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19 October 2017

Platform for Collaboration On Tax
c/o The World Bank Group
1818 H Street, NW
Washington, DC 20433

Via email: taxcollaborationplatform@worldbank.org

RE: Taxation of Offshore Indirect Transfers – A Tookit

Dear Sir or Madam:

The Platform for Collaboration on Tax (the Platform), a joint initiative of the Organisation for Economic Co-Operation and Development, International Monetary Fund, United Nations, and World Bank, released a document entitled *The Taxation of Offshore Indirect Transfers – A Toolkit* (the Draft Toolkit or Toolkit) on 1 August 2017. The Draft Toolkit was designed to help developing countries address the complexities of taxing offshore indirect transfers of assets, which the Platform states is a practice by which some multinational corporations try to minimize their tax liability.

The Platform requested public feedback on the Draft Toolkit from interested stakeholders by 20 October 2017. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the Platform's request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world.[1]

TEI's members are responsible for managing the tax affairs of their companies and must contend daily with the provisions of the tax law relating to the operation of business enterprises, including issues surrounding the tax

[1] TEI is a corporation organized in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

complexities of offshore indirect transfers. We believe that the diversity and professional training of our members enable us to bring a balanced and practical perspective to the issues raised by the Draft Toolkit.

TEI Comments

Overview and Summary of Comments

TEI appreciates the opportunity to comment on the Draft Toolkit and its proposed approach to the tax issues presented by offshore indirect asset transfers. As a threshold matter, TEI notes the status of the Toolkit is unclear. The Draft Toolkit does not appear to be an officially sanctioned or endorsed view of any of the contributing organizations that comprise the Platform, nor any of the member countries. However, in TEI's view there is a strong possibility tax authorities, particularly in the less developed nations for which the draft Toolkit is being developed, will treat the Toolkit as authoritative guidance. Therefore, TEI recommends the Platform make clear that the Toolkit should not be treated as authoritative guidance and is not meant to override contrary guidance that is authoritative, including obligations imposed by bilateral income tax treaties. Changes to the fundamental policy underlying the capital gains articles of treaties should be the subject of discussion by countries, either bilaterally or in a multilateral framework.

Overall, we believe the Platform should reconsider its suggested approach to offshore indirect transfers as set forth in the Draft Toolkit and focus on helping countries make informed decisions about how to treat offshore indirect transfers for tax purposes. This could be done by detailing the advantages and disadvantages of various approaches to taxing or not taxing offshore indirect transfers, and in particular detailing the issues that should be considered when making the decision *whether* to tax such transfer before deciding *how* to tax them.

The Draft Toolkit should also ensure neutrality and symmetry for offshore indirect transfers when compared to direct asset transfers. Relevant issues to consider when assessing a tax on indirect transfers include how to determine the potential capital gain, how to ensure a step up in the basis of the underlying assets, whether deferral rather than recognition of gain is possible, how to limit the scope of the rules to ensure effective taxation while avoiding unintended taxation and other consequences, and how to address offshore indirect capital losses. It is critical that these issues be discussed in sufficient detail to ensure that the final toolkit provides helpful guidance to developing countries.

More broadly, TEI believes the Platform's agenda should be driven by the objective, also supported by the G20, of providing toolkits that increase certainty for taxpayers and tax authorities. Currently, how offshore indirect transfers will be assessed and taxed is often uncertain in various countries. Rather than trying to coordinate and recommend a consistent approach to taxation across countries, which in our view will fail, certainty can most likely be achieved in the Draft Toolkit by helping countries make clear and informed choices on whether such capital gains should be taxed, and, if so, how they should be taxed and what transactions will be subject to such a tax. Whether a transaction falls within the scope of an offshore indirect

transfer tax and the value of the actual result of the transfer, however both are determined, are the most common sources of disagreement between taxpayers and tax authorities, yet the Draft Toolkit offers very little to increase certainty in this respect.

As both taxpayers and tax authorities are looking for certainty, it would be helpful to bring them together with Platform representatives to discuss concerns and potential solutions before finalizing the Draft Toolkit.

Overall Approach of the Draft Toolkit

It is unclear what goal the Platform has in mind for the Draft Toolkit. As the organizations comprising the Platform have different objectives and deliverables, further clarification of the approach and objective would be helpful. One issue, as noted above, is the status of the final toolkit as "final" or "authoritative" guidance for any of the Platform's organizations.

More broadly, TEI believes the United Nations' (UN) approach to taxing offshore indirect transfers better suits the underlying technical issues. Generally, the UN provides different options for addressing tax issues and details the advantages and disadvantages of each. In general, the UN's endeavors to place tax authorities in a position to make an informed choice when determining tax policy without attempting to choose the best approach on behalf of countries. This has been the approach, for example, of the UN Subcommittee on Extractive Industry Taxation Issues for Developing Countries, which has opined on the taxation of capital gains – direct or indirect – for such industries. In contrast, the Draft Toolkit appears to strongly recommend countries tax indirect capital gains as an initial matter, and then provides two specific options of how to do so. This goes beyond the general approach that at least some of the Platform's contributing organizations take to such matters and may not be acceptable to countries who are members of those organizations, or other countries generally.

The efforts of the organizations comprising the Platform should be commended, however, as the Platform appears to be the best way to align the approaches of these multinational organizations toward developing countries. We hope coordination between these institutions can increase, which in TEI's view can be furthered with clarification of the Platform's objectives, approaches, and deliverables. This coordination should include aligning terminology, definitions, and even abbreviations among the organizations to ease understanding of the Platform's discussions and documents and reduce cross-organizational misunderstandings.

Taxation of Capital Gains and Indirect Capital Gains in General

The Draft Toolkit posits that a capital gains tax will not distort economic transactions. TEI believe that this is incorrect, particularly in extractive industries. In countries where capital gains taxation is present, introduced, or expanded, such taxation will likely result in fewer ownership transfers of business opportunities, which may leave them un- or under-exploited (either in efficiency or time). This approach may prevent the offshore business best suited to maximize the value of the opportunity from becoming involved, resulting in lower growth in the local country.

In general, investors assess after tax cash flows when determining the profitability of an opportunity. For this reason, the tax system, while not in itself decisive, will always be a factor in investment decisions. Moreover, tax systems are often specifically designed to encourage investment and increase employment. As capital is constrained via a capital gains tax, investors will compare alternatives. This is especially the case for business sectors whose profitability depends on the success of long term projects and prospects (*e.g.*, the extractive industries); corporate taxation and capital gains taxation are only part of a tax system that can affect investment returns. Royalties and project bonuses bring forward the moment of taxation before any particular long-term prospect may become profitable. A capital gains tax and/or an indirect capital gains tax would further frontload taxation, pushing the point of an investment's positive return further into the future. If a local tax system is already frontloaded, policymakers in that jurisdiction should consider whether to introduce or expand capital gains taxation in that context. In addition, introducing capital gains taxation may produce double taxation as the future income stream is taxed upon the disposal of a business and then again as the new owner generates income. An indirect capital gains tax only further increases the risk of double taxation.

In TEI's opinion, the above differences across tax systems in different countries makes the UN's approach preferable. It is more useful for policy makers in developing countries to be fully aware of the advantages and disadvantages of a tax on offshore indirect transfer so they can better assess whether the implementation of such a tax in their current system would be predictable and clear. Having a tax regime that is based on consistent and predictable application of principles-based tax rules is the best way to promote and attract investment. In TEI's view, tax principles and rules should be transparent, proportionate, administrable, fair, reasonably certain, conducive to timely determination of results, and avoid double taxation of profits or non-deduction of costs. Attempting to tax transactions in an ad hoc manner and potentially in contravention to agreed taxing rights (such as under a treaty) should be discouraged. Again, clearly presenting the advantages and disadvantages of capital gains taxation in the first instance, the same for indirect transfers second, and then options on how to implement such a tax is a better approach and will allow countries to make an informed decision on an indirect transfer tax that furthers their overall tax policy goals.

Technical Considerations to Permit an Informed Decision on Capital Gains Taxation of Offshore Indirect Transfers

Before considering options for the taxation of indirect transfers, TEI believes the developing countries that are the focus of the Draft Toolkit would be better served if the Toolkit addressed symmetry and neutrality in a broader sense. These aspects would help alleviate double taxation concerns that arise in many capital gains tax systems and should be analyzed in the Toolkit. While the toolkit early on recognizes that transfers of assets – either directly or indirectly – can generate capital gains as well as capital losses,[2] none of the options set forth how to address offshore indirect transfers that result in a loss. The Draft Toolkit several times emphasizes the need for neutrality between direct and indirect transfers of capital gains, and

[2] *See*, *e.g.*, Draft Toolkit, p. 11.

indeed various capital gains tax systems currently exist that provide neutrality for share transactions, if the profit generating assets remain in the country, which ensures tax neutrality for such transactions. Although the Toolkit supports tax neutrality in principle, it does not provide enough detail on approaches that actually result in neutrality. TEI recommends that the Toolkit be modified to include examples of neutrality approaches.

Symmetry in tax treatment is also not developed in the Toolkit. Generally, tax policy that taxes capital gains allows deductibility of losses. Should the Platform wish to make the case that where capital gains are taxed, indirect capital gains should also be taxed, it should detail how to deduct indirect capital losses. The options proposed in the paper only contain a short description of how offshore indirect transfers should be taxed and how that tax should be collected. A number of high level comments are then included on how to provide a basis step-up. Like the basis step-up, the treatment of a potential loss is not covered in detail at all, but merely mentioned, leaving countries, and in particular developing countries, to their own devices to address – or ignore – such critical issues.

TEI also recommends the Platform exclude internal reorganizations from the scope of any indirect asset transfer tax. In an internal reorganization assets may be indirectly transferred to other parts of the group, for operational, legal, and other reasons. When countries tax indirect offshore transfers, such changes in shareholding within a group of companies would generally fall within the scope of the tax without any actual ultimate change of control of who owns the assets.

The Toolkit also does not consider guidance on how to handle listed/publicly traded companies. When countries consider expanding their capital gains taxation to indirect transfers, all share transfers could create concerns. Shares in some companies may change hands frequently, so when assessing whether there has been a sufficient change in ownership to trigger an indirect capital gains tax, it would be extremely difficult to determine whether normal day-to-day trading of a company's shares has triggered the rule. More fundamentally, public trading of a company's shares does not present the same tax policy concerns as majority ownership transfers in an entity that holds local appreciated assets. For this reason, TEI recommends the final Toolkit exempt public trading on a stock exchange from the scope of any indirect transfer tax.

The Toolkit should also specifically address how to treat joint venture (JV) partners of a company transferring its ownership. That is, the Platform should spell out at what point is a capital gains tax triggered when only one JV partner transfers part or all of its shares (at once or within a specified time period) and who is liable for that tax as it raises several questions. For example, do the indirect transfer tax models expect the JV entity – owned by parties who have not transferred anything – to pay the tax, which would impact all JV partners? How would a step up in basis work in a JV scenario? How do the models in the Toolkit envisage a JV obtaining the funds necessary to pay any such tax if all the proceeds from a sale go to the JV owner? What if nobody acquires control in such a transfer? For example, suppose two JV partners sell 20% and 30% respectively, but to different purchasers – would that trigger the tax? Should there be a need for someone to gain control, as opposed to just a change in control, for the capital gains tax to be

triggered? Moreover, many JVs are organized as pass-through entities, with the tax burden of the JV's operations falling directly on the JV's owners. Thus, any tax levied on the JV entity for a sale of an interest in the entity would have an immediate deleterious economic impact in the JV's remaining owner(s). The Platform should therefore also address how to handle JV's formed as pass-through entities in the final Toolkit.

These types of issues need to be addressed by any country enacting an indirect transfer tax because they can substantially impede a country's ability to create certainty for investors, especially for large and long term investments. Elaborating in detail on some of these issues would therefore help improve tax certainty. With respect to the models generally, it would be very helpful to focus on clarifying the issues and options, as well as detailing their advantages and disadvantages.

Potential Anti-Abuse Approach

The Draft Toolkit describes the offshore indirect transfers that would be subject to tax as transfers made "offshore for tax purposes." In case the Toolkit only covers transfers made offshore for tax purposes, it should include examples of offshore transfers that are *not* made for tax purposes and therefore not subject to the tax. Most indirect transfers are made for non-tax reasons and it is critical that the Platform state this in the Toolkit. For example, share sales may be preferred to asset sales because of the ease of transferring the underlying assets and local employee considerations. Moreover, offshore companies are often used for non-tax reasons, such as the absence of robust local corporate legislation and the protection of intellectual property.

More broadly, the Draft Toolkit should avoid the inference that most companies illegally evade taxes. The vast majority of multinational companies are compliant and pay their taxes in accordance with all laws. To address those small number of companies who operate outside the law, countries with clear legislation and transparent tax policy could then tax offshore indirect transfers only in abusive cases. This approach would focus those countries on tax abuse while limiting unintended consequences to investments and the resulting negative impact on economic growth. Such a beneficial result would be furthered if application (or non-application) of such an anti-abuse legislation can be confirmed up front by tax authority rulings in a transparent manner. Should tax authorities decide to look through the corporate form and consider an indirect transfer as a direct asset transfer under an anti-abuse rule, the taxpayer should have the opportunity to provide evidence that the offshore transaction was made for non-tax purposes and therefore not within the scope of the rule.

Specific Comments on the Options for Implementing an Indirect Transfer Tax

The Draft Toolkit includes two pertinent options for implementing an offshore indirect transfer tax. The first option makes the direct corporate asset owner, who does not receive any compensation in the transfer, liable for the taxes on capital gains realized by another company. This option is problematic for a number of reasons, primarily because the asset owner may not have sufficient funds to pay what may be a substantial tax burden. The Draft Toolkit points this out on page 47, however, it does not address how such a tax payment could be funded nor, if the

payment is debt-funded, whether interest on that debt is deductible. The Toolkit also does not address the impact on JV partners of making the JV entity liable for the tax. JV partners are often not involved in indirect transfers (*i.e.*, the transfer is made by the other JV partner) but may nevertheless be taxed on a non-existent gain.

The second option has the advantage of taxing the party effecting the transfer. This should reduce or eliminate the issue of funding the resulting tax payment and will allow the party paying for the assets to obtain a step-up in basis. To be effective and provide more certainty, the Draft Toolkit should also discuss ongoing effects of a tax on an indirect sale, for example how should depreciation be allowed and on what basis.

In both options, determining the value of the actual gain is often a primary issue. The Draft Toolkit appears to imply (correctly) that only the gain should be taxed, not the proceeds. The Toolkit should state this explicitly and also include further clarification as to what assets the tax should apply, and how the gain is to be allocated among them (*e.g.*, based on their fair market value? Tax basis? Book value?).

Additional Specific Issues

The Draft Toolkit assumes that the "source" country has the primary right to tax the gain on the underlying property in an indirect transfer (*i.e.*, a transfer of shares in a company that owns the underlying property) and does not discuss the rationale for residence based taxation of shares. Under current general international tax principles, the country of residence has the right to tax capital gains other than those explicitly enumerated by the relevant tax treaty. The "political economy" argument – positing that the inability of a country in which an asset is located to tax indirect tax transfers provokes "intense domestic dissatisfaction" and may harm efforts to build a "tax-paying culture"[3] – focuses on a few high-profile cases that are not representative of the vast majority of asset transfers, whether direct or indirect. In TEI's view, the high-profile cases are more appropriately dealt with through narrower, targeted rules – perhaps an anti-abuse rule as discussed above.

The Draft Toolkit contains several examples of country practices in taxing offshore transfers, including a discussion of the U.S. taxation of dispositions of U.S. real property held by foreign investors. However, the examples deal with the simplest of cases and any rules promulgated to address offshore indirect transfers generally would need to adopt and define many thresholds and terms for such rules to be practically applied.

We also note that the Draft Toolkit abandons, without justification, the general treaty definition of immovable property. Instead, it advocates an alternative, novel, and expansive definition of such property, which the Toolkit then acknowledges is difficult to capture in legislative language. It is unclear how this new definition would be interpreted by tax authorities and would create a significant future risk of economic double taxation. TEI therefore recommends the Draft Toolkit use the traditional treaty definition of immovable property.

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[3] Draft Toolkit at 23.

Separately, the concept of location-specific rents is not helpful. As the Draft Toolkit acknowledges, access to a local market could be considered to generate location specific rents. However, it appears that the concept is intended to be interpreted expansively yet is poorly defined. As such, in TEI's view location specific rents will be interpreted in ways that will reduce certainty and deter investment. We recommend the final version of the Toolkit not include this concept.

Finally, the deemed disposal approach ignores the difficulties associated with imposing a tax on an entity that has no proceeds from a sale and may be unable to pay the tax. Also, depending on the thresholds, it may be difficult for the entity holding the local property to know that a transfer triggering gain recognition has occurred. This approach should be discarded or tightly limited to a small number of clearly delineated fact patterns.

Conclusion

TEI appreciates the opportunity to comment on the Draft Toolkit regarding offshore indirect transfers. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Giles Parsons. If you have any questions about the submission, please contact Mr. Parsons at +44 1455 826561, parsons_giles@cat.com, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 464 8353, bshreck@tei.org.

Sincerely yours,
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