

Joint Seminar on 14th/15th March 2014

OECD's Action Plan on Base Erosion and Profit shifting - “UK Bond case”

Action 2 - Neutralise the effects of hybrid mismatch arrangements

Hamburg, 14th March 2014

Dr. Valentino Tamburro

Ph. D. Candidate in Business and Tax Law

Luiss University “Guido Carli” in Rome

Summary

- Debt-Equity conundrum
- Double non taxation – Foreign tax credit generator
- Repurchase Agreement – Repo
- Italian legislation about Foreign Tax credit
- “UK Bonds”
- OECD Hybrid Mismatch Arrangements Report, 2012
- Action Plan on Base Erosion and Profit Shifting

Debt-Equity conundrum

- In Italian tax law the limitation of interest deductibility is based on an operating income test and there is no discrimination about the residence of the lender (Lankhorst-Honorst ECJ case Law C-324/00)
- The payment of dividends is not deductible for the company
- Corporate income tax is applicable only on 5% of the dividend in the hands of the shareholder
- Participation exemption

Double non taxation

Foreign tax credit generator

- Double non taxation – The same income is qualified as interest in the State A and as dividend in Italy
- Foreign tax credit generator – In a cross border operation there is a double tax credit claimed in two different states for the same WHT (“double dip” operations)

Repurchase Agreement operation

Economic and legal issues

- Bank A is the legal owner of a Bond and needs liquidity
- Bank A signs an agreement of double sale with Bank B
- Bank B is the legal owner of the securities and the distributions attached.

Euribor/Eurepo

Value on 5th March 2014

	1 mese	9 mesi
EUREPO	0,138	0,107
EURIBOR	0,216	0,468

Repo Operations Accounting Issues

Balance sheet

- The Bonds are included in the balance sheet of the Seller
- The Interests are taxable in the hands of the Purchaser

Foreign Tax credit

- Worldwide income taxation
- Article 165 of Italian Tax Code

Requirements

- Foreign income has to be included in the total income of the Italian company
- Per country limitation
- Italian tax rate (27,5%)
- The foreign tax has to be non-refundable
- The foreign income has to be included in the annual tax return
- Foreign income / Total income ratio

Foreign tax credit

Other issue:

- Gross income
- Carry back / carry forward

Amount of foreign tax credit deductible

	A	B	C
Foreign income	100	900	400
Italian income	900	100	600
Total income	1.000	1.000	1.000
Italian corporation tax (Ires 27,5%)	275	275	275
Foreign tax credit	20	180	110
Net taxes due in Italy	255	95	165
Foreign tax paid (20% A,B) (30% C)	20	180	120

A Max Amount of FTC deductible = $(100 * 275) / 1.000 = 27,5$

B Max Amount of FTC deductible = $(900 * 275) / 1000 = 247,50$

C Max Amount of FTC deductible = $(400 * 275) / 1000 = 110,00$

Harmful international tax planning schemes

UK - USA

BB&T and Barclays

Banks and multinational companies boosted their bottom lines in the past decade through structured finance deals. Some that produced foreign tax credits are now caught up in court battles with the US Internal Revenue Service. At issue is whether the transactions had legitimate business purpose or were designed to generate improper tax credits.

The IRS is looking at a specific arrangement between Barclays and US banks known as STARS deals – or structured trust advantaged repackaged securities deals.

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Source – Financial Times

Harmful international tax planning schemes

UK - ITALY

Uk bonds case

- Companies involved
- 2 English company (Issuer and subscriber of the bond)
- 1 Italian Bank (Purchase the bond and sell that bond to the German Bank)
- 1 German Bank (“Final purchaser”)

Uk bonds agreements

- High Yield Bond – 45 % (Turkish Lira)
- Swap transaction – 90% of the interest paid (manufactured payment)
- Net Yield of the Bond 4,5%
- Withholding tax applicable (10% of the gross interest)
- Early settlement if the WHT tax is not applicable

UK

- The Uk subscriber claimed the WHT credit because under UK law it is the economic owner of the bonds.

The whole operation was an abusive transaction

- Provincial Tax Court of Emilia Romagna, Judgment no. 242 of 15 November 2010. “The tax credit claim of an Italian bank was a tax arbitrage transaction, rejected under the GAAR law doctrine and jurisprudence”

Supreme Court Case Law

- Italian Supreme Court, in its judgment no. 30055/08, 30056/08 and 30057/08 of 02 december 2008 held that the Italian tax law contains a general anti avoidance principle deriving directly from the Article 53 of Italian Constitution (Tax Capability principle)

OECD Hybrid Mismatch Arrangements Report 2012

- 59. Italian tax law provides a specific rule which can be used to tackle foreign tax credit generator schemes. [...]
- As a consequence, the borrower can claim a foreign tax credit only if the lender is an Italian entity or a foreign entity with a permanent establishment in Italy.
- Article 2(3) Legislative decree 461/1997 was modified in 2009.

Action Plan on BEPS

- Action 2 – Neutralise the effects of hybrid mismatch arrangements
- Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) on hybrid instruments and entities.
- This may include: a) changes to OECD Model Tax Convention to ensure that Hybrid instruments are not used to obtain the benefit of treaties unduly; b) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; c) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient; d) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; e) guidance on co-ordination or tie-breaker rule if more than one country seeks to apply such rules to a transaction or structure.

Other rules

- The exemption of foreign dividends (95%) from the taxable income is denied if that income is deductible in the other State. Articles 89(3) and 44 of Italian Tax Code. Circular letter 4/E of 18 January 2006 (§1.1).
- Articolo 109, comma 9 del Tuir:
- It is not deductible any remuneration due to:
 - a) the participation to the economic performance of the company.
 - b) Joint venture agreement under Article 2554 of Italian Civil Code

Other examples

- Article 110(10), related to black list costs.
- Article 37-bis of Presidential Decree no. 600 of 1973
- - credit securitization
- -payment of royalties in favour of companies that are controlled by other company that are resident in a tax haven
- Presumption of residence in Italy (Article 73 of Italian Tax Code)
- CFC legislation (Article 167 and 168 of Italian Tax Code)

Conclusions

- UK Bond case in an example of the advantages of the exchange of information
- The Italian rule that address that schemes could fall under the tax ruling discipline
- It is necessary an update of the DTC
- Co-operative compliance in Italy: Does it stand a chance?

- Thank you for your attention

- Dank für Ihre Aufmerksamkeit