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Tax News and Developments
North America Tax Practice Group

Newsletter

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In This Issue:

Potential US Tax Litigation

Congress and the administration continue to consider various tax proposals. A detailed description of the same will be included in next month's newsletter.

***By Alexandra Minkovich* and *Joshua D. Odintz,* Washington, DC**

Multilateral Instrument Signed

On June 7, 2017, 67 countries and jurisdictions covering 68 jurisdictions signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "MLI") at a ceremony in Paris, France. The BEPS Action 15 report specifically called for the development of a multilateral instrument to swiftly modify bilateral tax treaties in accordance with the BEPS project initiatives. As a result, the MLI was developed by a group of over 100 countries and jurisdictions in order to implement the tax treaty-related measures advanced by the BEPS project. As was widely expected, the United States did not sign the MLI last week, although US Treasury officials have stated that the United States may do so at a later date. In addition to the 68 jurisdictions that have already signed the MLI, 9 additional jurisdictions have expressed their intent to sign the MLI.

The MLI includes measures against hybrid mismatch arrangements (BEPS Action 2) and treaty abuse (BEPS Action 6), as well as measures to strengthen the definition of a permanent establishment (BEPS Action 7) and make dispute resolution and mutual agreement procedures more effective (BEPS Action 14). Tax treaties listed by both contracting parties to a treaty are automatically modified by the MLI eliminating the need for bilateral renegotiations. Signatories to the MLI may freely choose which tax treaties are to be modified by the MLI and remain free to make subsequent amendments to their modified tax treaties through bilateral negotiations. In addition, the MLI also provides some flexibility to signatories by allowing parties to opt in or out of, in whole or in part, certain provisions of the MLI with some limitations. Where the MLI provision reflects a BEPS minimum standard (i.e., standards which were agreed to by the countries involved in the BEPS project), a MLI signatory may opt out of such provision only if the relevant tax treaty already meets the BEPS minimum standard addressed by such MLI provision. Conversely, where a MLI provision does not address a BEPS minimum standard, a party may use a reservation to opt out of such provision, so that the provision does not apply to all of the reserving party's listed tax treaties.

Upcoming Tax Events

Wealth Management Briefing

Miami, FL
► July 26, 2017

Global Transfer Pricing Workshop

San Francisco, CA
► July 28, 2017

Tax Planning and Transactions Seminar

Minneapolis, MN
► September 7, 2017

Fifth Annual TEI / Baker McKenzie Tax Workshop

Austin, TX
► September 12, 2017

To review the complete Tax Events Calendar visit www.bakermckenzie.com/tax/event

Given the vast amount of unique treaties (2,365 total) and already matched treaties (1,105 total) listed by the MLI signatories, the OECD estimates that the first treaty modifications will become effective sometime in 2018. Timing of the modifications will vary depending on local country treaty ratification procedures in the signatory jurisdictions. The MLI signatories are required to provide notice of completed treaty ratification procedures to the OECD, which will then provide information on the impact of the MLI provisions to the general public. In order to provide the public with additional guidance on the MLI, the OECD is currently in the process of developing online tools, including interactive flowcharts on each of the substantive MLI provisions and their application.

By Ena Patel, San Francisco

Tax Court Upholds Validity of Section 883 Bearer Share Regulations

Code Section 883(a)(1) excludes from gross income and exempts from US federal income taxation the gross income derived by a foreign corporation from the international operation of ships, provided that the foreign country in which the foreign corporation is organized grants an equivalent exemption to corporations organized in the United States (the "reciprocal exemption provision"). Section 883(c)(1) provides that the reciprocal exemption provision shall not apply to any foreign corporation if 50 percent or more of the value of its stock is "owned" by individuals who are not residents of a reciprocal exemption jurisdiction. If section 883 does not apply, then a foreign corporation is, with certain exceptions, subject to a 4 percent tax under section 887 on its US source gross transportation income, which in general is 50 percent of the gross "transportation income" from a voyage that begins or ends in the United States. *See* I.R.C. § 863(c)(2) and (c)(3). Congress added section 887 to the Code and amended section 883, as part of the Tax Reform Act of 1986. Prior to 1987, section 883(a)(1) exempted earnings from the operation of ships based on the country of flag (or registry) of the ship, as long as such country granted an equivalent exemption to US corporations. Congress amended section 883 because, in its view, it "placed US persons with US-based transportation income and subject to US tax at a competitive disadvantage vis-à-vis their foreign counterparts who claim exemption from US tax and who are not taxed in their country of residence or where the ships are registered." S. Rept. No. 99-313 (1986), 1986 C.B. (Vol. 3) 1, 340. Congress was concerned that the exemption applied "without regard to the residence of persons receiving the exemption or whether commerce is conducted in that country." *Id*.

In *Good Fortune Shipping SA v. Commissioner*, 148 T.C. No. 10 (2017), the United States Tax Court recently upheld the validity of the former section 883 regulations' treatment of bearer shares, resulting in a denial of the reciprocal exemption from US federal income tax with respect to income from the international operation of ships derived by a Marshall Islands corporation that was indirectly owned by residents of Greece through bearer shares. Applying the two-step analysis prescribed by the US Supreme Court in *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984), the Tax Court first held that section 883 does not address how ownership by individuals of a foreign corporation should be established for purposes of section 883(c). Under step two of the *Chevron* analysis, the court held that Treasury did not act unreasonably, arbitrarily, or capriciously in promulgating regulations that precluded taking into account ownership in a foreign corporation held through bearer shares for purposes of section 883. The court's holding should be narrowly interpreted to apply only with respect to the section 883 regulations as in effect before amended bearer share regulations became effective for taxable years beginning after September 17, 2010. Moreover, the court's holding should not apply to similar ownership tests found, for example, in the limitation on benefits article of US income tax treaties or in the section 884 branch profits tax regulations, as those ownership tests do not include a specific rule addressing the ownership of a foreign corporation through bearer shares. It remains to be seen whether the taxpayer will appeal the Tax Court's holding.

The regulations under section 883 generally provide that certain "qualified income" derived by a "qualified foreign corporation" from its international operation of ships is excluded from gross income and exempt from US federal income tax. Treas. Reg. § 1.883-1(a). Among other requirements, a foreign corporation must satisfy one of three stock ownership tests to be a qualified foreign corporation. Treas. Reg. § 1.883-1(c)(2). One of those tests—and the one relevant to the facts in *Good Fortune Shipping*—is the qualified shareholder stock ownership test (the "qualified shareholder test"). A foreign corporation satisfies the qualified shareholder test if more than 50 percent of the value of its outstanding shares is owned, or is treated as owned by applying certain attribution rules (regarding indirect ownership), for at least half the number of days in the foreign corporation's taxable year by one or more "qualified shareholders," including by an individual who is considered to be a resident of a reciprocal exemption jurisdiction. Treas. Reg. § 1.883-4(a). A foreign corporation is not considered to satisfy the qualified shareholder test unless it meets certain substantiation and reporting requirements, which very generally require the foreign corporation to establish the requisite qualified ownership by obtaining very detailed ownership statements, signed under penalties of perjury, from its direct and indirect shareholders. *See generally* Treas. Reg. § 1.883-4(d). Treasury promulgated the regulations under section 883 pursuant to the authority granted by Congress under section 7805(a) to prescribe "all needful rules and regulations for the enforcement of" the Internal Revenue Code.

In general, any person who has physical possession of a bearer share certificate is recognized as a shareholder or owner of the corporation. No name is shown on a bearer share certificate that a company issues. There is no need for any paperwork or changes to the registry of the company. The shareholders of the company remain in "almost complete anonymity." *Good Fortune Shipping*, 148 T.C. No. 10, at 41-43. The mere delivery, or transfer of physical possession, of the company stock certificate issued in bearer form to another person effects a change of ownership. The regulations in effect for the 2007 taxable year of Good Fortune Shipping SA provided, in relevant part, that a shareholder would not be considered a "qualified shareholder" if he owns his interest in the foreign corporation through bearer shares, either directly or indirectly by applying the attribution rules of Treas. Reg. § 1.883-4(c). Treas. Reg. § 1.883-4(b)(1)(ii) and -4(d)(1). In addition, the regulations provided that a foreign corporation cannot meet the substantiation requirements with respect to any stock that is issued in bearer form. Treas. Reg. § 1.883-4(d)(1). Similarly, the shareholder was required to include in his ownership statement a statement as to whether the individual owned his shares in the foreign corporation directly or indirectly through bearer shares. Treas. Reg. § 1.883-4(d)(4)(i)(E). Treasury and the IRS amended the regulations in 2010. The amended regulations continue to provide a general prohibition against ownership through bearer shares. However, the regulations now provide that ownership through bearer shares *is* permitted if the bearer shares are maintained in a "dematerialized or immobilized book-entry system," which allow for tracking of ownership of the bearer shares. A dematerialized book-entry system is one in which the bearer shares are represented only by book entries and no physical certificates are issued or transferred. An immobilized book-entry system is one in which evidence of ownership is maintained on the books and records of the corporate issuer or by a broker or financial institution. Treas. Reg. § 1.883-1(c)(3)(i)(G).

The relevant facts in *Good Fortune Shipping* were as follows. The taxpayer, Good Fortune Shipping SA, was a corporation organized under the laws of the Republic of Marshall Islands and that was directly wholly owned by another Marshall Islands corporation, Good Fortune Holding SA, which in turn was directly wholly owned by another Marshall Islands corporation, Good Luck Shipping SA. Two individual Greek residents each directly owned 40 percent of the common shares of Good Luck Shipping for the 2007 taxable year. 100 percent of the outstanding shares of each of the three corporations were issued in bearer form. As permitted under Marshall Islands law, Good Fortune Shipping SA chose to issue its shares in bearer form, although apparently it could have issued the shares in registered form. Resident Marshall Islands domestic corporations are not permitted to issue shares in bearer form. 52 Marshall Islands Revised Code, Associations Law, pt. 1, div. 5, sec. 42(2) (2004), *cited in Good Fortune Shipping*, 148 T.C. No. 10, at 9. The taxpayer was not a resident Marshall Islands corporation. *Id.* Transfer of the shares was permitted through delivery of the share certificates. Good Fortune Shipping did not maintain a stock register or ledger showing the names of its owners or a stock transfer book. *Good Fortune Shipping*, 148 T.C. No. 10, at 9-17. With its 2007 US income tax return, the taxpayer included a Form 8275-R (Regulation Disclosure Statement) challenging the validity of the section 883 regulations' treatment of bearer shares.

Under step one of the *Chevron* analysis, the taxpayer argued that Congress had spoken directly to the precise question at issue. According to the taxpayer, the statute's use of "owned," without more, properly encompasses all types of ownership, including through bearer shares. While the taxpayer acknowledged that establishing *proof* of ownership is not addressed in the statute and may be addressed in regulations, proof of ownership is different from ownership itself, with respect to which the statute is unambiguous. The court disagreed. Relying on the Supreme Court's analysis in *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44 (2011), the Tax Court framed the question at issue differently from the taxpayer, explaining that Congress had not directly spoken (in the statute or in the legislative history) to the issue of how ownership by individuals may be *established* for purposes of section 883. Accordingly, the court held that Treasury was authorized to "fill the gap" that Congress left by promulgating regulations. *Id*. at 25-33.

Because the court found against the taxpayer in step one of the *Chevron* analysis, the court proceeded to the step two analysis, namely, whether the agency's regulations are based upon a permissible interpretation of the statute. Under this analysis, a court is required to defer to the regulation provided that the agency's construction of the statute is reasonable and is not arbitrary, capricious, or manifestly contrary to the statute. The taxpayer argued that the regulations are invalid under the step two analysis because they unreasonably and automatically do not permit taxpayers to establish, on a case-by-case basis, ownership through bearer shares. The Tax Court again rejected the taxpayer's arguments, emphasizing the practical difficulties and evidentiary issues with establishing ownership through bearer shares, as explained by Treasury and the IRS in the preamble to the 2002 re-proposed section 883 regulations. 67 Fed. Reg. 50,510, at 50518 (Aug. 2, 2002). In this regard, the court noted that establishing proof of qualified ownership through bearer shares is "virtually impossible" where, as here, the IRS's determination is made after the fact in connection with an audit of the taxpayer's position. The court added that the regulations reasonably effectuate Congress's desire to limit the benefits of section 883 "in order to curb abuse by residents of certain foreign countries who owned stock in a foreign corporation that was seeking the benefits of section 883(a)(1) where those foreign countries did not provide an equivalent exemption to US corporations." The court also cited OECD reports from 1998 and 2003 identifying bearer shares as "one of the most harmful tax characteristics globally of certain tax systems" and as "one of the most common and effective mechanisms of providing total anonymity regarding beneficial ownership of a company in the shipping industry." Accordingly, the court upheld the validity of the regulations because they "set forth a sensible approach" to effecting Congress's intent in enacting section 883. *Good Fortune Shipping*, 148 T.C. No. 10, at 33-47.

As alluded to above, the court's holding in *Good Fortune Shipping* should have a rather narrow application. The section 883 regulations were amended in 2010 to permit ownership through bearer shares maintained in a "dematerialized or immobilized book-entry system" because such systems permit tracking of ownership. However, the court's holding would likely apply to the 2010 regulations if the bearer shares do not meet the requirements for a "dematerialized or immobilized book-entry system." Similar ownership tests found in the limitation on benefits article of US income tax treaties and under other Code sections (*e.g.*, the branch profits tax regulations, Treas. Reg. § 1.884-5) should not be implicated by the court's holding, although those tests are intended to prevent a similar perceived abuse. In contrast to the regulations under section 883, the latter ownership tests do not include any rules proscribing ownership through bearer shares. In the absence of such rules, those ownership tests should not be interpreted in a manner that prohibits ownership through bearer shares. *See, e.g.*, Treas. Reg. § 1.884-5(b)(10), ex. 1 (permitting ownership to be attributed to shareholders that indirectly owns shares in a foreign corporation through bearer shares). *See also* Treas. Reg. § 1.884-5(d)(5) (providing that a foreign corporation meets its burden of proving that it is a qualified resident for purposes of section 884, either with respect to registered *or bearer shares*, if it has no reason to know and has no actual knowledge of facts that would cause the corporation's stock not to be treated as regularly traded). Query why Treasury and the IRS appear, through examples at least, to permit ownership through bearer shares in the context of the branch profits tax regulations.

In addition, other aspects of the section 883 are still susceptible to challenges on their validity despite the court's holding in *Good Fortune Shipping*. For example, the regulations provide that the exemption for income derived by a foreign corporation otherwise engaged in the international operation of ships extends to income from certain activities "incidental" to such operation. Treas. Reg. § 1.883-1(g). Treasury and the IRS have taken the position that income from the sale of, or arranging for, single-day shore excursions or land tour packages does not qualify as such incidental activities. Treas. Reg. § 1.883-1(g)(2)(i). However, Treasury and the IRS have failed, in regulatory preamble or otherwise, to adequately explain their position. As anyone who has been on a cruise well knows, one of the primary reasons for going on a cruise is to enjoy the various shore excursions offered. It is difficult to understand how the exclusion for shore excursions is a reasonable interpretation of the statute.

By Rafic Barrage, Washington, DC

Knowing Me, Knowing You: The New UK Corporate Criminal Offense of Failure to Prevent Tax Evasion

Companies will need to have robust procedures in place to safeguard against potential criminal liability under a new offense coming into force in the fall.

In a post-BEPS world, most tax authorities (including HM Revenue and Customs ("HMRC")) are on a mission to eradicate offshore tax evasion and revolutionize international tax transparency. The UK Government has focused on the role corporations play in facilitating tax evasion by third parties. A new law setting forth a criminal offense for corporations that fail to prevent the facilitation of tax evasion by persons associated with them (the "Corporate Tax Offense") will take effect in the Fall. A key feature of the new legislation is its cross-border reach; any corporation with a UK presence will be within the scope of the law, **irrespective of whether UK or foreign tax is evaded**.

The Corporate Tax Offense is included in the Criminal Finances Act 2017, which became law on April 27, 2017. However, the offense itself will not apply until a start date is set by the UK government through regulations, expected early Fall 2017.

US multinationals should use this interim period before the regulations are enacted as an opportunity to undertake an internal risk review, upgrade their internal tax compliance policies and procedures and, where necessary, take preemptive steps to mitigate any high-level risks before the Corporate Tax Offense comes into force.

What is the Corporate Tax Offense?

Elements of the Offense

The Corporate Tax Offense is designed to shift responsibility for monitoring third-party tax compliance and fraud prevention from HMRC to large businesses, and to encourage self-reporting. The new rule will make a *"relevant body"* criminally liable if it fails to take reasonable steps to prevent an "*associated person"* from facilitating the commission of a UK tax evasion offense (or an overseas tax evasion offense that would amount to an offense if committed in the UK) by a taxpayer.

- **Tax**: captures all domestic taxes, direct and indirect, as well as foreign taxes in certain circumstances.
- **Relevant body**: any one of a body corporate, a partnership or a limited partnership (but not limited liability partnerships) and referred to as "corporation" throughout this article.
- **Associated person**: any legal or natural person that performs services for or on behalf of the corporation, such as an employee, agent, subsidiary, distributor and/or a joint venture. HMRC's draft guidance emphasizes that the definition is intended to be wide in its application (based on the relevant facts)—*i.e.*, looking beyond contractual relationships between the parties.
- **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 offense. The examples in HMRC's draft guidance include a broad range of activities, such as setting up and maintaining bank accounts, providing bank services and providing planning advice.

Tax Evader	Associated Person	Corporation
Criminal tax evasion (UK or overseas) by a taxpayer…	*…criminally facilitated by an associated person…*	*…which a corporation failed to take reasonable steps to prevent.*

HMRC will carry out the initial investigations for UK-based offenses, and the Serious Fraud Office or the National Crime Agency will be charged with investigating any offenses beyond the UK borders. We expect that there will be close cooperation between these agencies in investigating and prosecuting companies under the Corporate Tax Offense.

Importantly, HMRC and any other prosecuting body can start investigating a company's reasonable prevention procedures even if they only have a reasonable suspicion that facilitation of tax evasion has occurred. In other words, HMRC does not have to first win a court case against the evader and the facilitator before it can investigate a corporation, nor must it even verify that a corporation has undertaken an internal risk review in light of the new law.

Worldwide Application

The Corporate Tax Offense is broad-reaching, and US multinationals can be caught in respect of evaded **UK tax and/or foreign tax**.

- **Facilitating UK tax offenses**: provided there is an evasion of UK tax, it does not matter whether the corporation that failed to prevent facilitation is resident or incorporated in the UK. Moreover, the facilitation or evasion need not have occurred within the UK for the Corporate Tax Offense to apply.

Example: A US incorporated company could fall foul of the Corporate Tax Offense if, through a series of meetings and discussions occurring in France, an employee criminally facilitates the evasion of UK tax by a third party (*e.g.*, a French customer or supplier).

- **Facilitating foreign tax offenses**: if the tax evaded is not UK tax, a corporation will be caught if: (i) it carries on any part of its business in the UK; or (ii) the acts giving rise to the facilitation by its associated person occurred in the UK.

Example: A US corporation with a UK subsidiary would be caught by the Corporate Tax Offense if an employee of the UK subsidiary criminally facilitates evasion of German taxes, amounting to an offense in Germany as determined under German law, by one of the corporation's customers.

Consequences of Breach

A corporation guilty of the Corporate Tax Offense is liable to pay a **fine starting at 100% of the tax evaded**, which can increase up to 300%. Even if the tax evaded is recouped from the facilitator, HMRC can still impose the fine on the corporation as the rule is aimed at deterring unacceptable behaviour from corporations that allow facilitation of tax evasion by a third party.

The prosecuting body may agree (under the supervision of a judge) to a Deferred Prosecution Agreement. The process would likely allow for the suspension of prosecution provided certain conditions are met, for example, strengthening any weaknesses in the corporation's tax policies and compliance.

Defenses

The prosecuting bodies have the burden of proof. It is important to note, however, that, like the UK Bribery Act, this is a **strict liability offense** - meaning that once: (i) a third party is found guilty of committing tax evasion; and (ii) a person associated with the corporation is also found to have criminally facilitated the evasion, the corporation will be automatically liable under the Corporate Tax Offense. It is immaterial that the corporation itself had no intention to evade tax.

The only defense available to a corporation caught under the Corporate Tax Offense is to prove that: (i) it adopted "*reasonable prevention procedures*"; or (ii) it is unreasonable to expect the corporation to have had such procedures in place (a welcome defense, but in practice this will be very difficult to apply).

Six guiding principles are set out in HMRC's draft guidance to help determine whether procedures meet the reasonableness test (these overlap with other compliance obligations in the UK, such as the anti-money laundering obligations):

1. risk assessment
2. proportional response to level of risk identified
3. top-level commitment
4. due diligence
5. communication (including training); and
6. monitoring and review.

The circumstances surrounding each case will be considered by the prosecuting body and the level of control/supervision a corporation has over an associated person will also be a key factor.

What does it mean for US corporations?

The Corporate Tax Offense has **worldwide application** and the legislation has been drafted specifically **to maximize extra-territorial enforcement**. Multinationals, particularly those in the higher risk areas (*e.g.*, with large numbers of employees), must acknowledge the real risks if the correct compliance approach is not adopted early on. The UK government has been clear since introducing the idea of a cross-border criminal offense that it would seek to target overseas tax evasion with the same vigor as any domestic corporate criminality.

One particular area of concern for US corporations should be the applicability of the Corporation Tax Offense to a wide variety of circumstances including, but not limited to:

- due diligence during M&A deals (*e.g.*, suspicious sale/acquisition structures proposed by the counterparty);

- unusual requests received from suppliers or sellers (*e.g.*, requesting split payments to different entities/bank accounts);
- third parties failing to comply with tax obligations relating to the import and export of goods;
- the lack of VAT registration numbers from suppliers; and
- geographical risks (*e.g.*, lack of transparency).

What can you do to prepare?

HMRC has expressed an expectation that corporations adopt "rapid implementation" and it is therefore strongly advised that any corporations potentially caught within the Corporate Tax Offense take an active approach to addressing potential problem areas as soon as possible. To this end, the following represents a suggested action plan for the coming months:

1. **June - July**: conduct a risk assessment to identify how the business might be exposed to the risk of liability under the Corporate Tax Offense;
2. **August**: undertake a gap analysis of the current compliance policies and procedures and consider what (and how) these need to be updated in light of the new rules;
3. **August - September**: implement any changes identified at step 2 (above) and ensure members of the corporation, particularly those at risk of facilitating evasion, are trained appropriately; and
4. **September and beyond**: ensure the procedures are implemented in time and are periodically reviewed (especially as the business develops).

The Corporate Tax Offense goes beyond just tax, it requires practical and strategic considerations. Corporations must take a holistic approach to prepare and involve relevant practices from across the business - - not just tax but compliance, legal and regulatory, too. With carefully planned and timely preparation, relevant bodies can ensure they are as prepared as possible for when the Corporate Tax Offense comes into force.

***By Piermario Porcheddu,* London and *Aliss Mansfield*, London/New York**

OVDP Compliance Campaign Rollout

As part of the IRS's Large Business and International division's move toward issue-based examinations, it announced the identification and selection of 13 campaigns. One of those campaigns is devoted to certain applicants of the several Offshore Voluntary Disclosure Programs (OVDP) that have been ongoing since 2009. The OVDP Declines-Withdrawals Campaign is meant to address the potential noncompliance of applicants who initially applied for pre-clearance into the OVDP since 2009, but were either (i) denied entry by IRS Criminal Investigation division, or (ii) withdrew prior to acceptance into the OVDP. The IRS has clarified that taxpayers who opted out of the OVDP, who were removed from an OVDP, or who are currently in an OVDP are not subject to this campaign. It is estimated that 6,000 taxpayers may be targeted as part of this campaign. Please see previously released global wealth management client alert, *OVDP Compliance Campaign Rollout*, distributed on May 31, 2017 and available under insight at www.bakermckenzie.com/tax.

***By Daniel Hudson,* Miami and *Rodney Read,* Houston**

Massachusetts Draws a Bright Line in the Silicon

On April 3, 2017, the Massachusetts Department of Revenue (the "Department") issued Directive 17-1 (the "Directive"), setting forth the Department's bright-line nexus threshold for internet vendors. Effective July 1, 2017, internet vendors with a principal place of business outside Massachusetts will be required to register, collect, and remit Massachusetts sales or use tax on its Massachusetts sales if it: (1) had Massachusetts sales in excess of $500,000 during the preceding calendar year; and (2) made 100 or more sales for delivery into Massachusetts during the preceding calendar year. For the short period between July 1, 2017 and December 31, 2017, the Department will look to whether these sales thresholds were met between July 1, 2016 and June 30, 2017.

Unlike states like Alabama and South Dakota that are directly challenging the validity of the physical presence nexus standard of *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), Massachusetts attempts to redefine physical presence for the digital age. Specifically, Massachusetts is taking the position that in-state software, like apps downloaded by in-state customers, cookies downloaded to a customer's computer, use of content distribution networks to speed up the delivery of web pages to customers, and other representative contacts constitute an in-state physical presence for large internet vendors. By doing so, Massachusetts attempts to factually distinguish internet vendors from the mail order vendor at issue in *Quill*, although such attempts appear suspect and subject to challenge on numerous grounds, including whether electronically downloaded software is tangible personal property for purposes of the physical presence nexus standard and, if so, whether it would be considered to be the vendor's tangible personal property when it is accessed on the customer's hardware. In addition, the Directive may run afoul of the federal Internet Tax Freedom Act's prohibition on discriminatory taxes. Challenges on these grounds and potentially others are reasonably anticipated after the Directive goes into effect.

For more discussion and insight on the Massachusetts Directive, please see the SALT Savvy blog post from May 16, 2017, *Massachusetts Draws a Bright Line in the Silicon*, available at www.saltsavvy.com

***By John Paek,* Palo Alto and *Julie Townsley,* Chicago**

Exclusive Control Over Remotely Accessed Software Necessary for the Arizona Transaction Privilege Tax to Apply

The Arizona Department of Revenue recently published Letter Ruling 16-011, which concluded that income from electronic transaction processing services that involved the use of software was not subject to the Arizona transaction privilege

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tax. The taxpayer at issue was a subscription billing and reoccurring payment provider that worked with third-party payment processors to process electronic payment transactions for its clients' sales. The taxpayer's customers used taxpayer-owned cloud-based and web-based software to interact with the taxpayer's services. This Ruling is significant because the Department, like revenue departments in several other states (including New York), has historically concluded that online services involving the remote access or use of software were subject to tax as a rental of tangible personal property, without analyzing the degree of control the customer had over the software. In a departure from previous rulings, the Department found that the taxpayer's services were not taxable because the taxpayer's customers did not have the requisite level of control over the software.

For more discussion and insight on the Arizona ruling, please see the SALT Savvy blog post from May 4, 2017, Exclusive Control Over Remotely Accessed Software Necessary for the Arizona Transaction Privilege Tax to Apply, available at www.saltsavvy.com.

By Trevor Mauck, New York

Join Baker McKenzie at the 17th Annual Global Transfer Pricing Workshop: San Francisco – July 28

On Friday, July 28, Baker McKenzie's global tax practitioners will present a full-day Workshop, ***Transfer Pricing in the Age of Transparency, Innovation, and Transformation*** at the historic Palace Hotel in downtown San Francisco.

With the completion of most of the BEPS Action Items by the OECD, countries around the world have begun implementing the OECD recommendations into law, resulting in increasing compliance obligations and enforcement activity for multinational corporations. This year’s Workshop, designed for in-house corporate tax professionals, will focus on transfer pricing policy developments, the impact the legislative changes will have on current transfer pricing structures and the strategies companies are considering as they move forward in this unprecedented environment.

The program will begin and end with plenary sessions focused on US tax reform and the potential implications for transfer pricing, recent high profile transfer pricing cases, and an active discussion between Baker McKenzie practitioners and corporate attendees on what challenges multinationals face, and the best practices to manage transfer pricing issues.

Morning and afternoon breakout sessions will allow attendees to customize their day by attending sessions that are most applicable, such as IP and supply chain structures, permanent establishments, value chain analysis, and valuation of intangibles.

Being held in conjunction with the Firm’s annual Transfer Pricing Subpractice Conference, over 100 global transfer pricing practitioners from the US, Asia Pacific, Europe, and Latin America will convene in San Francisco for the

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Workshop and subsequent internal training program. We hope that you and your colleagues are able to join us for what promises to be an interesting and informative event!

For full conference details, agenda, and registration information, see the Global Transfer Pricing Workshop event page, also available at www.bakermckenzie.com/tax/events.

Private Meetings Opportunity

Baker & McKenzie global transfer pricing practitioners will be available for client meetings the week of July 24 in advance of the seminar for confidential, one-on-one meetings on a promotional basis. If you are interested in scheduling such a meeting, please contact Ashley Defay at ashley.defay@bakermckenzie.com.

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For further information regarding the North American Tax Practice Group, any of the items or Upcoming Events appearing in this Newsletter, or to receive *Tax News and Developments* directly, please contact Marie Caylor at 312-861-8029 or marie.caylor@bakermckenzie.com.

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