (subordinated or related parties) and (ii) not domiciled/resident in Colombia may be deemed to be a Controlled Foreign Company - CFC - for tax purposes. Therefore the controlling entities/individuals and any other with a participation of 10% or more in the capital or rights to benefits from the controlled entity must comply with the reporting obligations of the new CFC regime.

2.2. In order to determine the existence of control, the definition of subordinate entities[9] and foreign related parties[10] applicable for transfer pricing purposes must be observed. There would also be a presumption of control in cases where the "vehicle" is resident, incorporated or operating in a tax haven or under a preferential entities tax regime.

2.3. Once the control occurs, every Colombian tax resident with a participation of 10% or more in the capital and results of the CFC must include in his/her/its income tax return the income, costs and expenses related to passive activities carried out by the controlled entities and pay taxes on it. Losses cannot be applied or carried forward by the Colombian taxpayer having control over the entity.

2.4. The CFC regime comprises passive income derived from:

(a) Dividends or income participations;

(b) Interest or financial income;

(c) Transfer or exploitation of intangible assets;

(d) Disposal or assignment of rights over assets that generate passive income, sale or lease of real estate;

(e) Purchase or sale of tangible assets acquired or alienated from, for, or on behalf of a related party, that are produced and used in a jurisdiction other than that where the CFC is domiciled; and

(f) Provision of technical services, technical assistance, administrative, engineering, architectural, scientific, qualified, industrial and commercial services, for or on behalf of related parties in a jurisdiction other than where the CFC is domiciled.

2.5. Additionally, if the CFC's passive income represents 80% or more of its total income, all income, costs and deductions will be considered as passive and therefore will be subject to the regime.

2.6. Law 1819 of 2016, also establishes a special treatment for the dividends and other benefits distributed by CFCs, according to which as far as the income from which they come has been declared and taxed under the CFC regime, could be distributed as non-taxable income to the CFC's Colombian owners.

[8] It includes corporations, trusts, mutual funds, other fiduciary businesses and private foundations, irrespective of whether they have legal status or whether they are transparent for tax purposes.
[9] Article 260-1 of the CTC provides that an individual or corporation has control over another one if, (i) he/she/it possesses holds directly or indirectly more than 50% of the entity's capital and participates proportionally in its results, or (ii) he/she/it participates in the management and has the capacity to control the business decisions of the controlled entity.
[10] Pursuant to numeral 5° of Article 260-1 of the CTC, there is economic entailment in transactions involving (i) two subordinates of a same parent entity, (ii) two entities controlled by the same corporation or individual or (iii) consortiums, temporary unions, joint ventures or other structures without legal personality.

European Union

Electronic filing of annual accounts will soon be mandatory

by M-C Brzezinski (Amsterdam)

It will no longer be possible for certain companies to file annual accounts with the Trade Register by mail or email. Electronic filing of the annual accounts will be mandatory.

When does this change become effective?

For micro and small companies, electronic filing became mandatory for annual accounts relating to financial years that started on or after 1 January 2016. For medium-sized companies, this requirement followed one year later, i.e. for annual accounts relating to financial years starting on or after 1 January 2017. Large companies will, for the time being, not be affected by this change.

A company qualifies as micro, small, medium-sized or large if it has met two or three of the following criteria on two consecutive balance sheet dates, without interruption afterwards on two consecutive balance sheet dates:

	Micro	Small	Medium	Large
Total value of assets	≤ EUR350,000	≤ EUR6 million	≤ EUR20 million	> EUR20 million
Net turnover	≤ EUR700,000	≤ EUR12 million	≤ EUR40 million	> EUR40 million
Number of employees	< 10	< 50	< 250	≥ 250

What does electronic filing of the annual accounts entail?

Electronic filing is mandatory for annual accounts prepared in accordance with Dutch generally accepted accounting principles.

There are two possibilities for micro and small companies to file their annual accounts by electronic means:

1. Standard Business Reporting (SBR); or
2. An online service offered by the Chamber of Commerce.

SBR is a uniform method of drawing up and delivering various financial and non-financial accounts electronically, directly based on data from a company's bookkeeping software. There should be a certain familiarity with this system, as it has been required for filing tax returns for a number of years.

The online Chamber of Commerce service is a web form in which you can manually insert all data relevant for preparing and filing annual accounts, free of charge.

What to do?

Micro and small companies must choose between the following three options to comply with the obligation to file their annual accounts electronically:

1. Request their financial adviser to prepare and file the annual accounts on their behalf using SBR;
2. Obtain the relevant software, as well as a government-issued server certificate used to authenticate and encrypt the filing process, in order to use SBR themselves; or

3. Create an account with the Chamber of Commerce to prepare and file the annual accounts themselves.

The first option has the advantage that, unlike the second option, no software or certificate is required and, unlike the third option, the data do not have to be entered into the system manually.

Shorter term for publishing the annual accounts

As a reminder, please note that annual accounts relating to financial years that started on or after 1 January 2016 must be filed for publication within 12 months of the financial year end. This deadline is one month shorter than the one for previous financial years.

France

French-qualified Restricted Stock Units: introduction of a new post-Macron "hybrid" regime or the semi-unravelling of the Macron regime

by Agnès Charpenet and Geoffrey Poras (Paris)

Act no. 2016-1917 of 29 December 2016, the 2017 Finance Act, introduces a new tax and employee regime for free shares.

On the employer's side, the new regime provides for the company a 30% (instead of 20% under the "Macron" regime) employer's social contribution, due at vesting date and based on the vesting gain (i.e. fair market value of the vested shares at vesting date).

On the beneficiary's side, the taxation depends on the amounts of the vesting gain:

For the fraction of the vesting gain not exceeding an annual limit of EUR300,000: the vesting gain is taxable on the same terms as those provided pursuant to the "Macron" regime, i.e.:

- the progressive income tax rates up to 45% with a 50% allowance when the shares are held for more than two years after the vesting date;
- the progressive income tax rates up to 45% with a 65% allowance when the shares are held more than eight years after the vesting date. Additional social taxes (CSG/CRDS) of 15.5% (of which 5.1% is tax deductible) apply on the entire vesting gain (with no allowance).

For the fraction of vesting gain exceeding an annual limit of EUR300,000: the vesting gain is taxable on the same terms as those provided by the regime applicable to qualifying free shares attributed after 28 September 2012 (and which are not eligible for the "Macron" regime), i.e.:

- the progressive income tax rates up to 45% in the category of wages and salaries (with no allowance)
- additional social taxes (CSG/CRDS) of 8% (of which 5.1% is tax deductible) apply on the entire vesting gain (with no allowance).
- Employee social contribution of 10% apply on the entire vesting gain (with no allowance).

It should be noted that the new regime will apply to French-qualified Restricted Stock Units (RSUs) granted pursuant to a shareholders' authorization dated after the date of publication of the 2017 French finance tax bill.

If the shareholders' authorization to grant French-qualified RSUs is effective before the publication of the 2017 Finance bill, then the Macron regime is applicable.

Seventeen (17) months only after the "Macron Law" and the latest French-qualified regime commonly called the "Macron regime", this new regime is a "half-step back" to the social and tax regime applicable to French-qualified RSUs granted as of 28 September 2012 and not under the Macron regime. However, this new regime keeps some of the favorable provisions of the Macron regime.

With this brand new regime, entities granting French-qualified RSUs have to deal now with three (3) different social and tax regimes that will coexist based on the date of grant but also on the date shareholders authorized the grants under which French-qualified RSU grant are made:

- French-qualified RSUs granted as of 28 September 2012 (not eligible for the Macron regime);
- French-qualified RSUs granted pursuant to shareholders' authorization as of 7 August 2015;
- French-qualified RSUs granted pursuant to shareholders' authorization as of 30 December 2016.

How long will this new regime last? Only the future will tell us.

Reinforcement of the impatriates' regime: Impatriate income tax regime of Article 155 B of the French Tax Code extended and exemption from payroll tax ("taxe sur les salaires")

by Agnès Charpenet and Geoffrey Poras (Paris)

Employees and senior executives who are deemed employees and are seconded or hired from abroad to fill a position in a company in France may, subject to certain conditions, benefit from the specific regime called the "impatriates' regime" (Article 155 B of the French Tax Code).

This regime was initially applicable until 31 December of the 5th calendar year following the year in which the employee started his position in France.

In order to strengthen France's attractiveness, and notably to attempt to take advantage of the Brexit effect, the term during which there is an exemption of French income tax is extended to 31 December of the 8th year following the year in which the employee starts his position in France.

This measure will apply to eligible employees who started their duties in France as of 6 July 2016. Employees who started their position in France prior to this date, therefore, are not affected by the extension.

It should be noted that the specific impatriate regime on French wealth tax provided by Article 885 A 1° of the French Tax Code is not affected by this extension. Therefore, such specific wealth tax regime is still applicable until 31 December of the 5th year after the year in which the impatriate has established or re-established his tax domicile in France.

This measure also provides for an exemption from the payroll tax ("taxes sur les salaires") for compensation that is eligible for a tax exemption pertaining to supplemental wages (wage items mentioned in Article 155 B I 1) paid to impatriate employees who are eligible for the specific impatriate income tax regime.

The exemption of payroll tax, therefore, does not apply to the portion of compensation for days worked abroad that is possibly exempted.

Lastly, this exemption will apply to compensation paid as of 1 January 2017.

Wealth tax and the anti-abuse mechanism regarding the capping mechanism

by Hervé Quéré and Malvina Puzenat (Paris)

Article 7 of the 2017 Finance Act enacts a mechanism of which the purpose is to prevent abuses pertaining to the wealth tax's capping mechanism by capitalizing distributed income.

As of the 2017 Wealth Tax, the French tax authorities may reincorporate into the taxpayer's income taken into account for the capping mechanism, the income distributed to a company controlled by the taxpayer and subject to corporate income tax (in practice, a holding company) if the tax authorities establish the following evidence:

- the main purpose of the company's existence and the reason for choosing to use it is to avoid all or part of the wealth tax, and
- the taxpayer benefits from a tax advantage that goes against the purpose or ultimate aim of the capping mechanism.

Report no. 140 of the Senate Finance Committee regarding this anti-abuse mechanism states that, "*within the framework of this strategy* [of locating investment income in a holding company], *the taxpayer's lifestyle is then most often provided for by taking out loans* […], *the payment by the holding company of a limited amount of dividends, accumulated savings*." The purpose, therefore, is to fight against the capitalization of distributed income in a company, thanks to which, "*the costs or income* [of the taxpayer] *are, for the capping's reference year and in the amount of this reassessment, provided, directly or indirectly, by this company in an artificial manner*" (Decision of the French Constitutional Court, Dec. 29, 2016, no. 2016-744 DC - recital no. 22).

The tax authorities' implementation of this mechanism, which will surely not be easy, borrows somewhat from the abuse of law procedure as the taxpayer may refer the matter to the Fiscal Abuse of Law Committee in the event of a disagreement with the tax authorities. Nevertheless, the 80% penalty applicable if an abuse of law is proven is not applicable in this case.

80% penalty for undisclosed foreign assets

by Malvina Puzenat and Emilie Suryasumirat (Paris)

The new penalty measures enacted by Article 110 of the 2016 Amending Finance Act takes into account the French Constitutional Court's decision of 22 July 2016, in which the Court ruled that the 5% proportional penalty applicable to undisclosed bank accounts held abroad with a value of more than EUR50,000 was disproportionate and unconstitutional, in cases where no tax has been avoided (Cons. const. QPC, Jul. 22, 2016 no. 2016-554).

The new penalties regime for failure to complete statements, which has to be applied as of 30 December 2016, may be summarized as follows:

	Failure to disclose an offshore bank account	Failure to disclose an offshore life insurance contract	Failure to disclose a trust linked to France
Penalties	• Flat-rate penalties (minimum penalties) o EUR1,500 o EUR10,000 (NCTCs) **OR** • 80% penalty based on the amount of taxes due in case of reassessment related to an undisclosed bank account	• Flat-rate penalties (minimum penalties) o EUR1,500 o EUR10,000 (NCTCs) **OR** • 80% penalty based on the amount of taxes due in case of reassessment related to an undisclosed life insurance contract.	• Flat-rate penalty (minimum penalty): o EUR20,000 **OR** • 80% penalty based on the amount of taxes due in case of reassessment related to undisclosed assets, rights or proceeds mentioned in Article 990 J III 1° and 2° and which should have been disclosed pursuant to Article 990 J of the FTC.
	The penalty cannot be lower than EUR1,500 or EUR10,000/EUR20,000 respectively		

The question of the applicability of the 5% and 12.5% proportional penalties if due to a simple failure to disclose life-insurance contracts and trusts held abroad is still open for the past.

Modifications of wealth tax exemptions (as of the 2017 wealth tax)

by Hervé Quéré and Malvina Puzenat (Paris)

Exemption of business assets: non-necessary assets for a business activity held by subsidiaries

Article 885 0 *ter* of the French Tax Code (FTC) limits the exemption of the value of shares which may be exempt as business assets to only the items of assets that are necessary for such company's business. This article, prior its amendment, had to be narrowly interpreted and, as a result, could not be applied to assets held by the company's subsidiaries and sub-subsidiaries in order to limit the exemption base (French Supreme Court, Comm. Div., Oct. 20, 2015 no.14-19.598 FS-PB).

Article 885 O *ter* of the FTC was completed to exclude from the amount of the wealth tax exemption the value corresponding to the shares or parts of subsidiaries and sub-subsidiaries which are not necessary for the business activity and which are held by subsidiaries and sub-subsidiaries, except in the case of a good faith taxpayer who does not have the necessary information to be aware of the situation.

Exemption of business assets: clarification of the term "normal remuneration"

Article 885 O *bis* of the FTC provided no definition of the term "normal remuneration", which was consequently defined by administrative doctrine (BOI-PAT-ISF-30-30-30-10 no.210) and case law (French Supreme Court, Comm. Div., 21/01/2004 no. 02-11.607 F-D).

Article 29 of the 2016 Amending Finance Act modifies Article 885 O *bis* of the FTC, reproducing the definition of remuneration provided by Article 885 I *quater* of the FTC pertaining to employees' and corporate officers' remuneration. Remuneration, therefore, must be normal compared to similar remuneration in the company or in companies established in France, and it must represent more than half of the taxpayer's professional income.

Partial exemption of 75% of the value of shares held by employees and corporate officers: remuneration must be paid for the person's main activity

Prior to its modification, Article 885 I *quarter* of the FTC did not state whether the corporate officers' main activity had to be remunerated. A decision of the French Supreme Court on 5 January 2016 (French Supreme Court, Comm. Div., Jan. 5, 2016 no. 14-23.681), stated that corporate officers did not have to be paid remuneration for their main activity.

As of the 2017 wealth tax, application of the partial exemption presumes that remuneration must be paid for employees' or corporate officers' main activity. This remuneration must be normal as compared with the same type of remuneration paid for analogous positions in the company or in similar companies established in France, and it must represent more than half of the taxpayer's income subjected to income tax, excluding non-professional income.

Taxes on the cash balancing payment paid in share contribution or exchange transactions

by Hervé Quéré and Malvina Puzenat (Paris)

In share contribution or exchange transactions, and in the case of payment of a cash balance not exceeding 10% of the shares received par value, the capital gains realized may be tax deferred (Article 150 0 B of the FTC and article 150 0 B ter of the CGI).

Henceforth, for share contribution or exchange transactions carried out as of 1 January 2017, deferring taxes on the contribution or exchange, capital gains will still be possible, but these capital gains, in the amount of the cash balance payment received, will be systematically taxed for the year during which the transaction was performed. The balance of the capital gains, meaning the amount above the cash balance payment, will be deferred for tax purposes.

Tax deferral measures: modification of reinvestment terms

by Hervé Quéré and Malvina Puzenat (Paris)

In a share contribution transaction benefiting from a tax deferral (Article 150 0 B ter of the FTC), the company receiving these shares must hold them for a 3-year period. If the contributed shares are sold before this 3-year period expires, the tax deferral ends, unless 50% of the sales proceeds is reinvested within a 24-month period as of the sale.

Three modifications were made:

- reinvestment in assets not devoted to an economic activity is excluded, but, on the other hand, reinvestment by acquiring a fraction of the capital of a company conducting an economic

activity located within the European Union or within the EEA is now possible, provided that such activity is subject to a tax comparable to the corporate income tax;

- shares or assets acquired within the framework of reinvestment must be held for at least 12 months;
- in case of a payment of a price complement, administrative doctrine stated, without any legal basis for doing so, that the 50% reinvestment threshold had to be assessed with respect to the sales price and the related price complement. This clarification is now included in the wording of Article 150 0 B ter of the CGI.

Italy

Implementation guidelines on new beneficial tax regime for new residents

by Francesco Florenzano and Giulio Allevato (Milan)

On 8 March 2017, the Italian tax authorities released official guidelines ("Guidelines") aimed at implementing a beneficial tax regime (the "Regime") for foreigners who relocate their tax residence to Italy, as well as returning Italian citizens.

Main features and scope of application

As already discussed, eligible taxpayers – i.e., individuals who have not qualified as Italian tax residents for at least nine of the past 10 years – may opt for the application of an annual EUR100,000 substitute tax on their foreign-sourced income.

Therefore, no Italian statutory progressive tax on foreign-sourced income will be levied, provided that the annual EUR100,000 substitute tax is paid and irrespective of the actual amount of the foreign income and its remittance to Italy.

An additional and ancillary consequence of the Regime consists in the exemption from gift and inheritance tax on the applicant's transfer of assets and rights located outside of Italy.

Capital gains arising out of transfers of significant interests in foreign companies generated in the first five years are subject to Italian statutory taxation (which, however, grants an exemption of roughly 50%).

Qualifying individuals can benefit from the Regime for up to 15 years. The **election can be withdrawn at any time**, save for any effects prior to the withdrawal. The above features concerning the freedom to remit assets and funds to Italy and the length of the Regime's duration make it more appealing than many other regimes.

Election

In the newly released guidelines, the Italian tax authorities have clarified that electing for the Regime must be exercised by the **deadline for submitting the tax return** related to the fiscal year in which the qualifying individuals become Italian tax residents (**ie, by 30 September 2018 for fiscal year 2017**) or the following fiscal year.

It is worth highlighting that, although the law through which the Regime has been introduced requires **taxpayers to pursue tax authorities' approval by means of an advance ruling**, the Guidelines seem to connect the effectiveness of the election to the mere filing of the official application form with the tax authorities (and to the extent that all of the necessary information is disclosed in the form), regardless of obtaining an advance ruling.

However, it is still advisable to seek an advance ruling from the tax authorities at least four months before the deadline for filing the tax return in which the election is made (the tax authorities have 120 days to respond to a request). **Furthermore, the Guidelines clarify that a request for an advance ruling can be filed even before the individual moves to Italy**.

The new legislation also provides for an **expedited visa process** for foreigners wishing to adhere to the Regime.

It is possible to exclude income generated in certain jurisdictions from the scope of the Regime, provided that such jurisdictions are expressly listed in the application form. Such foreign-sourced income will therefore be subject to **Italian statutory taxation** (or to the taxation laws provided for under the relevant double tax treaties between Italy and the other jurisdiction) and benefit from a **tax credit**.

Furthermore, an **election** for the Regime can be **extended to one or more relatives** of the qualifying individuals, provided that the relatives meet the requirements for the Regime and also relocate their tax residence to Italy. In such a case, the annual substitute tax related to each relative will amount to **EUR25,000**.

The Guidelines clarify that, if a qualifying individual withdraws or is excluded from the Regime, the relatives are also automatically pushed out of the Regime's scope, unless they expressly opt for the continuation of the Regime in regard to their individual positions.

Final considerations

The Regime represents a **new option to be considered by High Net Worth Individuals** ("HNWIs") who are looking for a jurisdiction which combines a **good lifestyle** with **tax optimization**.

In addition, as briefly illustrated in the paragraphs above, the Regime seems to offer **better and more straightforward conditions than the regimes currently implemented by many other jurisdictions**.

However, as we believe that it will take a considerable amount of time to collect and file the inherent documentation and to accurately evaluate all of the relevant aspects of an individual's position, it is advisable that those individuals who are interested in adhering to the Regime beginning in 2017 **initiate their consultation with their tax and wealth advisers as soon as possible**.

Deciding to adhere to the Regime certainly requires **advance and detailed tax and legal planning** in order to carefully evaluate the eligibility requirements, to design and implement an advance asset restructuring, to take into due account the outbound jurisdiction's domestic tax law (eg, exit taxation, deemed domiciled status for some moving from the UK) and to test the interaction of the regime with tax treaty law, source countries' tax law and relevant succession and family law.

Malaysia

Automatic Exchange of Information and Common Reporting Standards in Malaysia

by Adeline Wong, Istee Cheah, Joyce Khoo and Sarah Sheah (Kuala Lumpur)

In efforts towards global transparency, over 100 countries have agreed to automatically exchange information relating to financial accounts ("AEOI") with each other under the Convention on Mutual Administrative Assistance in Tax Matters ("Convention"). The OECD had also developed the Common Reporting Standards ("CRS") which set out the common information to be collected and reported by financial institutions of participating jurisdictions, for purposes of implementing AEOI locally.

As part of Malaysia's commitment to implement AEOI, Malaysia had:

a) on 27 January 2016, signed the Multilateral Competent Authority Agreement which details the rules on exchange of information between participating jurisdictions; and

b) on 25 August 2016, signed the Convention in view of fostering all forms of administrative assistance in tax matters with the other signatories of the Convention.

New legislation in Malaysia

On 23 December 2016, the following legislation was introduced in Malaysia:

a) the Income Tax (Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information) Order 2016;

b) the Income Tax (Convention on Mutual Administrative Assistance in Tax Matters) Order 2016; and

c) the Income Tax (Automatic Exchange of Financial Account Information) Rules 2016 ("AEOI Rules").

Exchange of information by Malaysia

Under the new legislation, Malaysia has committed to exchange information with respect to different types of accounts opened and maintained by Malaysian financial institutions in accordance with the following timelines:

Type of accounts		Intended date for the exchange of information
New account (generally refers to a financial account opened on or after 1 July 2017)		September 2018
Pre-existing account (generally refers to a financial account opened as of 30 June 2017)	Individual high-value account[11]	September 2018
	Individual low-value account[12]	September 2018 or September 2019, depending on when the account is identified as reportable
	Entity account	September 2018 or September 2019, depending on when the account is identified as reportable

The Inland Revenue Board of Malaysia ("IRB") has announced that the first list of reportable jurisdictions will be published by 15 January 2018, and will be revised by 15 January of the following years.

Obligations of the Malaysian Financial Institutions

The AEOI Rules, which came into effect on 1 January 2017, implements the CRS in Malaysia, with certain modifications. The AEOI Rules apply to every Reporting Financial Institution, which is defined as a Financial Institution that is resident in Malaysia (excluding any branch of that Financial Institution that is located outside of Malaysia) and any branch of a Financial Institution that is not resident in

[11] Generally refers to an account with an aggregate balance or value that exceeds USD1,000,000.00 as of 30 June 2017, 31 December 2017 or 31 December of any subsequent year.
[12] Generally refers to an account with an aggregate balance or value that does not exceed USD1,000,000.00 as of 30 June 2017.

Malaysia if that branch is located in Malaysia. A Financial Institution is defined under Section VIII of the CRS.

Under the AEOI Rules, every Reporting Financial Institution is required to comply with the following:

1. Due diligence requirements

Each Reporting Financial Institution is required to identify the relevant reportable accounts maintained by the Reporting Financial Institution by applying the relevant due diligence procedures as prescribed under the CRS. There are different due diligence procedures depending on whether these are pre-existing accounts or new accounts, and whether such accounts are held by individuals or entities. The Reporting Financial Institutions are required to complete the due diligence review in respect of its account holders in accordance with the timeline below:

Type of accounts		Deadline for completion of review
Pre-existing high value individual account		30 June 2018
Pre-existing low value individual account		30 June 2019
Pre-existing entity account	Aggregate account balance or value that exceeds USD250,000 as of 30 June 2017	30 June 2019
	Aggregate account balance or value that does not exceed USD250,000 as of 30 June 2017	Within the calendar year[13] of the following year in which the aggregate account balance or value exceeds USD 250,000

2. Reporting obligations

Every Reporting Financial Institution is required to furnish an information return to the Director General of Inland Revenue ("DGIR") on or before 30 June of the year following the calendar year to which the return relates. As such, the first reporting in respect of the calendar year 2017 will be required to be made to the DGIR by 30 June 2018. The reporting would need to be made via the IT platform maintained by the IRB, the details of which are expected to be released later this year.

The information return will need to contain certain details relating to each reportable account, including the name, address, jurisdiction(s) of residence, tax identification number(s) of the account holders, and the account balance or value as of the end of the relevant calendar year (or, if the account was closed during such year, the closure of the account).

New penalties

The Finance Act 2016, which was gazetted on 16 January 2017, introduces new penalty provisions to the Malaysian Income Tax Act ("MITA"). Under the proposed new Sections 113A and 119B of the MITA, it is an offence for any person to make an incorrect or false return, or fail to comply with any rules made to implement or facilitate any mutual administrative assistance arrangement (including the AEOI Rules).

[13] For this purpose, the following are treated as separate calendar years:
(a) 1 January 2017 to 30 June 2017; and
(b) 1 July 2017 to 31 December 2017.

Any person who is convicted of an offence under these new provisions will be liable to a fine of not less than RM 20,000 and not more than RM 100,000 and / or imprisonment for a term not exceeding six months.

Key takeaways

Most of the players in the financial industry are Financial Institutions within the meaning of the CRS, including banks, insurance companies, brokers, investment funds and trust companies. However, the classification rules under the CRS and AEOI Rules are complex and it is important for the industry players to undertake a detailed assessment of their internal activities in determining how these rules apply to them.

With the introduction of the AEOI Rules, it is also timely for Malaysian financial institutions to review and refine the customer due diligence procedures and internal processes to ensure that reportable accounts are identified in accordance with the AEOI Rules. On-going monitoring for changes in circumstances is also crucial in ensuring that information relating to the account holder maintained by the financial institutions is accurate and up to date.

In light of the broad list of jurisdictions adopting and enforcing the AEOI, individual taxpayers should also be cognizant that the Malaysian government will receive financial information of Malaysian residents relating to bank accounts maintained outside of the country. For high-net-worth individuals in particular, AEOI and CRS will result in significantly increased transparency in relation to their financial assets and wealth management structures. In this regard, it would be prudent to undertake a review of the existing structures to consider if there are any historical non-compliance issues which need to be addressed via any applicable tax amnesty programmes or voluntary disclosure schemes. Tax and foreign exchange control rules will also need to be considered and assessed as the exchange of information will further bring to light any non-compliance in these areas.

Spain

Ultimatum to Spain: EU Commission confirms declaration of assets kept abroad by Spanish taxpayers could be illegal

by Bruno Domínguez and Davinia Rogel (Barcelona)

Since this new obligation was introduced at the end of 2012, Spanish tax residents have the obligation to report assets and rights located abroad every year using Tax Form 720.

Last 24 November 2015, an infringement procedure against Spain was launched by the European Commission for considering that the penalties system applicable to the 720 Tax Form is not fully in line with European standards. The 720 Tax Form has been labelled as illegal due to the fact that the penalties applied for failing to comply have been regarded as disproportionate when compared to similar penalties in case the assets would be located in Spain.

In particular, this reporting obligation affects assets located out of Spain having a value higher than EUR50,000. Additionally, a severe system of penalties is applicable. In case the 720 Tax Form would not be submitted or submitted with incomplete, false or inaccurate information, Spanish Tax Authorities will impose penalties of EUR5,000 for any missing data. In case the 720 Tax Form would not be submitted on time, penalties of EUR100 will be imposed for any missing data. Moreover, in such cases, the taxpayer will be taxed in its Personal Income Tax at the marginal rate for the unjustified capital gain up to 48% in some Autonomous Communities and a penalty of the 150% will be imposed. Additionally, the assets located abroad would not be subject to any statute of limitations meaning that the Spanish Tax Authorities would have an unlimited period to investigate the case.

Despite the above, during this period no changes have been made by the Spanish Tax Authorities to the penalty regime of the 720 Tax Form, which is still applicable. Accordingly, on 15 February of 2017, the Commission has gone a step further and has sent a Reasoned Opinion to Spain requesting it to soften the penalties applicable to the 720 Tax Form. Although the Commission considers that Spain has the right to require its tax residents' information about their assets located abroad, the Spanish provisions may be discriminatory. In absence of a satisfactory response within two months, the European Commission could haul the Spanish Tax Authorities before the European Court of Justice.

United Kingdom

New corporate criminal offence: failure to prevent facilitation of tax evasion

by Piermario Porcheddu, Jennifer Revis and Charles Thomson (London)

Introduction

HMRC is on a mission to eradicate offshore tax evasion and revolutionize international tax transparency. Already the UK is party to a series of tax information exchange agreements with countries both within and outside the European Union.

Against this backdrop the Government is now legislating for a new criminal offence for corporations who fail to prevent the facilitation of tax evasion by persons associated with them (the "Corporate Tax Offence").

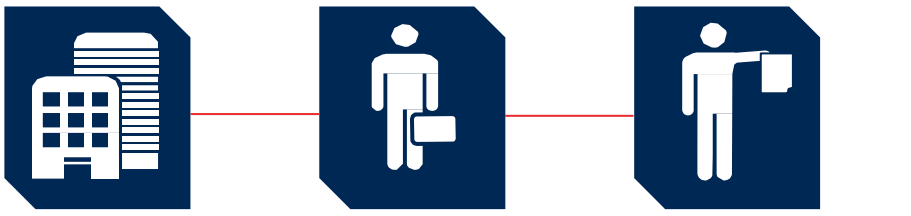
Here we explain what the offence is, how it is likely to affect you and what you should be doing now to prepare for it.

The Corporate Tax Offence

Status and effect

Following consultation in 2016, the offence has been included in the Criminal Finances Bill, and is expected to take effect on Royal Assent (which is likely to be in early autumn 2017, although it may be earlier). Companies, therefore, should start taking steps now to ensure that they are compliant by having the necessary procedures in place at the time the offence comes into force.

What is the offence?



Corporation
Corporation failed to take reasonable steps to prevent…

Associated Person
…criminal facilitation by natural or legal person associated with the corporation

Tax Evader
…of criminal tax evasion by a taxpayer under existing UK or overseas law

Under the Corporate Tax Offence, a body corporate or partnership will be criminally liable if it fails to take reasonable steps to prevent an associated person facilitating the commission of a UK tax evasion offence (or an overseas tax evasion offence that would amount to an offence if committed in the UK) by a taxpayer. A corporation guilty of the offence is liable to an unlimited fine.

Who is an associated person?

An associated person is defined as any legal or natural person that performs services for or on behalf of the corporation, such as an employee, agent subsidiary, distributor and a joint venture. HMRC has issued draft guidance[14] which emphasizes that contractual relationships are not relevant in establishing who is an associated person. Instead the definition is intended to have wide application based on the relevant facts.

What is criminal facilitation?

Criminal facilitation occurs if the associated person either: (i) is knowingly concerned in, or takes steps with a view to, the fraudulent evasion of tax by another person; or (ii) aids, abets, counsels or procures the commission of a tax evasion offence. The examples given in HMRC's guidance as to what would constitute facilitation include a broad category of activities, including setting up and maintaining bank accounts, providing bank services, and making introductions.

What is the territorial scope of the offence?

There are some nuances in terms of the geographic scope of the Corporate Tax Offence. Where an associated person facilitates the commission of a **UK** tax evasion offence, the corporation will be liable irrespective of where it was incorporated or formed. Where an associated person facilitates the commission of an **overseas** tax evasion offence, the corporation will be liable if: (i) it was incorporated or formed in the UK; (ii) it carries on a business (or part of a business) in the UK; or (iii) any part of the criminal facilitation occurred in the UK.

Are there any defences?

There are only two defences available. A corporation will have a defence if it had in place "reasonable" procedures designed to prevent its associated persons from committing tax evasion facilitation offences. HMRC's guidance provides six Guiding Principles to help determine whether procedures meet the test of reasonableness. They are:

1. Risk assessment;
2. Proportionality;
3. Top-level commitment;
4. Due diligence;
5. Communication (including training); and
6. Monitoring and review.

All the surrounding circumstances will be considered for the purposes of assessing what is reasonable. For example, corporations operating in a more high-risk sector, such as financial services, will be required to have more robust procedures in place in order to meet the standard of reasonableness. The level of control or supervision a corporate has over an associated person will also be a key factor.

A corporation will also have a defence if it was not reasonable in the circumstances for the corporation to have procedures in place to seek to prevent the particular form of criminal facilitation. We expect this defence would rarely apply in practice.

[14] http://bit.ly/2e8cne0

Comparison between the UK Bribery Act 2010 and the Corporate Tax Offence

The Corporate Tax Offence is undoubtedly modelled on the Bribery Act 2010 ("UKBA"). However, there are some notable differences.

Whilst the UKBA offence provides for corporate criminal liability as a result of actions carried out by an associated person (i.e. bribery by an associated person), the Corporate Tax Offence provides for corporate criminal liability where an associated person facilitates an act by **another** (i.e. tax evasion by a taxpayer). The additional third party element makes the Corporate Tax Offence structurally and fundamentally different from the UKBA offence.

Under the UKBA, an associated person must intend to obtain a benefit for the corporation. Under the Corporate Tax Offence, however, the associated person need only perform services for or on behalf of the corporation; there is no requirement for the associated person to intend its facilitation to benefit the corporation in any way. This makes the Corporate Tax Offence broader in scope.

Finally, with regard to the defence language, the UKBA refers to "adequate procedures" whereas the Corporate Tax Offence refers to "reasonable procedures". Reasonableness is arguably a less stringent test than adequacy. Indeed, in its response to the initial consultation the Government stated that corporations are not expected to be able to stop every instance of non-compliance by its associated persons and that it intends to include specific provisions stating that a process that successfully detects and discloses wrongdoing is likely to be found reasonable.

How will this affect you and what can you do to prepare?

The Corporate Tax Offence can apply in any industry, as demonstrated by the case studies included in this alert. As there are only a few months until the expected commencement of the offence, it is important that corporations start taking steps now to ensure they are fully compliant. To this end, we recommend that corporations:

- first, conduct a **thorough risk assessment** to identify how the business might be exposed to the risk of committing the Corporate Tax Offence;
- secondly, corporations should **undertake a gap analysis of their current compliance policies and procedures** and consider how their terms need to be updated in light of the new offence;
- thirdly, members of the corporation, particularly those identified as associated persons for the purposes of the new offence, should **be trained appropriately**, and training procedures should be put in place now, perhaps as part of the anti-bribery and corruption training; and
- finally, corporations should ensure that appropriate **procedures are implemented and their success monitored**.

The new offence requires practical and strategic considerations that go beyond just tax principles. The combined expertise of our tax, compliance and criminal disputes teams means we can assist you in preparing for this new challenge in the most effective way.

Tax evasion and the Criminal Finances Bill - 10 Things to Consider

by Arun Srivastava (London)

The Criminal Finances Bill will hold firms criminally liable where employees facilitate tax evasion by their clients. To protect themselves, firms must implement reasonable prevention procedures to mitigate the risk of facilitating a tax evasion offence. The Panama Papers scandal and increased political interest in the issue of tax evasion (and indeed tax avoidance) have driven the agenda.

It is, of course, already a crime to dishonestly evade tax and already a crime to assist a taxpayer to do so. Conduct by the taxpayer and employee is, therefore, already criminalized and not targeted by the Bill. The Bill instead addresses the position of the employer, the firm holding the client relationship. In the UK it is notoriously difficult to criminally prosecute a large company because of the "governing mind" principle. This can be contrasted with the United States where it is relatively easy to prosecute corporates on the principle of vicarious liability. Paradoxically, English law creates an incentive on the part of management to turn a blind eye to non-compliant behavior. The absence of senior management knowledge or involvement in wrongdoing makes it difficult to prosecute - if prosecutors cannot prove the knowledge or involvement of senior management they will struggle to secure a conviction. The Bill will shake this up by introducing strict liability. Firms have to show that they have reasonable preventative procedures in place to escape prosecution.

The Criminal Finances Bill is expected to receive the Royal Assent in the Autumn and come into force in 2018. Here are 10 things that financial institutions should be thinking of doing to comply with its requirements:

Reviewing existing financial crime and AML policies

Financial institutions need to update their current AML and financial crime policies. It will not be sufficient to rely on what you already do.

Financial institutions are already subject to financial crime systems and controls requirements from the FCA and under the Money Laundering Regulations 2007. As tax evasion is a money laundering predicate offence, existing procedures will be a starting point in developing reasonable prevention procedures under the Bill.

HMRC are clear, however, that the Bill is intended to "promote" tax evasion as a topic within a firm's policies. In other words, greater priority will need to be attached to this issue. HMRC have stated that merely applying old procedures tailored to different types of risk will not be an adequate response. HMRC have also said that firms with a higher risk profile may choose to articulate their procedures under the Bill separately.

What will reasonable preventative procedures look like?

HMRC has published draft Guidance[15] (*Tackling tax evasion: Government guidance for the corporate offence of failure to prevent the criminal facilitation of tax evasion*) scoping out the elements of the prevention procedures that HMRC expects firms to put in place. These procedures fall under six Guiding Principles:

a. Risk assessment

b. Proportionality of risk based prevention procedures

c. Top level commitment

d. Due diligence

e. Communication (including training)

f. Monitoring and review

The above Principles will already be embedded within existing AML and financial crime controls. Firms will be familiar with the concept of performing a risk assessment which then drives the firm's approach to due diligence and monitoring of individual customers and transactions.

What firms need to do differently is to separately identify and address the risks of employees or agents assisting clients to evade UK or foreign tax.

[15] Read the draft guidance here http://bit.ly/2e8cne0.

Training is a key aspect of the required policies. Firms should develop training modules that specifically address the risk that their employees or other "associates" acting on their behalf may facilitate tax evasion. Training will need to be tailored. For example, front office staff dealing with customers from a particular jurisdiction are likely to be expected to have a better understanding of that country's local environment and laws.

What are the higher risk business lines for the purpose of the Bill?

HMRC states in its draft Guidance that higher risk business lines will be those involved in giving bespoke financial advice or tax advice.

A steer on what constitutes higher risk business for these purposes can also be taken from the Joint European Supervisory Authorities (ESA) Guidelines on Simplified and Enhanced Due Diligence and also the JMLSG (the latter being expressly referred to in the HMRC Guidance).

While the ESA Guidelines cover money laundering risks generally, they are strongly influenced by considerations relating to tax evasion. Geographical risk factors include connections to "tax havens," "secrecy havens" or "offshore jurisdictions." The use of trusts, asset holding vehicles and multiple jurisdictions are all indicators of higher risk. The Guidelines focus on cross border business and suggest that firms who provide services to non-resident clients should ask themselves whether the clients would be better serviced elsewhere.

Client risk profiles and PEPs

Firms need to review their methodologies for building client risk profiles.

The risk factors and risk weightings which produce the client's risk rating need to be revised to reflect risks around tax evasion. Risk weightings may need to be adjusted upwards to give greater prominence, for example, to country risks (e.g., connections to "tax haven" jurisdictions) and to ensure that tax considerations are promoted.

Politically Exposed Persons (PEPs) trigger enhanced due diligence requirements under the Money Laundering Directive, though this does not mean that they have to default to the firm's highest risk category.

The Bill does, however, highlight the need for firms to focus on the source of wealth of clients who are PEPs. Unexplained Wealth Orders are an innovation under the Bill. These orders focus on the potential of a disparity between a client's wealth and the client's declared sources of income. Clearly, the new power targets clients who have undeclared incomes for tax purposes or who have acquired assets through criminally derived funds. Law enforcement authorities will be able to apply to the High Court for orders requiring foreign PEPs to explain how they have acquired specified property. Such an order will be obtainable where there are reasonable grounds to suspect that a person's known sources of income would not have been sufficient to fund the purchase of the property concerned. This emphasises the need for firms to properly investigate PEPs' source of wealth. Law enforcement action in this area might otherwise expose deficiencies in the firm's process.

Liability for third parties

Firms will be held criminally liable for acts of their "associated persons." This term includes employees, agents and other third parties who act on the firm's behalf. The concept of an associated person is therefore broad, giving rise to the potential that firms will be held criminally liable for non-employees acting outside the control environment of the firm itself. In order to address this risk, firms need to review the role of agents and third parties who might fall within the definition of associated persons for these purposes and ensure that risk mitigation procedures are extended to cover such parties. Firms should focus on parties such as financial advisers who may have introduced business to the firm or may intermediate the relationship between the firm and the client. Such parties might provide services to the underlying client but might also be treated as the firm's agent.

Do I need to become a tax expert?

The answer to this is no. The new offence is directed at deliberate or dishonest behavior. HMRC also say that if an employee is only proved to have acted accidentally, ignorantly or negligently in facilitating tax evasion by a client, no offence will be committed.

However, the position is a little more nuanced. It is also clear that there are expectations that if a firm is targeting a particular market (e.g., wealthy individuals from France) staff will have a greater knowledge of requirements in that market.

Does the Criminal Finances Bill apply to people outside the UK?

Yes, the Bill has an extremely broad reach. The Bill criminalizes the failure to prevent the facilitation of evasion of both UK and foreign taxes.

Facilitating UK tax offences – the offence of failure to prevent the facilitation of UK tax evasion can be committed by a business anywhere in the world. The only hook required for UK criminal law jurisdiction is that a taxpayer is evading a UK tax. Businesses outside the UK need to be compliant. A group subsidiary or branch located outside the UK could be guilty of a criminal offence under UK law if an employee or agent has facilitated the evasion of UK taxes. For example, a UK firm could commit an offence if an employee or agent of its Singapore branch has helped a client booked in Singapore to evade UK tax.

Facilitating foreign tax offences – this offence is narrower in scope in that it can only be committed where the offender is a UK company or partnership, the offender carries on part of its business in the UK, or any relevant conduct takes place in the UK.

Deconstructing the above, the wide jurisdictional scope of the Bill means that:

- Branches of a UK firm operating outside the UK are fully within the scope of the Bill and must have UK level preventative procedures.
- The "Head Office" of a foreign bank with a UK branch is also fully within scope. The UK offence applies extra-territorially to activities outside the UK. The foreign offence applies because the firm is carrying on part of its business in the UK, even though the UK branch is not involved in assisting the evasion of the foreign tax. A German bank with a London branch therefore needs to consider the application of the Bill to activities carried on in Germany in relation to German clients.

Do we need to review our ToBAs and other documentation?

Firms should review ToBAs, marketing materials and other literature to ensure that these provide an accurate description of services being provided. Firms should, where appropriate, remove wording that suggests they provide services relating to tax structuring or tax advice. ToBAs should contain an express stipulation that the firm does not provide tax advice or related services, if this is the case.

Should we consider de-risking?

Depending on their business model, firms may seek to mitigate risks by not providing certain higher risk services or reviewing the firm's portfolio of clients.

Enhancing monitoring and surveillance

Firms will need to amend monitoring processes to ensure that staff are complying with procedures put in place to ensure compliance with the Bill. If firms decide to cease giving advice or being involved in structuring, then monitor procedures should focus on this. Surveillance presently carried on to monitor conduct and market abuse issues could also be extended to include potential facilitation of tax evasion.

The Bill is a foretaste of things to come. The Government is presently conducting a Call for Evidence on the proposed corporate offence of failure to prevent economic crime that would extend similar

obligations across other types of economic crime. Both pieces of intended legislation mark the criminalization of conduct that would otherwise have been categorized as a regulatory systems and controls failing. With the imposition of strict liability, prosecuting a business will become much easier.

United States

Tax debts put passports at risk

by Paul DePasquale and Rebecca Lasky (New York)

Beginning in early 2017, the US Treasury Department and the IRS will start to use a tax enforcement procedure that could result in limiting, denying, or revoking the passports of US citizens. A recent update to the IRS website says that the IRS will soon begin using its authority under a 2015 law to inform the US State Department of individual citizens with seriously delinquent tax debt. The State Department can then limit, deny, or revoke the taxpayer's passport. Each of these consequences would cause significant hardship for US citizens, particularly frequent travelers and citizens living abroad. US citizens should review their tax compliance profile and take action to resolve tax debt before it becomes seriously delinquent.

What is a "seriously delinquent tax debt"?

A seriously delinquent tax debt is an unpaid, legally enforceable federal tax liability in excess of USD50,000 (adjusted for inflation) if either (i) a levy has been issued to collect the debt or (ii) a notice of federal tax lien has been filed and the taxpayer's administrative remedies have lapsed or have been exhausted. In other words, the IRS must go through concrete steps to assess and collect. Merely having unpaid taxes in excess of USD50,000 is not a seriously delinquent tax debt.

Taxpayers can reach the USD50,000 threshold rather easily. This is because any type of federal tax liability counts toward the threshold and the threshold counts the taxpayer's total cumulative tax debt (rather than a per year threshold). Moreover, interest and penalties count toward the threshold. Many IRS penalties relate to compliance failures involving the international reporting obligations of US citizens with assets and connections outside the United States. These individuals could be among those most likely to suffer from passport restrictions.

How to prevent debt from becoming seriously delinquent

Taxpayers need to be aware of their remedies for IRS collection actions because a notice of federal tax lien does not cause a tax debt to become seriously delinquent if the taxpayer has administrative remedies available. Taxpayers need to review IRS notices and timely respond. Timing is important because, in certain circumstances, a taxpayer may become delinquent if they fail to respond. Highly mobile individuals should ensure that they have reliable arrangements in place for receiving and responding to IRS notices.

Some tax debt does not count as seriously delinquent tax debt. These are generally tax debts where the taxpayer is engaged with the IRS in challenging or resolving the debt through specified procedures.

Risks for passport holders

When the IRS certifies that an individual is a seriously delinquent taxpayer, the Secretary of the Treasury sends the certification to the State Department. At the same time, the IRS must notify the individual that it is certifying the debt to the State Department. That notice will describe the individual's rights to challenge the certification. The IRS website states that the State Department will generally not issue or renew a passport to an individual after receiving certification from the IRS. A taxpayer will have 90 days to challenge the certification or resolve the debt before denial of a passport application. The State Department may revoke an already issued passport.

Next steps for clients

Taxpayers can avoid the passport restrictions by resolving outstanding tax debts. Taxpayers need to respond to IRS notices in a timely manner to preserve administrative remedies and avoid unintended consequences of a debt becoming seriously delinquent. The consequences of having unresolved seriously delinquent tax debts are particularly harsh. These consequences will disproportionately affect US citizens living abroad who generally need to have a valid passport for local law, administrative, or business purposes.

PFIC: Determining ownership and reporting requirements under new regulations

by Rodney Read (Houston) and Daniel Hudson (Miami)

On 27 December 2016, the Treasury Department and IRS published final regulations (TD 9806) that provided guidance on determining ownership of a passive foreign investment company (PFIC), as well as certain annual reporting requirements for shareholders of PFICs (Final Regulations). The Final Regulations essentially finalize the 2013 proposed regulations, withdraw the 2013 temporary regulations and implement the rules announced in Notice 2014-28 and Notice 2014-51. Ultimately, the Final Regulations do more to implement current guidance than provide additional insight into determining who is considered a shareholder of a PFIC and their annual filing requirements. That being said, there were some clarifications to the definitions of "Shareholder" and "Indirect Shareholder" in the PFIC context as well as clarification and additional exceptions to Form 8621 reporting. The following discussion is an overview of the Final Regulations with a focus on who is considered a shareholder of a PFIC in the trust context and the reporting requirements and exceptions for trusts and beneficiaries of trusts.

Who is considered a shareholder of a PFIC?

The Final Regulations adopt the 2013 temporary regulations definition of shareholder, with a few notable revisions and clarifications in relation to an indirect shareholder of PFIC stock.

First, the Final Regulations modify the definition of shareholder as announced by Treasury and the IRS in Notice 2014-28, whereby a United States (US) person shall not be treated as a shareholder of a PFIC to the extent such person owns PFIC stock through a tax-exempt organization or account. This effectively extends the exemption that was already afforded to the tax exempt organization under the temporary and proposed regulations to the US shareholder(s) of such organization, and expands the exemption to encompass tax exempt accounts as well. As a result, for instance, a US person owning stock of a PFIC through an individual retirement account (IRA) described in Section 408(a) will not be treated as the shareholder of the PFIC stock, and in turn, not subject to the PFIC rules. Because Notice 2014-28 originally provided for the aforementioned exemption, it will be effective for the taxable years of US persons that own stock of a PFIC through a tax-exempt organization or account ending on or after 31 December 2013.

In addition, the Final Regulations confirm that a grantor trust is not treated as a shareholder of PFIC stock held by the trust except for information reporting purposes relating to domestic grantor trust's qualifying as liquidating trusts or fixed investment trusts. Instead, under the indirect shareholder rules, the grantor of foreign and domestic grantor trusts are considered to own the interest of any PFIC stock held by the trust. In the context of a nongrantor trust, the Final Regulations confirm that each beneficiary of the nongrantor trust is considered to own a proportionate amount of any PFIC stock owned directly or indirectly by the trust. No guidance was provided on how to determine each beneficiary's proportionate amount in the context of a discretionary trust.

Next, the Final Regulations revised (and attempted to clarify) the 2013 temporary regulations in relation to when a US person is considered an indirect shareholder as a result of attribution through a domestic

corporation. However, to understand this nuanced revision and clarification requires us to take a step back in time. In 1992, Treasury and the IRS issues proposed PFIC regulations that, among other things, included rules for determining when a US person is treated as indirectly owning stock of a PFIC. One of these rules provided that a US person who directly or indirectly owns 50% or more (in value) of a foreign corporation that is not a PFIC is considered to own a proportionate amount (by value) of any PFIC stock owned directly or indirectly by such foreign corporation. Since this rule applies to US persons owning a foreign non-PFIC corporation, Treasury and the IRS were concerned that a US person could arguably interpose a domestic C corporation into an ownership structure to avoid shareholder status of PFIC stock that the US person indirectly owns through one or more foreign non-PFIC corporations, absent the following old rule relating to attribution through a domestic corporation. The old rule provided that if PFIC stock was not treated as owned indirectly by a US person under any other PFIC attribution rules, but would be treated as owned by a US person if the above foreign non-PFIC corporation attribution rule applied to domestic corporations, then the stock of the PFIC stock would be considered as owned by such US person.

The scenario that Treasury and the IRS sought to combat with the above two rules is where, for example, Albert, a US citizen, owns 49% of the stock in ForeignCo, a foreign corporation that is not a PFIC, and separately owns all the stock of USCo, a domestic corporation that is not an S corporation. USCo, in turn, owns the remaining 51% of the stock in ForeignCo, and ForeignCo owns 100 shares of PFIC stock. In this scenario, USCo is treated as an indirect shareholder with respect to 51% of the PFIC stock held by ForeignCo under the above foreign non-PFIC corporation attribution rule. However, because Albert directly owns less than 50% of the value of ForeignCo, Albert might not be treated as an indirect shareholder with respect to any of the PFIC stock held by ForeignCo absent the domestic corporation attribution rule.

On the other hand, Treasury and the IRS recognized that a literal reading of the domestic corporation attribution rule could be interpreted to create overlapping ownership by two or more US persons in the same PFIC stock. For instance, under the above rules, Albert (a US person) may be considered as indirectly owning 100% of the underlying PFIC stock, even though 51% of those shares are considered owned indirectly by USCo, which is a second, separately taxable, US person. In response to this duplicative result, the Final Regulations include a non-duplication rule, which provides that a US person will not be treated, as a result of the domestic corporation attribution rule, as owning PFIC stock that is directly or indirectly owned by another US person. So, in Albert's case, he should only be treated as indirectly owning 49% of the underlying PFIC stock under this new non-duplication rule because USCo, a separate US taxpayer, is treated as indirectly owning the remaining 51% of the PFIC stock.

Lastly, the Final Regulations made two additional clarifications with respect to the above rules. One clarifies that the above attribution rules does not apply to stock owned directly or indirectly through an S corporation, and the other clarifies that the domestic corporation attribution rule applies for all PFIC purposes, not just PFICs taxable under Section 1291.

Who is required to report their ownership of a PFIC?

If it is determined that you are a shareholder of a PFIC, you must next find out if you are required to report.

Direct shareholders of a PFIC are required to file Form 8621 *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund* unless an exception applies. The reporting rules for indirect shareholders depend on whether the shareholder owns through foreign entities or domestic entities. The regulations then provide the several exceptions to reporting followed by specifics for filing the Form 8621.

Attribution through foreign entities

US persons have a Form 8621 filing obligation if they are indirect shareholders of PFICs through a foreign entity or if they are treated as the owner of any portion of grantor trusts that directly or

indirectly through a foreign entity are treated as having any interest in a PFIC. Therefore, a US person beneficiary of a foreign nongrantor trust (i.e., foreign entity) that is treated as a direct or indirect shareholder of a PFIC generally must file a Form 8621. Furthermore, a US person grantor of a grantor trust that is treated as a direct or indirect shareholder of a PFIC generally must file a Form 8621.

The regulations provide an exception from filing for certain US person beneficiaries of foreign trusts. If the foreign trust owns a PFIC and has not made either a Qualified Electing Fund (QEF) election or Marked to Market (MTM) election with respect to the PFIC the US person beneficiary is not required to report the PFIC unless the beneficiary is treated as receiving an excess distribution or is treated as recognizing gain that is treated as an excess distribution.

Attribution through domestic entities

US persons have a Form 8621 filing obligation if they are indirect shareholders of PFICs through a domestic entity only if they (i) are treated as receiving an excess distribution, (ii) are treated as recognizing gain that is treated as an excess distribution as a result of a disposition, (iii) have a QEF inclusion, (iv) have a MTM inclusion, or (v) are required to report the status of a Section 1294 election.[16] Therefore, a US person beneficiary of a US nongrantor trust is required to file a Form 8621 only if one of (i) through (v) above is applicable. Outside of these circumstances, the US nongrantor trust should be filing the Form 8621.

Exceptions

The regulations provide eight general categories of exceptions from the requirement to file Form 8621: (i) if shareholder is a tax-exempt entity, (ii) if aggregate value of shareholder's PFIC stock is USD25,000 or less, or value of shareholder's indirect PFIC stock is USD5,000 or less, (iii) for PFIC stock marked to market under a provision other than Section 1296, (iv) for PFIC stock held through certain foreign pension funds, (v) for certain shareholders who are dual resident taxpayers, (vi) for certain domestic partnerships, (vii) for certain short-term ownership of PFIC stock, and (viii) certain bona fide residents of certain US territories. We discuss several of these exceptions below.

USD25,000/USD5,000 Exception

A shareholder is not required to file Form 8621 for a PFIC if (i) they have not made a QEF election, (ii) they have not received an excess distribution or recognized gain treated as an excess distribution during the year, and (iii) as of the last day of the year (a) the value of all their PFIC stock is USD25,000 or less, or (b) the value of their indirect PFIC stock is USD5,000 or less.

When determining the USD25,000 threshold, the shareholder does not have to include the value of PFIC stock (i) owned through another US person, (ii) owned through a PFIC, or (iii) marked to market under a provision other than Section 1296 (with some exceptions). The USD25,000 threshold is raised to USD50,000 in the aggregate for spouses filing jointly.

Because each beneficiary of a nongrantor trust is considered to own a proportionate amount of any PFIC stock owned directly or indirectly by the trust, the value of the PFIC stock should be divided among the beneficiaries when determining whether they meet the exception threshold.

PFIC stock held through certain foreign pension funds

A shareholder is not required to file Form 8621 if they are a beneficiary of a foreign pension fund (or equivalent) under a relevant US income tax treaty that holds PFICs and pursuant to the applicable income tax treaty, the income earned by the foreign pension fund may be taxed as the income of the shareholder only when and to the extent the income is paid to, or for the benefit of, the shareholder.

[16] In the context of QEF inclusion and MTM inclusion, the US person indirect shareholders do not have to report if the lower tier entity reports the PFIC. However, this exception is not applicable if the lower tier entity is a domestic partnership or S corporation and they do not make a QEF election with respect to the PFIC.

Dual resident taxpayers

A shareholder is not required to file Form 8621 if they are a considered a dual resident taxpayer under a relevant US income tax treaty and take a treaty position that they are a nonresident alien for purposes of computing their US income tax liability filing all the required forms.

Certain domestic partnerships

A domestic partnership is not required to file a Form 8621 if each partner (i) is not a shareholder of the PFIC (e.g., a tax exempt shareholder), (ii) a tax-exempt entity not required to file Form 8621, (iii) dual resident taxpayer not required to file Form 8621, or (iv) a domestic partnership not required to file Form 8621.

Short-term ownership

A shareholder is not required to file Form 8621 if they held the PFIC for 30 days or less and is not treated as receiving an excess distribution or recognizing gain that is treated as an excess distribution.

Specifics regarding filing Form 8621

If required, a Form 8621 must be filed whether or not the shareholder files a US federal income tax return. In the case of a failure to file Form 8621, the three year statue of limitations to assess additional tax does not begin running. In the case where the taxpayer is unsure or unable to determine whether the company is a PFIC, a protectively filed Form 8621 does not start the three year statute of limitations to assess additional tax. Instead, Treasury deciding to rely on reasonable cause statements in those instances to provide relief.

In the event a shareholder holds multiple PFICs they are not allowed to consolidate filing, instead a separate Form 8621 must be filed for each PFIC.

Transitional relief for equity-linked products but challenges remain

by Paul DePasquale (New York) and Sarah Stein (Geneva)

Taxpayers and withholding agents face challenges in complying with the withholding rules for dividend equivalent payments under section 871(m) of the Internal Revenue Code (the "Code")[17]. These challenges affect dealers, banks, parties with indirect exposure to US equities, withholding agents, and intermediaries. While Congress enacted section 871(m) in 2010, and it became effective for certain types of contracts that year, the full scope of section 871(m) has been the subject of ongoing discussions between the US Treasury Department, the Internal Revenue Service, and industry participants. In late 2015, the US Treasury Department and the IRS released final, temporary, and proposed regulations outlining the scope of 871(m) that were largely responsive to industry input. Nonetheless, significant questions remained under section 871(m) following the release of these regulations. The IRS addressed some open issues in guidance released on 2 December 2016. That guidance, issued in Notice 2016-76, addresses the challenges market participants face by providing transitional relief and answering several (but not all) open questions.

Significant developments made in Notice 2016-76 include the following:

1. To obtain qualified derivatives dealer ("QDD") status as of 1 January 2017, prospective QDDs have until 31 March 2017 to submit their updated qualified intermediary ("QI") agreement with QDD provisions.

[17] All references to "Code" herein refer to the US Internal Revenue Code of 1986, as amended.

2. QDDs will determine the residual US tax owed under section 871(m) (the "section 871(m) amount") using a "net delta" approach.

3. QDDs will remain subject to US withholding tax on actual and deemed dividends with respect to physical stock positions.

4. For 2017, the IRS will take the good-faith efforts of QDDs into account when enforcing compliance with the QDD provisions in their QI agreement.

5. Grandfathering rules are extended to apply to "delta one" transactions issued before 2017 and non-"delta one" transactions issued before 2018.

6. The IRS will take the good-faith efforts of taxpayers and withholding agents into account when enforcing section 871(m) for delta one transactions in 2017 and non-delta one transactions in 2018.

7. Withholding agents can use a simplified rule for the requirement to combine transactions for section 871(m) purposes for 2017 transactions.

8. Dividend equivalent withholding will not apply to certain existing exchange traded notes until 1 January 2020.

The following discussion provides a more comprehensive background of the dividend equivalent withholding regime and Notice 2016-76, as well as a discussion of treaty issues and the creditability of taxes imposed on dividend equivalents in non-US jurisdictions. The discussion concludes with proposed next steps for persons impacted by section 871(m).

What is dividend equivalent withholding?

Congress enacted section 871(m) in 2010 in response to concerns that non-US persons could avoid US withholding tax on US source dividends by using equity derivatives or other means of achieving synthetic exposure to US equities. The United States imposes a 30% withholding tax on US source dividends and other fixed or determinable annual or periodical ("FDAP") income. An applicable tax treaty can reduce or eliminate the 30% withholding on US source FDAP.

Under the applicable US tax rules, dividends paid by US issuers are generally treated as US source dividends subject to FDAP withholding. By contrast, the residence of the recipient generally determines the source of income on notional principal contract. The term "notional principal contract" is a US tax term, which generally includes swaps.

Prior to section 871(m), these different rules created tax planning opportunities. For example, a non-US investor holding the shares of a US corporation would be subject to 30% withholding tax on dividends paid by the US corporation, absent treaty relief. Instead of investing directly in the shares, the non-US investor could enter into an equity swap with a financial institution. The financial institution would pay the investor an amount equal to the dividend paid on the underlying US shares; however, this amount would not, itself, trigger FDAP withholding because the payment would be sourced based on the residence of the non-US investor. Section 871(m) closes this loophole by treating payments (and deemed payments) calculated by reference to US dividends as US source dividends, subject to FDAP withholding.

What is a "dividend equivalent"?

Payments currently treated as dividend equivalent payments subject to section 871(m) include:

1. Substitute dividends paid on a securities lending or sale-repurchase (i.e., a repo) transaction;

2. Payments on notional principal contracts that are contingent upon or determined by reference to the payment of a dividend from US sources where:

    (a) in connection with entering into such contract, the long party to the contract transfers the underlying security to the short party ("crossing in" or "legging in") or the short party transfers the underlying security to the long party ("crossing out" or "legging out");

    (b) the underlying security is illiquid; or

    (c) the short party posts the underlying security as collateral to the long party.

The 2015 regulations expanded the universe of payments and transactions that may be treated as giving rise to dividend equivalent payments, which now includes a wider group of notional principal contracts and "equity-linked instruments". An "equity-linked instrument" is a financial transaction (other than a notional principal contract, a repo, or a securities loan) that references the value of one or more underlying securities, and could include forwards, options, and even certain debt instruments. As a result of this expansion, many derivatives and other transactions linked to US equities could trigger dividend equivalent withholding obligations.

The 2015 regulations divide transactions (other than securities lending or repo transactions) into (i) simple contracts, and (ii) complex contracts. Generally, a "simple contract" is a contract that upon issuance references a single fixed number of shares of an underlying security and has a single maturity or exercise date. A "complex contract" is any contract that is not a simple contract.

A simple contract is not subject to section 871(m) dividend equivalent withholding unless its delta is 0.8 or greater when compared to the underlying security. "Delta" is a measure of the relationship between changes in the value of the contract and changes in the value of the underlying security. Imposing withholding on high-delta contract reflects the policy behind section 871(m) because the economics of holding a high-delta contract more closely reflect the economics of holding the security underlying the contract. A delta of one indicates perfect correlation between changes in the value of the contract and changes in the value of the underlying security.

> For example, assume a notional principal contract between a non-US investor and a US bank require the investor to pay the bank an amount equal to all of the decrease in the value of 100 shares of ABC Co stock and an interest-rate based return. In return, the bank must pay the investor an amount equal all appreciation of 100 shares of ABC Co stock and any dividends paid on ABC Co stock. The value of the contract will change by USD1.00 for each USD0.01 change in the price of a share of ABC Co stock. This contract has a delta of 1.0 (USD1.00 / USD0.01 * 100).

A complex contract is subject to dividend equivalent withholding if it meets a substantial equivalence test. The substantial equivalence test is outlined in temporary regulations as a multi-step analysis intended to determine whether the contract replicates the economic performance of an underlying US security.

The 2015 regulations contemplate the possibility of parties using multiple transactions in order to replicate the economic return of a section 871(m) transaction without being subject to the 871(m) rules. Therefore, the regulations require parties to determine whether contracts need to be combined for section 871(m) purposes. Combined transactions are linked transactions that are treated as a single transaction for the purposes of testing whether the transaction is subject to section 871(m). The short

party and withholding agent for possible combined transactions may rely on certain presumption rules when determining whether the transactions are subject to withholding (there is no analogous relief for the long party). The 2016-76 Notice allows withholding agents to rely on a simplified standard for determining whether transactions are combined transactions for 2017.

Qualified Derivatives Dealers

Withholding on dividend equivalent payments comes with a risk of cascading withholding. Cascading withholding, in the section 871(m) context, occurs when withholding is required more than once with respect to a single dividend payment.

> For example, assume a non-US bank and a non-US client enter into an equity swap over stock of a US issuer. The non-US bank may decide to hedge by holding the physical security. If the bank receives a US source dividend on the hedge, the bank would be subject to withholding on the actual dividend payment it receives from the issuer. The bank must then withhold if it makes a dividend equivalent payment subject to 871(m) withholding to its client, resulting in two instances of withholding from the same original dividend payment. Had the client received the US dividend directly, there would have been only one instance of withholding.

The QDD rules are intended to provide relief from cascading withholding for entities that qualify as QDDs. Treasury and the IRS amended the existing QI agreement to add QDD provisions. Treasury and the IRS published a proposed modified QI agreement with QDD provisions on 1 July, 2016. The proposed QI agreement outlines eligibility for QDD status, as well as the tax, withholding, and compliance obligations of a QDD. Treasury and the IRS intend to publish a final QI agreement before the end of 2016.

A QDD must be one of the following:

i. a securities dealer that subject to regulatory supervision by a governmental authority in the jurisdiction in which it is organized or operates,

ii. a bank subject to regularly supervision as a bank by a governmental authority in the jurisdiction in which it is organized or operates that issues potential section 871(m) transactions to customers and receives dividends or dividend equivalent payments pursuant to section 871(m) transactions entered into to hedge the customer transactions,

iii. an entity wholly owned by a bank described in (ii), or

iv. a non-US branch of a US financial institution.

Further, in order to be treated as a QDD, it must enter into and comply with a QI agreement.

Significant obligations attach to QDD status. When a QI acts as a QDD, it must assume primary chapter 3 and 4 withholding responsibility and primary Form 1099 reporting and backup withholding responsibility for all payments with respect to potential section 871(m) transactions for which it acts as a principal. The QDD rules reduce the risk of cascading withholding by limits the circumstances when a QDD is subject to tax on dividends and dividend equivalents it receives in its dealer capacity. However, Notice 2016-76 provides that a QDD is subject to withholding on actual dividends received on physical securities it holds as a hedge. Further, Notice 2016-76 does not address the possibility of cascading withholding in transactions involving non-QDDs.

What does Notice 2016-76 mean for market participants?

Notice 2016-76 outlines and updates the phased implementation of dividend equivalent withholding. Treasury and the IRS expect to change the section 871(m) regulations in combination with Notice 2016-76. The key developments in Notice 2016-76 are the following:

QDD Provisions

Notice 2016-76 introduced several important developments for QDDs. We summarize these developments as follows.

(a) Effective dates of QI agreement and QDD status

Under the terms of the updated QI agreement, there is a three-month window in which to apply for a QI agreement effective for the entire calendar year. Therefore, if a prospective QDD applies for QI status on or before 31 March 2017, and the IRS accepts that status, then the QDD status will be effective as of 1 January 2017. Later QI applications can still be effective as of 1 January, but only for QDDs that did not receive any reportable payments prior to the QI application being submitted. Prospective QDDs waiting on approval of their application have a grace period during which they can represent that they are QDDs.

(b) Calculation of "Section 871(m) Amount" and "Net Delta" for QDDs

Notice 2016-76 introduced an important change to how a QDD calculates its residual tax liability under section 871(m). Contrary to past guidance, the Notice provides that a QDD will be liable for tax and subject to withholding on actual dividends it receives on physical positions. Instead of an exemption from these taxes, to determine its total 871(m) tax liability, the QDD will calculate its "section 871(m) amount" based on its "net delta" exposure to a given underlying security multiplied by the relevant dividend amount per share. The net delta exposure requires aggregating the delta of all physical positions and potential section 871(m) transactions with respect to an underlying security entered into by a QDD in its equity derivatives dealer capacity. The QDD may offset any taxes it has already paid against associated section 871(m) tax liabilities.

(c) 2017 is a QDD phase-in year

2017 will be a phase-in year for QDD compliance. Because 2017 is a phase-in year, the IRS will take into account whether a QDD made a good-faith effort to comply with the relevant provisions of the QI agreement for 2017 when enforcing and administering the QDD rules for 2017.

"Good-faith" compliance, grandfathering for delta one transactions in 2017, other transactions in 2018

Section 871(m) dividend equivalent withholding will generally apply to relevant payments made on or after 1 January 2017 for delta one section 871(m) transactions issued on or after that date. However, 2017 is a phase-in year for delta one transactions, during which the IRS will take into account whether a withholding agent made a good-faith effort to comply with the section 871(m) regulations when enforcing section 871(m) for delta one transactions.

Further, Treasury and the IRS intend to revise the section 871(m) regulations to reflect a deferred implementation date for non-delta one transactions. No withholding is required on non-delta one transactions issued prior to 2018, which will be a phase-in year for such transactions. As a phase-in year, the IRS will take into account whether a withholding agent made a good-faith effort to comply with the section 871(m) regulations non-delta one transactions.

To benefit from the phase-in year relief, withholding agents and taxpayers must demonstrate good-faith efforts to comply with section 871(m) obligations. The IRS will take into account efforts such as (i) building or updating documentation and withholding systems to comply with section 871(m), (ii) determining whether transactions are combined (under the simplified standard discussed below), (iii) reporting required information to transaction parties, and (iv) implementing the substantial equivalence test for complex contracts.

Simplified combination rule for 2017

Under the simplified combination rule of Notice 2016-76, in 2017, a withholding agent will only be required to combine transactions when the transactions are over-the-counter transactions that are priced, marketed, or sold in connection with each other. Transactions that are entered into in 2017 that are not combined under this simplified standard will not become combined transactions as a result of applying the broader combined transaction rule in later years, unless as a result of a reissuance or other event that causes retesting.

ETNs with delayed withholding effective date

Section 871(m) will not apply to certain exchange-traded notes specifically identified in Notice 2016-76 until 1 January 2020.

Treaty and crediting remains uncertain

Non-US taxpayers are sensitive to the non-US tax treatment of US withholding on dividend equivalents. The United States takes the view that dividend equivalents are subject to the "Dividend" article of an applicable tax treaty. However, non-US governments have argued that dividend equivalents fall under the "Other Income" article of the treaty. If a dividend equivalent is treated as being governed by the "Other Income" article of the treaty, this treatment would restrict the power of the United States to tax the dividend equivalent absent a treaty override. Moreover, the non-US tax characterization of the dividend equivalent will generally affect the taxpayer's ability to credit the US dividend equivalent withholding tax in the relevant non-US taxing jurisdiction. Without such a credit, the non-US taxpayer may be subject to double taxation with respect to dividend equivalents.

Next steps

Withholding and reporting systems will need to account for the implementation of section 871(m) and the developments of Notice 2016-76. While the Notice provides valuable phase-in relief for good-faith efforts to comply with the new withholding obligations under the section 817(m) regulations, that relief is available only where the taxpayer is building and updating the relevant systems to comply with section 871(m).

Taxpayers and intermediaries need to review transactions, contracts, and products to identify any contracts that may have section 871(m) withholding obligations. These contracts should be analyzed to determine when such withholding may arise, and required documentation for section 871(m) compliance, and to ensure the contract properly allocates section 871(m) tax risk.

Taxpayers who may be subject to section 871(m) withholding should asses the home country treatment of dividend equivalents along with related treaty relief and credit eligibility.

Prospective QDDs must take action to determine eligibility for QDD status and enter or renew the QI agreement by 31 March 2017, to ensure that they are treated as a QDD effective as of 1 January 2017. Withholding agents should develop operational processes for accepting QDD documentation from account holders while QDDs should provide documentation of QDD status to counterparties.

IRS issues new final qualified intermediary agreement

By Ashleigh Hebert and Elaine Wilkins (New York)

On 30 December 2016, the IRS released Rev. Proc. 2017-15, 2017-3 I.R.B. 437, which sets forth the final qualified intermediary withholding agreement ("2017 QI Agreement") under Treas. Reg. § 1.1441-1(e)(5). Although the 2017 QI Agreement is based on the proposed QI agreement from Notice 2016-42, 2016-29 I.R.B. 67 (released in July 2016) (the "2016 Proposed QI Agreement"), it contains several changes and clarifications that may significantly increase the operational burdens on qualified

intermediaries ("QIs") subject to withholding and reporting requirements, including QIs seeking to become qualified derivatives dealers ("QDDs").

Under Treas. Reg. § 1.1441-1(b)(1), a withholding agent must withhold 30% on all amounts subject to withholding and payable to a foreign person unless it receives documentation that: (i) the payee is a US person; or (ii) the payment is made to a beneficial owner that is a foreign person entitled to a reduced rate of withholding under a treaty or the Code. However, a withholding agent's responsibilities are generally reduced with respect to payments made to QIs (non-US financial institutions or clearing organizations acting as intermediaries that have entered into a QI agreement with the IRS). If a foreign entity is a QI, it must provide the withholding agent with a withholding certificate that contains certifications on behalf of its account holders for purposes of claiming reduced withholding rates. Treas. Reg. § 1.1441-1(e)(5)(i). Although the QI is required to obtain withholding certificates or other documentation from the beneficial owners of the payments as required by the applicable intergovernmental agreement ("IGA") (an agreement between the United States and another government that specifies the responsibilities of each party under the Foreign Account Tax Compliance Act ("FATCA")), it is generally not required to attach this documentation to the intermediary withholding certificate.

A QI agreement elaborates on the QI's withholding and reporting requirements, and authorizes foreign persons acting as intermediaries to simplify their federal tax withholding and information reporting obligations. In exchange for this simplification, however, the QI must implement procedures that identify investors in US securities.

The QI compliance program

Rev. Proc. 2017-15 explains that the 2017 QI Agreement expands on the compliance requirements from the 2016 Proposed QI Agreement and replaces the external audit requirement with the requirement to create a compliance program. The compliance program includes the appointment of a responsible officer to make periodic compliance certifications to the IRS and maintain the compliance program. The QI must also draft and update written policies and procedures that enable the QI to satisfy its obligations under the QI agreement. Additionally, the QI must train relevant personnel and ensure that systems and processes are in place to facilitate compliance with its obligations under the QI Agreement. The responsible officer must also arrange for an independent person to periodically review the QI's compliance with its QI agreement, including testing the QI's compliance with documentation, withholding, reporting, and other obligations. The reviewer can be external or internal but must be competent and independent. The 2017 QI Agreement also clarifies that the periodic review will only include the accounts for which the QI is acting as an intermediary, as opposed to all accounts that could be subject to FATCA compliance.

The 2017 QI Agreement retains the consolidated compliance program provision contained in the 2016 Proposed QI Agreement. Under this program, QIs that are members of a group of entities under common control are permitted to designate a single QI to provide a compliance certificate on behalf of all QIs in the group if the QIs: (i) operate under a uniform compliance program; (ii) share practices, procedures, and systems subject to uniform monitoring and control; and (iii) are subject to a consolidated periodic review. The responsible officer must make the compliance certification for the consolidated group.

If a QI would be required to perform a periodic review of 50 or more accounts to determine its compliance with the relevant QI agreement, the 2016 Proposed QI Agreement allowed for the use of a statistical sampling of accounts (as opposed to a detailed review of each individual account). The 2017 QI Agreement retains the use of statistical sampling where the relevant QI has 60 or more accounts to review. A variety of methodologies can be used to conduct the statistical sampling, provided the methodology is documented.

Documentation requirements

Prior versions of the QI agreement were unclear regarding the application of the presumption rules (and specifically, which set of presumption rules apply), a set of guidelines that are applied to determine the status of an account holder that has not provided sufficient information for a QI to determine its status (as a US or a foreign person) and the person's other relevant characteristics (e.g., as an owner or intermediary, as an individual, trust, partnership or corporation). The 2017 QI Agreement explains that if a QI is a reporting Model 1 foreign financial institution ("FFI") or a reporting Model 2 FFI and it does not have sufficient information to determine the FATCA status of an account holder, the FFI must obtain a self-certification to establish the account holder's status, and the certification must be consistent with the applicable IGA. If the QI is unable to obtain information or a self-certification, the QI must apply the presumption rules from Treas. Reg. § 1.1471-3(f) and treat the entity as a nonparticipating FFI. If an FFI has too many undocumented accounts, the US Competent Authority may determine that there is significant non-compliance and terminate the agreement.

Consistent with the prior QI agreements, a QI must use its best efforts to obtain documentation from account holders to determine whether a payment will be subject to withholding or is reportable. However, the 2017 QI Agreement imposes greater responsibilities on QIs and requires them to cure any conflicts that are contained in a payee's account file, even in circumstances where the QI has not received a withholding certificate that contains information that conflicts with the account file.

QDDs

In Notice 2016-42, the IRS introduced new provisions permitting certain QIs (including regulated equity derivatives dealers, regulated banks and bank holding companies, and certain entities wholly-owned by regulated banks and bank holding companies) to act as QDDs. The QDD regime addresses cascading withholding requirements that would otherwise apply to "dividend equivalent" payments under Code Section 871(m), preventing the need for a withholding agent to withhold on certain payments made to the QDD when the QDD acts as a principal and provides a valid withholding certificate.

QDDs assume primary withholding responsibility for all payments made as a QDD, and the amount subject to withholding is not reduced by any taxes paid by the QDD. However, a QI can elect to assume primary withholding responsibility with respect to payments for which it is not required to act as a QDD.

Under the 2017 QI Agreement, a QDD's tax liability is equal to the sum of:

> (A) for each dividend on each underlying security, the amount by which its tax liability under section 881 for its section 871(m) amount exceeds the amount of tax paid by the QDD in its capacity as an equity derivatives dealer under section 881(a)(1) on that dividend, (B) its tax liability under section 881 for dividend equivalent payments received as a QDD in its non-equity derivatives dealer capacity, and (C) its tax liability under section 881 for any payments, such as dividends or interest, received as a QDD with respect to potential section 871(m) transactions that are not dividend or dividend equivalent payments to the extent the full liability was not satisfied by withholding.

QDDs are subject to additional reporting requirements (beyond those generally imposed on a QI). For example, QDDs are required to maintain a reconciliation schedule for section 871(m) amounts and must have written policies and procedures in place sufficient for the QI to satisfy its QDD tax liability. Rev. Proc. 2017-15 provides a phase-in process for QDD compliance with respect to the section 871(m) regulations and the relevant provisions of the 2017 QI Agreement. For the calendar year 2017, a QDD will be considered to satisfy QDD-specific compliance obligations under the 2017 QI Agreement if the QDD "made a good faith effort to comply with the relevant terms of [the 2017 QI Agreement]."

Application procedure and effective dates

The QI agreement previously in effect expired on 31 December 2016. The 2017 QI Agreement takes effect on or after 1 January 2017. The effective date of the 2017 QI Agreement for a new QI applicant will depend on when the QI submits its application and whether the QI has previously received any reportable payments.

To become a QI, a prospective QI must submit the information specified in Form 14345 and establish, to the satisfaction of the IRS, that it has adequate resources and procedures to comply with the terms of the QI agreement. An entity that intends to become a QI for purposes of acting as a QDD must apply to enter into a QI agreement and include the information on the application relating to QDDs. If a QI wishes to renew its QI agreement and also act as a QDD, it must supplement its renewal request by providing all of the required information relating to QDDs.

Is regulatory reform coming to Washington?

By Alexandra Minkovich and Joshua Odintz (Washington DC)

While President Trump's executive orders temporarily freezing the issuance of new regulations and requiring agencies to identify two regulations to eliminate for every new regulation that they propose and advisor Steve Bannon's statements about ensuring "the deconstruction of the administrative state" have garnered lots of attention, several bills are under consideration in Congress that could have a more transformative and long-lasting effect on administrative law.

Most of the activity related to changing the way regulations are developed and issued has occurred in the House of Representatives, which has held hearings and considered bills revising the regulatory process for several years in the recent past.

On 5 January 2017, the House passed H.R. 26, Regulations from the Executive In Need of Scrutiny Act of 2017 (REINS Act), which would require Congress to pass a joint resolution of approval before a major regulation can take effect. Non-major regulations will become effective unless Congress passes a joint resolution of disapproval. Congressional action under the REINS Act is not subject to judicial review. The bill also includes a "regulatory cut-go requirement," which requires agencies to repeal or amend an existing rule to completely offset the annual costs of any new rule on the US economy before the new rule may take effect. Finally, the REINS Act requires each agency to undertake an annual review of its existing rules and submit that review to Congress so Congress may determine, under the REINS Act's requirements for new rules, whether existing rules should remain in effect.

The REINS Act defines a major rule as one which the Administrator of the Office of Information and Regulatory Affairs in the Office of Management and Budget finds has resulted in, or is likely to result in, "(A) an annual cost on the economy of USD100,000,000 or more, adjusted annually for inflation; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets." A non-major rule is any rule that is not a major rule. The REINS Act's definition of a "major rule" is similar, but not identical, to the definition of a "significant regulatory action" in Executive Order 12866. Regular readers of this newsletter may recall that IRS regulations are typically not designated as significant regulatory actions, based on the IRS's position that the economic impact comes from the statute and not the regulation.

Similar legislation includes H.R. 998, Searching for and Cutting Regulations that are Unnecessarily Burdensome (SCRUB) Act, which passed the House on 2 March 2017; H.R. 75, All Economic Regulations are Transparent (ALERT) Act of 2017; H.R. 41, Preventing Overreach Within the Executive Rulemaking System (POWERS) Act of 2017; and H.R. 462, Reforming Executive Guidance (REG) Act of 2017.

On 5 January 2017, the House passed H.R. 21, Midnight Rules Relief Act of 2017, which would permit Congress to identify multiple regulations in the same resolution of disapproval under the Congressional Review Act. Currently, the Congressional Review Act requires Congress to pass a separate resolution of disapproval for each regulations that it wants to prevent from taking effect.

In addition to bills that would change the process by which agencies issue regulations and give Congress greater oversight of regulations, the House has also passed legislation addressing judicial review of regulations. On 12 January 2017, the House passed H.R. 5, Regulatory Accountability Act of 2017, which, among other things:

- revises the Administrative Procedure Act to require agencies to make preliminary and final factual determinations based on evidence and to consider certain items (including reasonable alternatives to the proposed rule and the potential costs and benefits associated with any such alternatives),
- permits immediate judicial review of interim rules, other than in cases involving national security interests,
- removes *Chevron* deference (*Chevron* established a two-part test for courts' review of agency action: (1) does the statute unambiguously address the issue? If yes, the statute controls. If no, go to step 2. (2) Was the agency's interpretation of the ambiguous provision reasonable and not arbitrary, capricious, or manifestly contrary to the statute?) by requiring courts reviewing agency actions to decide all questions of law de novo and without deference to the agency's interpretation,
- amends rulemaking requirements and agency procedures that affect small businesses, and
- delays the effective date of "high impact" rules (those with an annual economic impact of USD1 billion or more).

Requiring courts reviewing agency actions to decide all questions of law *de novo*, instead of applying *Chevron*, would be a dramatic shift in how courts review agency actions. The bill further provides that, if a court determines that there is a gap or ambiguity in the statute, the court shall not interpret that gap or ambiguity as (1) an implicit delegation of legislative rulemaking authority by Congress to an agency or (2) justification for deferring to the agency's interpretation of the statute or interpreting the agency's authority expansively.

None of the legislation in the House is explicitly targeted towards the IRS, nor does the legislation appear to be motivated by particular IRS regulations or other rulemaking activity. However, all of the House bills are broadly drafted and could apply to the IRS in the same way that they apply to other agencies.

The Senate's appetite for considering the bills passed by the House is uncertain. Several of these bills, or substantively similar legislation, has been passed by the House in previous Congresses, only to be ignored by the Senate. However, we understand that Senator Rob Portman (R-OH) plans to introduce the Regulatory Accountability Act, which would take a more moderate approach to changing the regulatory process than the REINS Act. Unlike the bills introduced in the House, Senator Portman's bill is intended to garner bipartisan support (which will be necessary to ensure passage in the Senate, due to the Republicans' slim 52-48 majority). Although the text of Senator Portman's bill was not released by the time this article went to publication, it is expected to apply only to "significant regulatory actions" (and, thus, may not apply to most IRS regulations).

Taxpayers should pay close attention to these legislative developments—if enacted, the REINS Act and the Regulatory Accountability Act would dramatically change the process by which regulations are proposed and issued by agencies and reviewed by courts. These changes could lead to a better, more thorough explanation of Treasury and the IRS's reasoning and policy choices underlying specific

regulations, but could also significantly slow the issuance of regulations as the IRS tries to comply with increased requirements imposed on a shrinking workforce. Moreover, if the Regulatory Accountability Act is enacted and courts are required to consider agency rulemaking de novo, taxpayers may find it easier to challenge the validity of IRS regulations in court.

First Circuit rules against taxpayer on STARS transactions

By Robert Walton (Chicago)

The government won the latest rounds of litigation over a structured trust advantaged repackaged securities, or "STARS," and whether the transaction lacked economic substance. *Santander Holdings, Inc., v. United States*, __ F.3d __ (1st Cir. 2016). The First Circuit in *Santander* reversed a taxpayer win in the district court. See prior Tax News and Developments article, *Mixed Results on STARS Transactions* (Vol. 15, Issue 6, Dec. 2015), located under insight at www.bakermckenzie.com. The STARS transaction is one of a number of so-called "foreign tax credit generators" that has caught the attention of the IRS. Indeed, Treasury issued temporary regulations in 2008 and final regulations in 2010 to curb what it believed to be abusive tax structures. See prior Tax News and Developments article *Ease Over Equity - IRS Issues Final Regulations Aimed to Prevent Foreign Tax Credit Generators* (Vol. 11, Issue 4, Aug. 2011), located under insight at www.bakermckenzie.com.

The STARS transaction

The STARS transaction was developed and marketed by Barclays Bank, PLC ("Barclays"), a UK-based bank, and KPMG. In simplified form, the STARS transaction operated as follows. The US taxpayer (or a related party) contributed income-producing assets to the STARS Trust (the "Trust"). The Trust then sold its shares to Barclays, and Barclays in turn loaned money to US taxpayer through the Trust.

The STARS transaction was designed to satisfy all US and UK tax requirements. For UK tax purposes, Barclays was treated as the owner of the Trust and was, therefore, entitled to claim deductions and credits against its UK taxes. For US tax purposes, however, the US taxpayer was treated as the owner of the trust and, therefore, US taxpayer claimed foreign tax credits for the UK taxes paid by Barclays on the trust income. Barclay's investment was intended to be debt for US tax purposes and equity for UK tax purposes.

The Court's opinion

The First Circuit sided with the IRS argument, adopting the analysis from the Federal Circuit decision in *Salem Financial, Inc., v. United States*, 786 F.3d 932 (Fed. Cir. 2015). The IRS argued that the STARS transaction lacked economic substance and, consequently, the foreign tax credits attributable to the STARS transaction should be disallowed. The IRS treated the foreign taxes paid as expenses in determining that the taxpayer did not have a "pre-tax" profit on the transaction.

The taxpayer, on the other hand, argued that the STARS transaction had economic substance because the taxpayer entered into the STARS transaction to obtain low-cost funding for its banking business and it reasonably expected to earn pre-tax profits from the transaction. The taxpayers argue that before both US and UK taxes, the transactions earned a pre-tax profit.

The First Circuit followed the decision in *Salem*. The Court relied on *Salem* to distinguish the taxpayer's arguments related under *Compaq Computer Corporation v. Commissioner*, 277 F.3d 778 (5th Cir. 2001) and *IES Industries, Inc. v. Commissioner*, 253 F.3d 350 (8th Cir. 2001), that the taxpayer's transactions had economic substance because the transactions generated a pre-tax profit. The Fifth Circuit in *Compaq* and the Eighth Circuit in *IES* held that for purposes of the calculation of pre-tax profit, foreign taxes were taxes and not expenses of the transaction.

The First Circuit, quoting *Salem*, concluded that "the Trust transaction is not comparable to [investments in nascent technologies] because it does not 'meaningfully alter the taxpayer's economic

position (other than with regard to tax consequences).'" The First Circuit agreed that the "UK tax was artificially generated through a series of circular cash flows through the Trust . . ." The court concluded that the "transaction was not a legitimate business and lacked economic substance." The First Circuit reversed the grant of summary judgment in the favor of the taxpayer on the primary issue. The government conceded the taxpayer was entitled to the interest deductions from the transaction. The First Circuit remanded the case to the district court for a trial on the penalties.

Reflections[18]

US estate tax repeal: What does it mean for global families?

by Marnin Michaels and Christopher Murrer (Zurich)

The estate tax is one of the most hated taxes in the United States. It has been called a "Death Tax" or a regressive tax. In fact, less than 5000 estates in the US had to file a federal estate tax return and pay any federal estate tax in 2015. It is an extremely limited tax. At the time of the writing of this article, both the US House of Representatives and the Senate have presented bills to repeal the estate tax, and it provides:

(1) the estate tax will not apply with respect to estates of decedents dying after the date of enactment;

(2) the generation-skipping transfer (GST) tax will not apply with respect to taxable transfers after the date of enactment;

(3) the gift tax will be retained with the present exemption and annual exclusion, with continued indexing;

(4) the gift tax top rate will be reduced to 35%, with respect to taxable transfers after USD500,000;

(5) the anti-estate freezing rules will be retained, presumably because they are needed to protect the integrity of the gift tax; and

(6) the present basis adjustment on the date of a decedent's death will be continued, even in the absence of an estate tax.

Unlike the Bush Tax Reform of 2001, which did not repeal the estate tax for non-US persons owning US situs assets, this proposal would. It should be noted, however, that this is only a proposal. It has not been voted upon, as of the date of this writing, by either the House or Senate and President Trump has not signed to make this a law. So, do not rush out so quickly to dismantle your structures.

What does this mean for global investors in the US?

1. There is no need to rush to dismantle your structures. The tax is not yet repealed.

2. Getting out of your structure may make sense from a US perspective, but have you considered home country issues? For example, would you trigger a tax in your home country by restructuring?

3. There are many US tax reform proposals at the moment. Waiting a year or so to get rid of a structure might save significant funds. For example, if someone is holding their assets in corporate form, given the number of proposals to reduce the US corporate income tax rate, perhaps waiting may make sense. There may not be such a huge benefit to collapsing a structure at the moment.

   If you have a structure in a non-US jurisdiction without a Tax Treaty, maybe consider migrating the structure to a jurisdiction with a Tax Treaty to mitigate the tax impact.

4. The structure may not be needed if the estate tax is repealed, but the estate tax could come back with the next administration. Maybe it makes sense to keep the structure for the time being.

[18] Views expressed in this section are the personal views of the authors.

5. Many structures set up for estate tax protection also have the benefit of providing creditor protection. Before unwinding a structure, consider any creditor protection benefits that would be lost.

6. Many of these structures also provide benefits in the context of divorce. Why risk converting a non-marital asset to a marital asset?

7. Finally, maintaining existing structures may plan for other taxes, such as a state-level estate tax, that could still apply even if the federal estate tax is repealed.

That is not to say that the estate tax may not finally be repealed, but as of now, it has not been. Careful consideration should be given to dismantling any structure at the moment.

Forthcoming Events

CONFERENCES

Munich

EMEA Tax Conference 2017
8 June 2017 (12:30-17:30)
The Westin Grand Munich
Arabellastr. 5/6
81925 Munich

Several workshops on taxation including:

- The German license barrier - whether and how multinationals can still benefit from preferential IP regimes in Europe
- Tax aspects of investing in emerging market economies - Brazil, China, Russia, Mexico
- Current tax challenges in the digital economy and their practical implications for business models
- Tax strategies after the reform of the German investment taxation 2018
- Tax-related developments for recapitalizations in Germany and other EU jurisdictions
- Times are changing? From certainty in advance to litigating transfer pricing
- Tax aspects of strategic partnerships in the pharmaceutical and life sciences industry
- The government's right to information for proper tax enforcement vs. the right to privacy

For more information, please contact blanca.pares@bakermckenzie.com

Miami

18th Annual International Tax and Trust Training Program
19-20 October 2017
Biltmore Hotel
1200 Anastasia Avenue
Coral Gables, FL 33134
For more information, please contact sylvie.jordan@bakermckenzie.com

BUSINESS BRIEFINGS

New York

23 May 2017 (08.30)
Brazil: 2017 Amnesty and Opportunities
Speakers: Paul DePasquale, Flavia Gerola (Baker McKenzie New York)

13 June 2017 (08.30)
International Succession Planning
Speakers: TBD

All events will take place at Baker McKenzie's New York Office, located at 452 5th Avenue, corner of 40th St. For inquiries, please contact: megan.kerney@bakermckenzie.com.

Geneva

31 May 2017 (16:30)
Planning Ahead: Wealth Management in Ukraine in the BEPS and De-Offshorization Era
Speaker: Hennadiy Voytsitskyi (Baker McKenzie Kyiv)

This business briefing will be held at Baker McKenzie Geneva, Rue Pedro-Meylan 5,1208 Geneva
For inquiries, please contact Ganchi Daali at ganchimeg.daali@bakermckenzie.com

Zurich

9 May 2017 (08:00)
The International Succession: Spotting the (Tax) Issues
Speakers: Andrea Bolliger and Sabine Herzog (Baker McKenzie Zurich)

30 May 2017 (08:00)
Planning Ahead: Wealth Management in Ukraine in the BEPS and De-Offshorization Era
Speaker: Hennadiy Voytsitskyi (Baker McKenzie Kyiv)

21 June 2017 (08:00)
UK Tax Developments & Updates
Speakers: Stephanie Jarrett (Baker McKenzie Geneva) and Lyubomir Georgiev (Baker McKenzie Zurch)

These business briefings will be held at Baker McKenzie Zurich, Holbeinstrasse 30, 8034 Zurich
For inquiries, please contact Miriam Corver at businessbriefings.zurich@bakermckenzie.com

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