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Europe as one Market?

European Tax Practice

Sandy Bhogal - Dr. Petra Eckl - Benjamin Homo - Astrid Pieron

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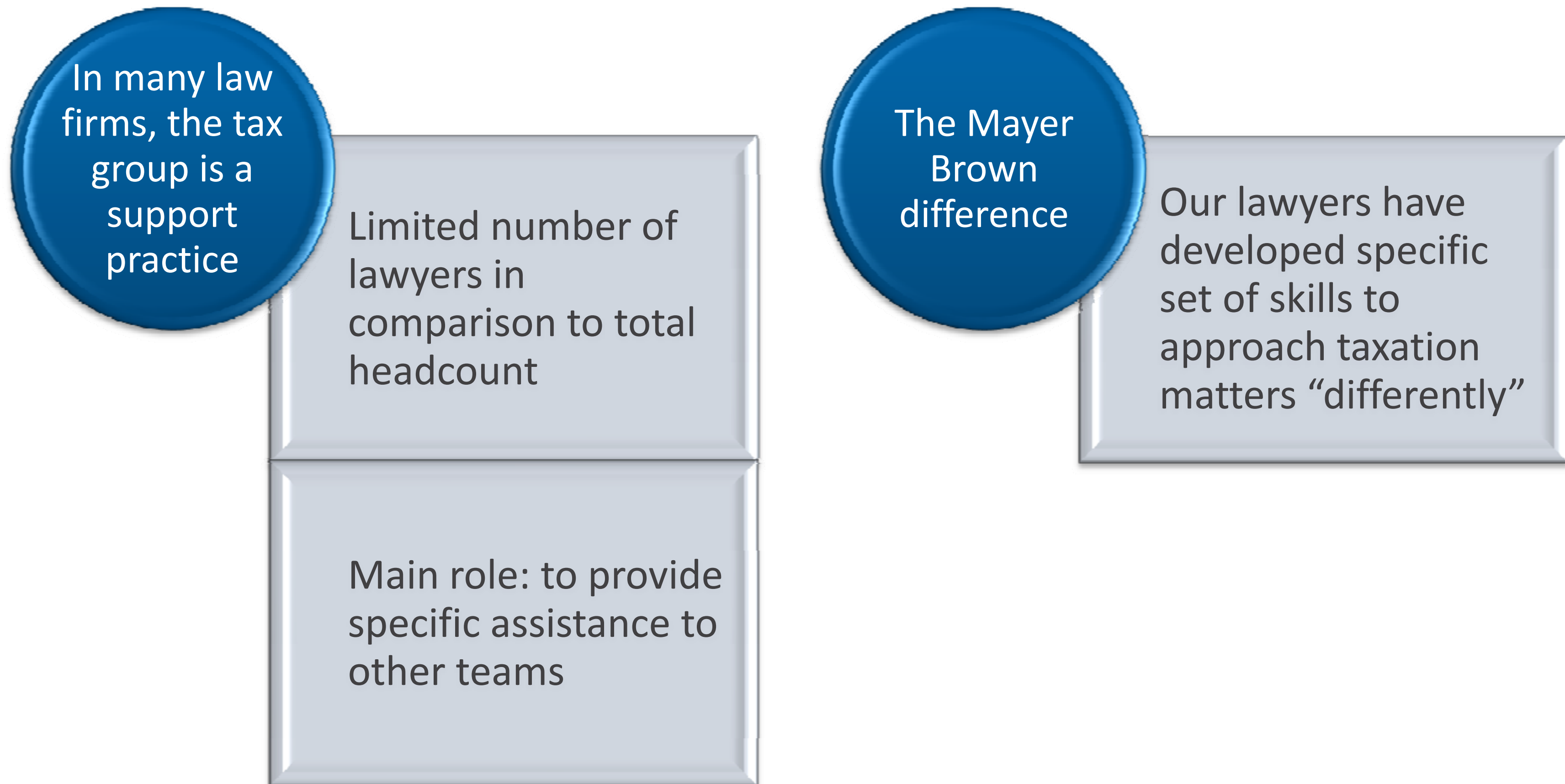
I. The Mayer Brown Tax Group



Our European Tax Practice

Our European tax practice covers every aspect of corporate, partnership, and individual taxation, including taxation of cross-border transactions, litigation, transfer pricing, and state and local issues

With offices throughout Europe and its global footprint, Mayer Brown offers the depth, knowledge, and experience to manage every tax challenge

Our European Tax Practice

The European mosaic represents both challenges and opportunities for taxpayers

Our team is used offering its expertise in cross-borders situations

Europe is not (yet) one single market in the field of taxation

Transaction & Consulting work

Transfer pricing work

II. Europe as one market?

- The European Union and the “others”

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II. Europe as one market?

- Within the 27 Member States of the European Union; the Single Market
- The Single Market has different “cornerstones”
  - Four freedoms (people, goods, services, capital)
  - The Customs Union
  - The Harmonization of Indirect Taxes (VAT, Capital duties)
  - The “coordination” of direct taxes

II. Europe as one market?

- In the field of indirect taxes, “harmonization” is the target, although instruments put in place (directives) still lead to (substantive) difference in approaches from country to country
- **What is VAT?**: a general consumption tax, in principle “neutral” for businesses
- EU VAT developments to look at:
  - Change of localization rules for services in B2B context
  - New frame for invoicing
  - Revamp of the existing financial and insurance exemption

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II. Europe as one market?

- In the field of corporate income tax, fiscal sovereignty of the member states, no tax harmonization BUT:
  - Legislative initiatives towards coordination by EU directives (Parent / Subsidiary, Interest / Royalty, Merger directives)
    - No withholding taxes in EU (EEA) situations, provided conditions are met
  - Infringement procedures by the EU Commission and case law of the European Court of Justice to chase “discriminations” such as:
    - Infringement on exit taxes (18 March 2010, IP 10/299 & 300)
    - Infringement for applying withholding tax on dividends distributed by domestic companies to foreign investment funds (whilst exempt when distributed to domestic counterpart) (28 January 2010, IP 10/91 & 94)

II. Europe as one market?

- The EU Joint Transfer Pricing Forum
  - The Code of Conduct on European Transfer Pricing Documentation (27 June 2006, Official Journal C176 dated 28 June 2006)
  - The APA Guidelines (endorsed by the EU Council on 5 June 2007)
  - The revamp of the Arbitration convention (COM/2009/472 dated 14 September 2009)
  - Draft report on routine services (January 2010, JTPF/020/REV1/2009/EN)
- Influence of the OECD work (e.g., report on business restructuring)
  - Discussion draft report issued on September 2008
  - Mayer Brown comments
  - Public Consultation in June 2009 (final draft expected)

III. Case study

- Your group is seeking to expand in Europe, re-assess its corporate organization there
- The Board agreed to establish a European holding platform to allow growth and acquisition
- Typical questions?
  - Where to locate your holding company?
  - What are the tax (and non tax) features in countries where you have (will have) operations? E.g., UK, France, Germany, Italy, Spain, Poland
  - What are the points of attention for acquisitions in Europe?
  - What are the tax aspects to consider when moving goods / services within or outside the EU

1. Your holding location in Europe

- Features to consider

Tax features	Non tax features
Capital duty on equity contribution	Country risk and environment (corporate framework, administrative burden, etc.)
Taxation of dividends received	Availability of qualified services providers
Taxation of interest	Suitable banking environment
Taxation of capital gain	Accessibility (cf. substance requirements)
Withholding tax rates	Others
Treaty network	
Others (rulings, exit strategies, etc.)	

1.1. Your holding location in Europe

	Belgium	France	Germany	Luxembourg	U.K.
Capital duty on equity contribution	No	No	No	No	No
Taxation of dividends received	95% exemption	95% exemption	95% exemption	100% exemption	No
Taxation of interest	Taxable - 33.99%	Taxable - 34.43%	Taxable – approx. 30%	Taxable - 28.59%	Taxable – 28%
Capital gain	Tax exempt	95% exemption	95% exemption	100% Participation exemption	Participation exemption
Withholding tax on dividends*	Yes – 25%**	Yes – 25% (18% if the dividends are paid to an individual resident of a member state of the European Union)	Yes – 25% or 15% plus solidarity surcharge	Yes – 15%	No
Withholding tax on interest*	Yes – 15%	No (except for interest paid in uncooperative territories - 50%)	No (if not secured by German located real estate)	No	Yes – 20%
Treaty network	90	113	90	55	116
Other elements	Limited thin cap NID deduction Ruling	Thin cap CFC	"Thin cap" (interest stripping rules) CFC Ruling	Thin cap Hybrid Instrument Ruling	Thin cap CFC Debt cap
Notes: *domestic rates. Reduced rates available under EU Directive (in EU context) or tax treaties	**Reduced rate of 15% and 10% available				

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1.1. Your holding location in Europe

	The Netherlands	Ireland	Switzerland	Hungary
Capital duty on equity contribution	No	No	Yes – 1%	No
Taxation of dividends received from abroad	100% participation exemption	Taxable (although tax credit available)	100% participation exemption	100% participation exemption
Taxation of interest	Taxable – 25.5%	Taxable – 12.5% or 25%	Taxable 8.5% (nominal of 7.8%)	Taxable – 16%
Capital gain	100% participation exemption	100% participation exemption	100% participation exemption	100% participation exemption
Withholding tax on dividends*	0% (where the conditions of the participation exemption are met) – 15 %	0% - 20%	35%	No**
Withholding tax on interest*	0%	0% - 20%	0% - 35%	No**
Treaty network	82	48	91	Around 65
Other elements	Ruling No CFC Thin cap (3:1)	Ruling No thin cap rule	Ruling No CFC Thin cap rules (safe haven)	Ruling CFC Thin cap (3:1)
Notes: *domestic rates. Reduced rates available under EU Directive (in EU context), similar arrangement (for Switzerland) or tax treaties				** if paid to a legal entity resident in a treaty country

1.2. Your operational companies in Europe

- Features to consider

Tax features	Non tax features
Tax rate and incentives	Country risk and environment (corporate framework, administrative burden, etc.)
Deductibility of interest / thin cap rules	Branch / Subsidiary
Deductibility of intra-group services charges	Availability of skilled workforce
Deduction for royalties	Compliance costs
Withholding tax on outgoing flows	Others
Group tax relief / consolidation	
Others	

1.2. Your operational companies in Europe

	France	Germany	U.K.
Tax rate	34.43% (15% for small and medium enterprises)	15% CIT (plus solidarity surcharge), approx. 15% trade tax	28%
Thin cap rules	Thin cap rules disallow the deduction of interest paid by a French company to a related party if the corresponding related party debt exceeds three cumulative thresholds, among which the 1.5 : 1 related party debt to equity ratio	Interest payments in excess of interest income received in the same year are deductible up to 30% of the tax EBITDA	Yes
Deductibility of intra-group services	yes, if arm's length	yes, if arm's length	yes, if arm's length
Deduction of royalties	yes, if arm's length	yes, if arm's length	yes, if arm's length
Domestic withholding tax*	25% or 18% on dividends and 0% on most interest payments	25% (plus solidarity surcharge)	WHT on property rental income and royalties income
Group consolidation	Yes, the so-called "*Intégration fiscale*"	yes, the so-called "Organschaft"	No formal tax consolidation
Others			
Notes: *domestic rates. Reduced rates available under EU Directive (in EU context), similar arrangement (for Switzerland) or tax treaties			

1.2. Your operational companies in Europe

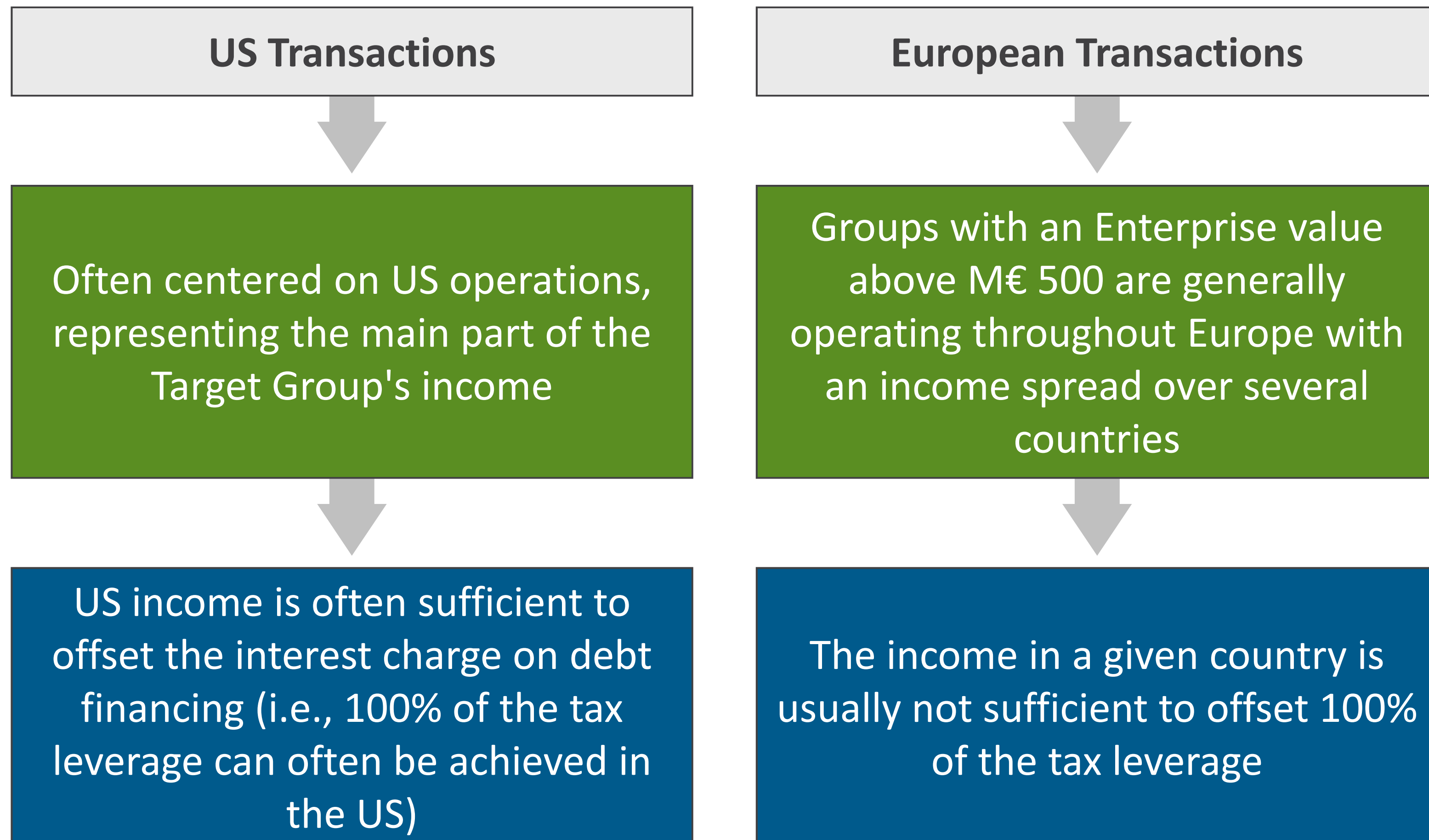
	Poland	Italy	Spain
Tax rate	19%	27.5% (plus regional taxes)	30%
Thin cap rules	3:1	Limitation on the deducibility of interests to 30% of the EBITDA	3:1 (in non-EU context)
Deductibility of intra-group services	Available, subject to conditions	Available, subject to conditions	Available, subject to conditions
Deduction of royalties	yes, if arm's length	yes, if arm's length	yes, if arm's length
Domestic withholding tax*	19% (dividends) – 20% (interest)**	12.5% to 27%	19% (for interest and dividends) 24% (royalties)
Group consolidation	Yes (but at domestic level)	Yes	Yes
Others			
Notes:*domestic rates. Reduced rates available under EU Directive (in EU context), similar arrangement (for Switzerland) or tax treaties	**Transitional period for implementation of the EU directives up to 30 June 2013 (5%)		

1.3. Acquisitions within or via Europe

- Features to consider

Tax features	Non tax features
Relief for purchase price	Country risk and environment (corporate framework, administrative burden, etc.)
Treatment of funding and debt push down	Full Due diligence, risk based due diligence, rely on VDD
Loss carry forward	Others
Existence of change of control rules	
Transfer tax and VAT	
Others (anti-avoidance rules)	

Key Differences Between US And European Transactions

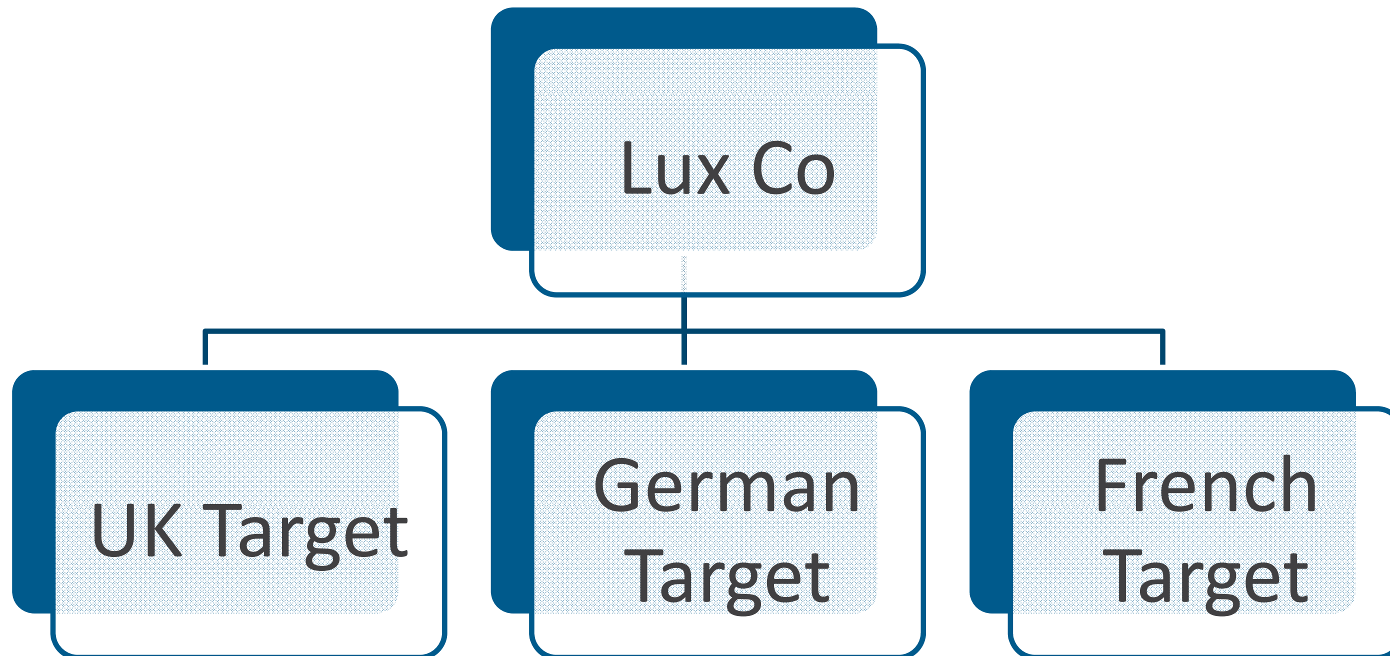


Resulting Constraint in European Transactions

- The need to split the acquisition debt between the various entities acquired is a key issue on which the structure shall be based.
  - The typical target structure in European acquisition often includes local NewCos that (i) acquire local companies and (ii) set-up a local tax consolidation (where available)

Typical Acquisition Structures

- A one-tier structure

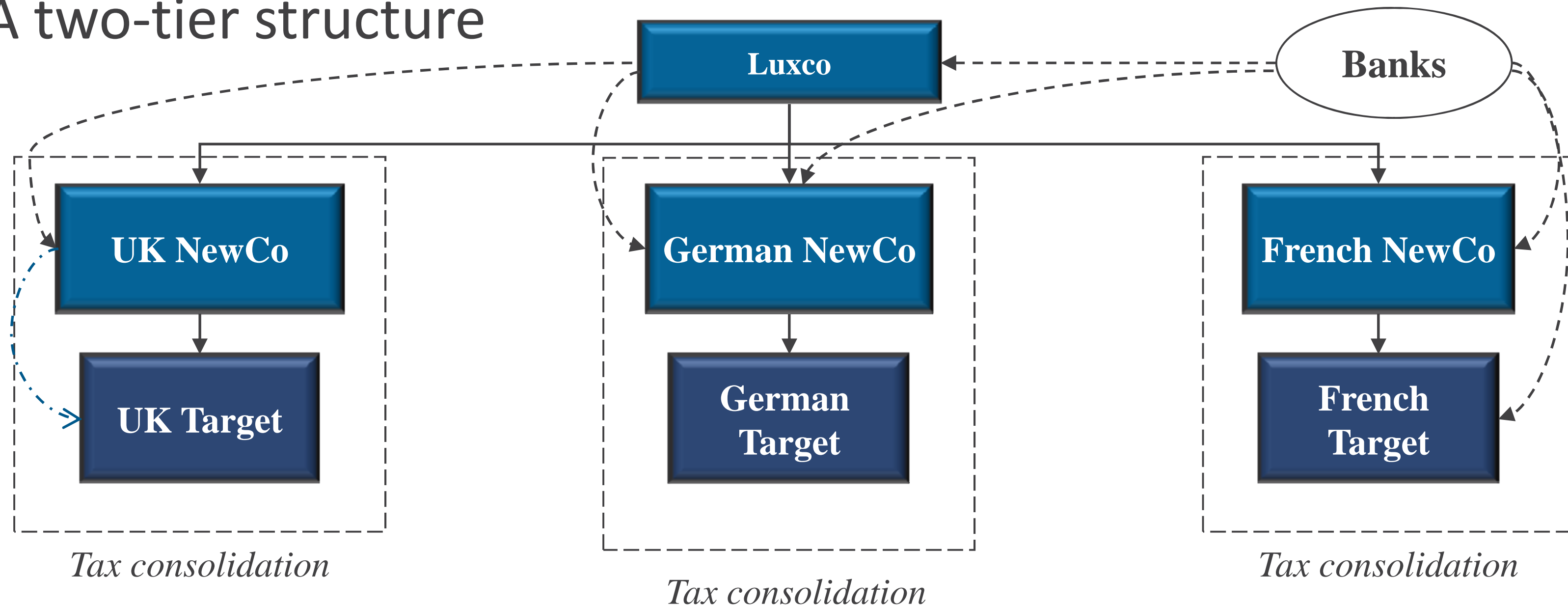


Location of the Debt

- First possible structure:
  - LuxCo enters into the entire debt with banks
  - Part of this debt finances the acquisition price, and the balance is lent by LuxCo to the target companies in order to refinance the Existing Debt
- In practice, this structure might have negative impact
  - US investors taxed on an accrual basis in respect of the interest spread which should be generated by LuxCo in respect of its borrowings/loans activity
  - The interest charge on the Acquisition Debt which is not on-lent is not used for tax purposes in Luxembourg, in the absence of taxable profits generated in that country

Typical Acquisition Structures

- A two-tier structure



- Expected benefits:
  - Losses generated by deductions for interest payments in local Holdco can be surrendered to local Target, thereby reducing local Target's taxable profits
  - No taxation of chargeable gain for local Holdco on disposal of shares

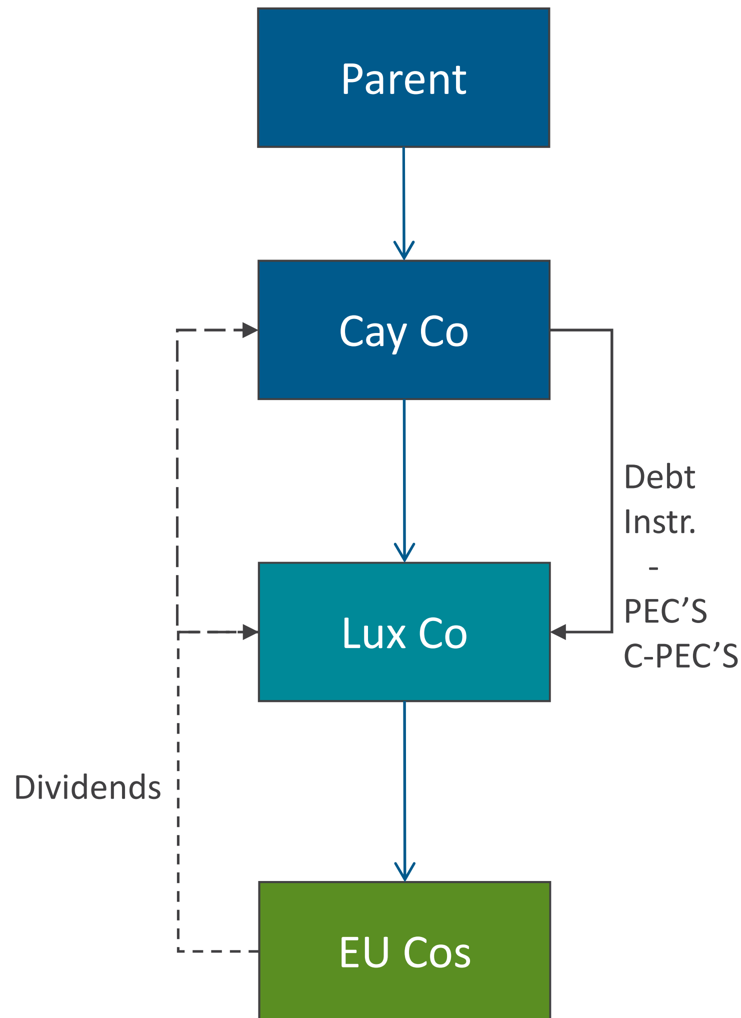
Location of the Debt

- Second possible structure
  - Creation of sub-holding companies for the purposes of the acquisition in each of the target countries (capital financed by LuxCo)
  - Each of the sub-holding companies takes out loans directly with the banks in order to finance the acquisition of the securities of the target companies
  - The banks directly refinance the Existing Debt in each of the operating companies
- In practice, the banks may prefer the idea of a loan to a single entity rather than several loans to various group companies
  - With the flexibility to be able to grant certain direct loans to large operating companies (direct guarantees with regard to their assets)

1.3. Acquisitions within or via Europe

- Financing structures:
  - "Stepping Stone" Structure
  - Belgium and Luxembourg as treasury centers / finance companies
  - US Consolidated structures

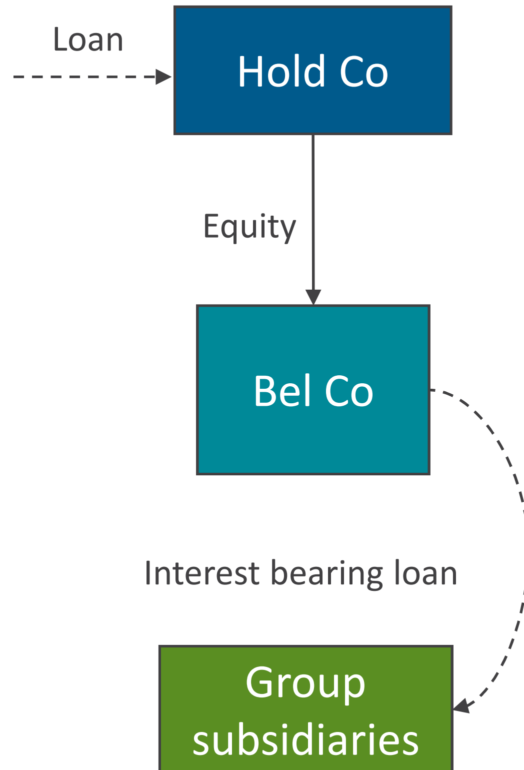
"Stepping Stone" Structure



Advantages

- No WHT on dividends distributed by EU Co to Lux Co (under the Parent – subsidiary Directive)
- Dividend and Capital gain are exempt in Luxembourg (participation exemption regime)
- No taxation of capital gain realised by Cay Co
- Repatriation of cash from Lux Co to Cay Co through hybrid instruments (C-PECS): no WHT

Belgium – NID Co



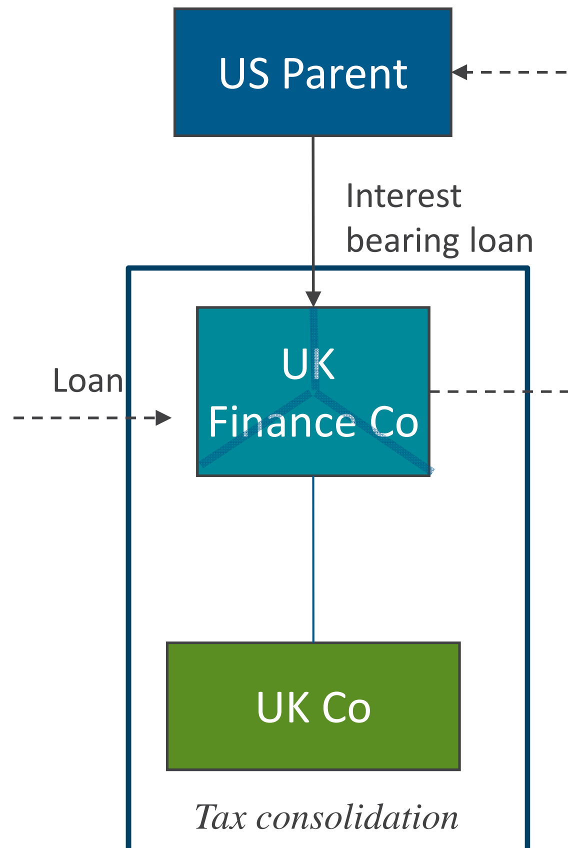
Advantages

- Deduction of interest expenses at the level of Hold Co and Group subsidiaries
- Notional Interest deduction at the level of Bel Co (3.8% of qualifying equity)
- Limited taxable basis in Bel Co

Issues

- Tax treatment in Hold Co country

US Consolidated Structure



Advantages

- Double dipping
- Group relief rules

Issues

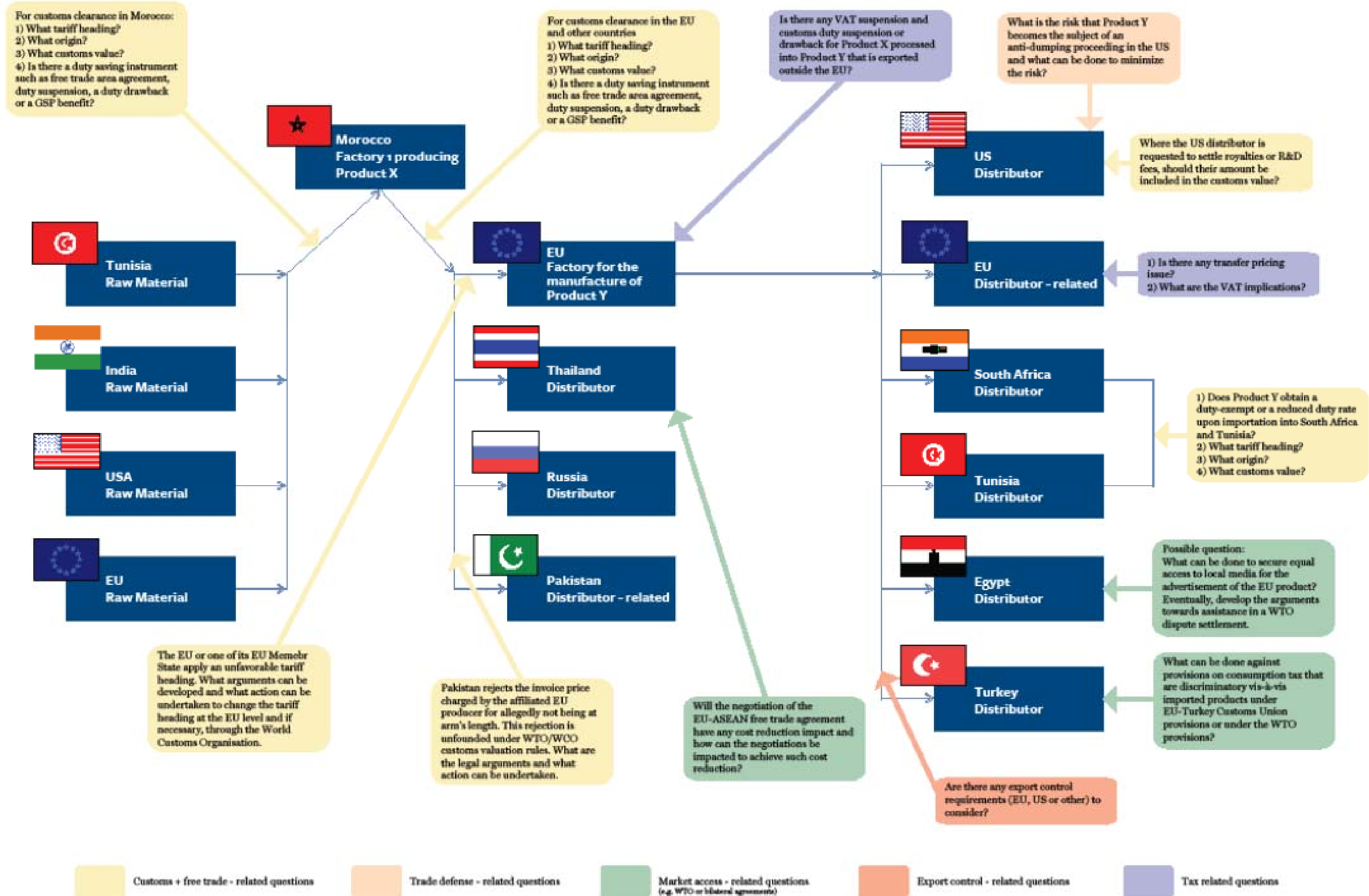
- Thin cap rules
- Arbitrage rules (UK)

1.4. Moving Goods (and services) within the Group

- Aspects to consider

Tax features	Non tax features
Customs duties	Logistics / Supply Chain
VAT	Contractual arrangements
Transfer Pricing	Market Access / Trade defense
Others (anti-avoidance rules)	Export Control
Tax compliance costs	
Others (link between all of the above)	

1.4. Moving Goods – the global picture



1.4. Moving goods: illustration of tension between direct taxes and customs duties

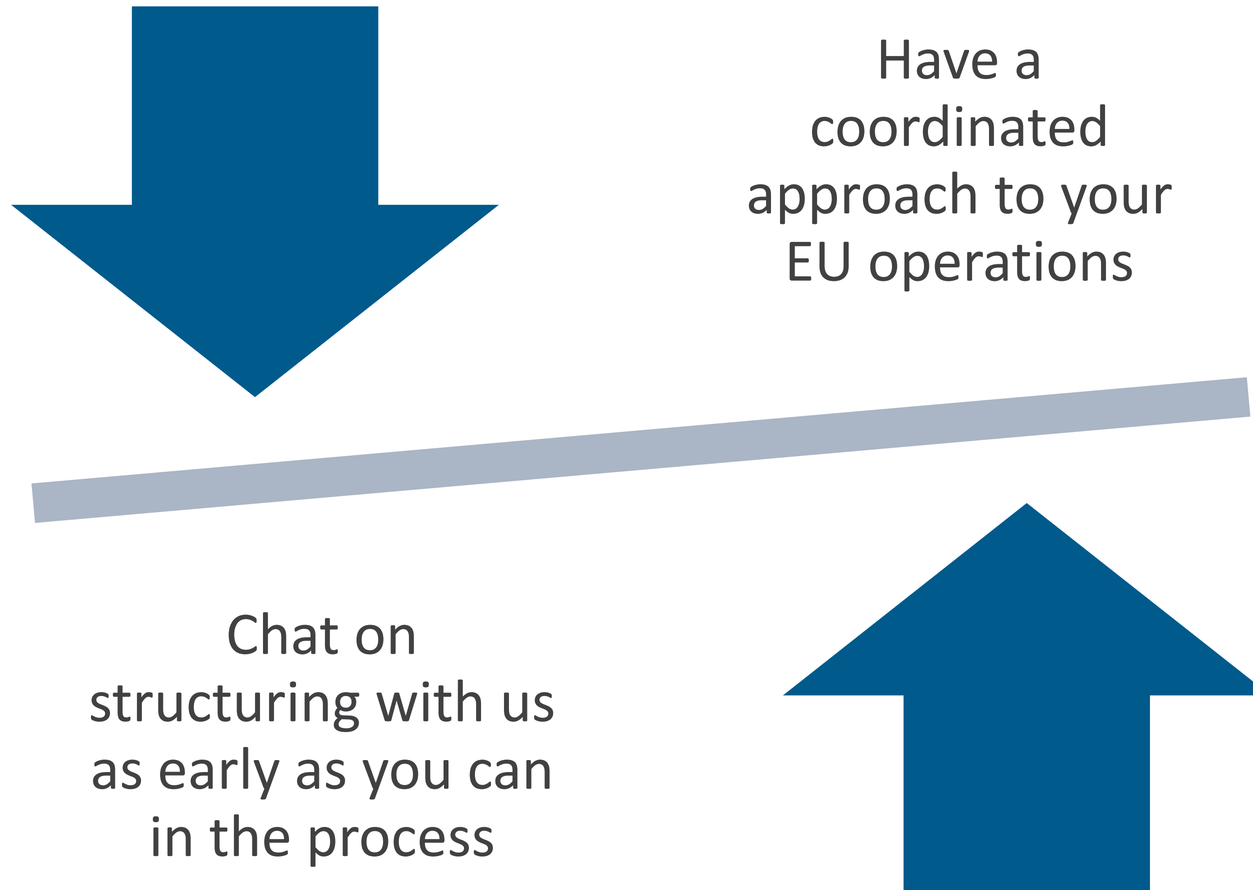
- Facts:
  - You sell finished products to an EU affiliate (importer)
  - The transfer pricing method implemented is the Resale Price Method (in-market resale price to unrelated customers)
  - The prices vary by jurisdiction, leading to different import prices
  - To reconcile with the transfer pricing method, the importer use the Deductive Value Method (customs “equivalent” of RPM, instead of the TV Method)

1.4. Moving goods: illustration of tension between direct taxes and customs duties

- Typical issues to cover to identify risks

Facts	To consider
Difference of import prices between VAT / Customs and Direct tax (transfer pricing policy)	Use of comparables: Customs will favor comparables derived from the country of importation. Are these the same as your transfer pricing comparables?
Difference in timing	Customs will attempt to use comparable transactions occurring within a 90-day period, within a well-defined sector. Will this be true of the transfer pricing comparables as well
Difference in purposes	Allocate profit (transfer pricing) v. setting up level playing field for international trade (customs duties) and taxing consumptions (VAT)

IV. Conclusions



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Brazilian Tax: General Overview and Recent Developments

Brazilian Tax Law

Ivan Tauil – Christiano Chagas

April 20, 2010

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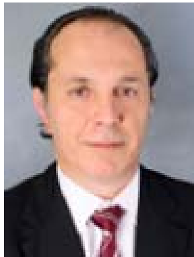
Speakers



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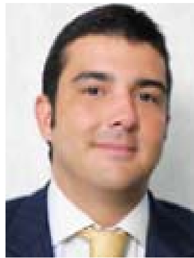

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About Tauil & Chequer

- Leading law firm offering local market knowledge combined with global reach.
- Founded in 2001; associated with Mayer Brown in 2009
- Two full-service offices
  - São Paulo, SP
  - Rio de Janeiro, RJ
- A multilingual team of 150 staff including 65 lawyers qualified in local and international jurisdictions.
- Unequalled global scope and scale enhanced by 2009 combination with Mayer Brown

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Structured Finance

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Oil & Gas

Banking & financial services

Business & technology sourcing

Construction & Engineering

Energy

Information technology

Infrastructure

Mining

Real estate

Shipping

Agribusiness

Immigration

Angola

Latin America

Brazilian Tax System
General Overview

Brazilian Tax System

- The current Federal Constitution share taxing power between the Federal Government, the States and Municipalities, granting unto each of them the power to levy tributes.

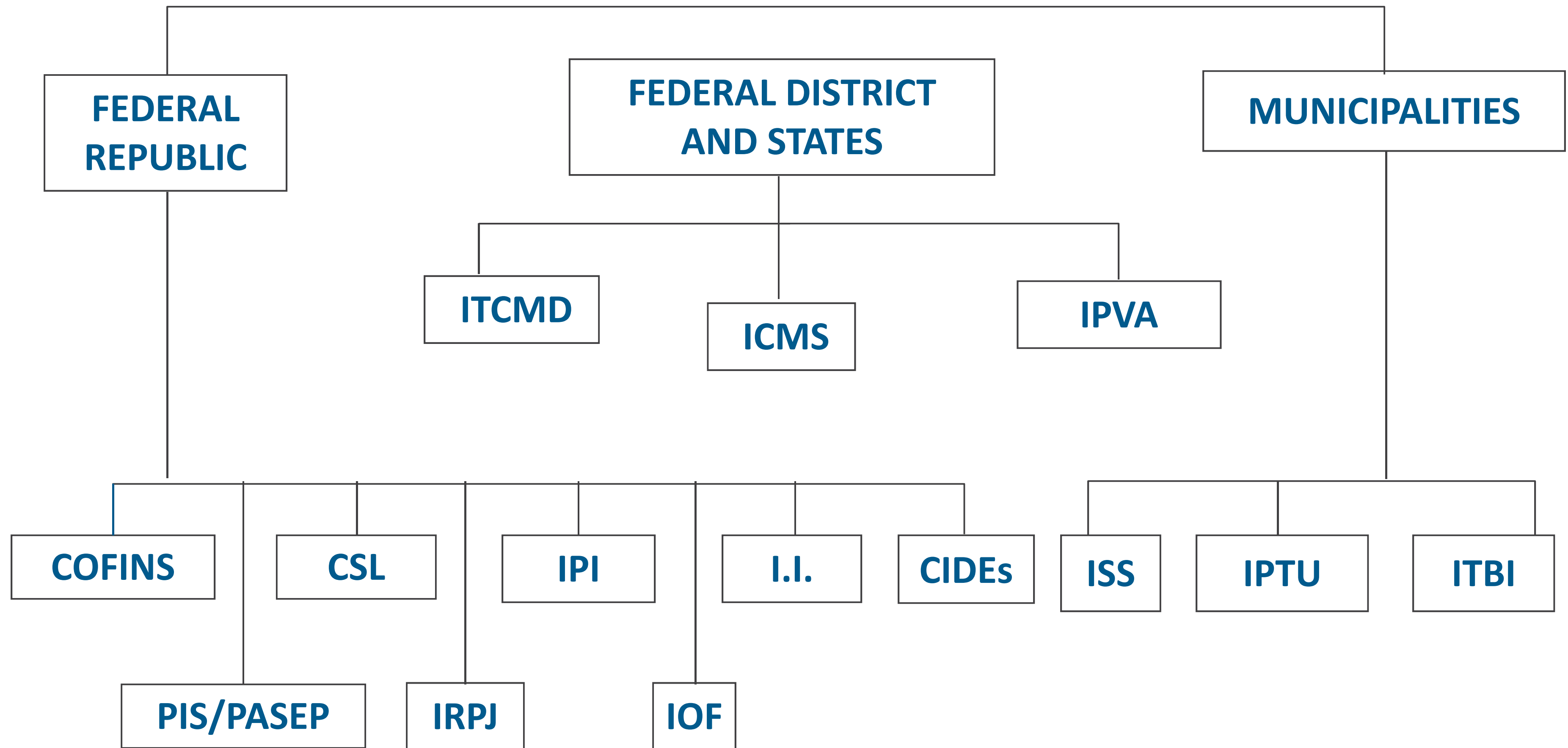
- Taxes in Brazil are divided into taxes, betterment fees, social contributions, other contributions and compulsory loans. Each level of government is allotted specific taxes which are listed in the Constitution.

Tax Principles

Taxes in whatever instance must always abide by certain tax law principles warranted by the Federal Constitution, including:

- Strict lawfulness principle (*princípio da legalidade*): any and all taxes must be created by a law detailing all triggering events, the taxpayer, the tax base and rate, when and how it will be owed and payable.
- *Ex post facto* taxation principle (*princípio da não retroatividade*): events predating the effectiveness of the law creating a tax or increasing its rate are not reached by such law.
- No same-tax-period taxation principle (*princípio da anterioridade*): except in a few cases for the implementation of economic policies, no tax may be levied in the same tax year in which the law creating or increasing it is published.

Brazilian Main Taxes



Brazilian Main Taxes

Event	Tax levied
Earning of Income	IRPJ/CSL
Earning of Gross Revenues	PIS/COFINS
Rendering of services	ISS
Sale of Merchandises	ICMS
Transfer of Real Estate Property	ITBI
Inheritance and Donation	ITCMD
Financial Transactions	IOF
Sale of industrialized Products	IPI
Import of Products	II
Export of Products	IE

Corporate Income Tax

- The Corporate Income Tax (“local acronym IRPJ”) is assessed on the income earned by individuals or legal entities domiciled in Brazil, derived from domestic or foreign sources. (Worldwide taxation principle)

- Brazilian legal entities also pay Social Contribution (“local acronym CSL”) on the profits earned. Total tax burden on income is 34% for corporations and 40% for financial institutions.

- The Income Tax is also levied on the income earned by non-residents in connection with Brazilian assets or derived from paying sources located in Brazil.

- Higher tax rates for income and capital gains earned by residents domiciled in tax haven jurisdictions.

- Brazil has signed Treaties to avoid Double Taxation on Income with several countries, including Spain, Italy, Belgium, Austria, France, Japan and China. There are no Treaties signed with US or UK yet.

Brazilian Transfer Pricing Rules

Brazilian Transfer Pricing Rules

➢ ***General Overview***

- Enacted in 1996. Currently regulated by Law nº 9.430/96 and its further amendments.

- Statement of Justification of Law 9430/96 : the purpose of these rules is to "prevent the abusive practice **of transferring results abroad by manipulating the prices agreed on for the import or export of goods, services and rights**, in transactions with related persons or persons resident or domiciled abroad."

- Applicable to export and import of goods, services or rights carried out between related parties. Loan transactions are also subject to Brazilian Transfer Pricing Rules.

- Concept of related parties is very broad and includes almost all companies that belong to the same economic group. Brazilian TP rules are also applicable to transactions carried out with residents domiciled in tax haven jurisdictions or in privileged tax regime.

Brazilian Transfer Pricing Rules

➢ ***General Overview***

- Although inspired in the OECD transfer pricing guidelines, the Brazilian rules are very peculiar and should be verified on a case-by-case basis for a consistent application.

- Statement of justification of Law 9430/96 sets forth that Brazilian TP Rules apply the arm´s length principle; however, the Brazilian legislation sets forth rigid methods that frequently does not leads to an arm´s length price.

- The difference between the price parameter achieved with the applications of the import and export methods is considered non-deductibile (import transactions) or added to IRPJ and CSL tax basis of the Company (export transactions).

Brazilian Transfer Pricing Rules

➢ ***Import Transactions - Methods***

- **Independent Comparative Prices Method ("PIC")**: defined as the average of the prices of identical or similar goods or services in the Brazilian market or in the markets of other countries for purchase and sale transactions on similar terms;

- **Resale Price Less Profit Method ("PRL")**: defined as the average resale price of the goods or services, less: the 60% profit margin calculated over the resale price after deduction of the some amounts allowed by the legislation and the value added in Brazil; **(revoked, as will be discussed in the next slides)**

- **Production Cost plus Profit Method ("CPL")**: defined as the average production cost of identical or similar goods or services, in the country where they were originally produced/rendered, plus taxes and fees charged by said country on export transactions, plus a 20% profit margin calculated on the assessed cost.

Brazilian Transfer Pricing Rules

➢ ***Export Transactions***

Safe Harbors

- Brazilian legislation provides for safe harbors for export transactions. If one of the conditions below is observed, the company is in compliance with Brazilian TP Rules:

  1. the revenues from the export of goods, services or rights is higher than 90% of the average price for the sale of the same goods or services in the Brazilian market, during the same period and in similar payment conditions.

  2. the Brazilian company can prove that it had net profits from exports to related parties, equivalent to at least 5% of the earnings from these transactions.

  3. when the total net earnings from exportations (both to related and non-related parties) does not exceed the limit of 5% of the total net revenue earned by the company.

Brazilian Transfer Pricing Rules

➢ ***Export Transactions - Methods***

- **Export Comparable Uncontrolled Price Method ("PVEx"):** defined as the average sales price in exports made by the same company to other customers or in exports made by another Brazilian exporter of equivalent or similar goods, services or rights during the same tax period and under similar payment conditions;
- **Wholesale Price Method ("PVA"):** average sales price for equivalent or similar goods in the wholesale market of the country of destination, under similar payment conditions less a profit margin of fifteen percent on the wholesale price;
- **Retail Price Method ("PVV"):** the average sales price for equivalent or similar goods in the retail market of the country of destination, under similar payment conditions, less taxes included in the price, less a profit margin of thirty percent on the retail price;
- **Cost Plus Method ("CAP"):** the average purchase cost or the average production cost for exported goods, services or rights, plus taxes paid in Brazil, plus a profit margin of fifteen percent over the total cost plus taxes.

Brazilian Transfer Pricing Rules

➢ ***Recent Change***

- Provisional Measure nº 478, enacted on December 29th, 2009 (“MP 478/09”) instituted a new method for import transactions called the Resale Price minus Profit (“PVL”), which revoked the former Resale Price method (PRL).

- The price parameter is calculated using PVL as follows: (a) the percentage of the cost of the imported good in the total cost sale of the product, (b) this percentage is applied on the resale price of the good, (c) over the amount of participation of the imported good in the final sale of the product is applied a 35% profit margin. The price parameter is the difference between (b) and (c).

- The main differences between former PRL and PVL are: (i) there is just one profit margin of 35%, regardless if the Brazilian company is submitting the imported good into a industrial process or not and (ii) the price parameter is calculated based on a proportional resale price based on the cost of the imported good.

Brazilian Transfer Pricing Rules

➢ ***Recent Change***

- MP 478/09 is still under analysis by the National Congress before its potential conversion into law. During such process, the provisional measure may be amended by the Congress.

- Federal Revenue Office may issue a normative ruling to regulate these new rules brought by MP 478/09.

Brazilian Thin Capitalization Rules

Brazilian Thin Capitalization Rules

- Until the end of 2009 there were no Thin Capitalization Rules in Brazil.

- Foreseen in Provisional Measure nº 472, enacted on December 15th, 2009 (“MP 472/09”).

- Purpose is to avoid non-residents with interest in Brazilian companies repatriate the invested funds through interest payment (deductible) rather than dividends (non deductible).

- Applicable to debt transactions carried out by Brazilian companies: (i) with related parties (same concept of Brazilian TP Rules) domiciled abroad and (ii) any natural person or legal entity domiciled in tax haven jurisdiction or privileged tax regime.

Brazilian Thin Capitalization Rules

Transactions with related parties

- Debt to equity ratio of 2/1 if the related party has equity interest in the Brazilian company.

- Total debt may not exceed 50% of the net equity of the Brazilian company if the related party does not have equity interest in the Brazilian company.

Transactions carried out with tax haven or privileged tax regime domiciled entities

- Total debt may not exceed 30% of the net equity of the company in Brazil.

Brazilian Thin Capitalization Rules

- Thin Cap Rules also apply if the Brazilian company enters to debt transaction in which the surety, guarantor, attorney in fact, or any consenting party is an associated person or a person incorporated in a tax haven jurisdiction or jurisdiction with privileged tax regime.

- Discussions on when Brazilian Thin Cap Rules will enter into force (2010 or 2011).

- MP 472 is still under analysis by the National Congress before its potential conversion into law. During such process, the provisional measure may be amended by the Congress.

- Federal Revenue Office may issue a normative ruling to regulate thin capitalization rules.

Questions & Answers

Thank you

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