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E&Y ROUNDTABLE

ERNST & YOUNG AND THE GLOBAL TAX ARENA - THE VIEW FROM THE DESK

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When people from Ernst & Young talk about “being a Desk,” this is neither a reverse twist on anthropomorphism nor a foray into method acting. Rather, it is the description of the role that they have played in the firm’s on-site, hands-on approach to addressing the needs of global businesses that began some 25 years ago. Known as the Foreign Desk Program, this network is made up of well-qualified individuals from the U.S. and dozens of other countries whose job is to provide multinationals with on-site tax and business knowledge and jurisdictional cultural insights, particularly with respect to the tax impact of both inbound and outbound transactions.

THE DESK PROGRAM

The Ernst & Young Foreign Tax Desk Program is the largest and longest-running foreign exchange program of its kind. In addition to its obvious service aspect, the Desk experience is designed to be an integral part of the career development arc, allowing seasoned tax professionals from around the world to be temporarily assigned to the company’s member firms in countries outside their country of origin. Duration of the overseas posting is typically two to three years, with some short-term assignments of six to 11 months or longer when necessary to meet specific service needs.

In keeping with the business landscape of the early 1980s, the first Desk was a U.S. Desk in Brussels, followed shortly by a Dutch Desk in New York. Since then, the roster has grown to well over 250 dedicated Foreign Desks

throughout the world. That includes almost 100 non-U.S. professionals working in the United States, more than 70 U.S. individuals in other countries, and another 100 professionals working in non-U.S. countries other than their own.

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Unlike other expatriate arrangements, the Desks are cooperative efforts between Ernst & Young LLP in the U.S. and each local E&Y member firm with shared responsibility and mutual commitment. The result of this dynamic collaboration is truly integrated, global tax planning in real time, moving beyond different time zones, geographic borders, and language barriers.

In December 2007, seven past and present members of the Foreign Tax Desk network gathered at Ernst & Young’s New York offices

AUTHOR:

Ernst & Young, a global leader in professional services, has 130,000 people in 140 countries providing a range of sophisticated services centered on the core competencies of auditing, accounting, tax, and transactions. For further information about Ernst & Young and its approach to a variety of business issues, see ey.com/us/perspectives.

to look back on the evolution of the Desk program and share their insights about its growth and ongoing relevance to the increasingly complex profile of international tax. Participating in that discussion from Ernst & Young were Philip L. Green, an international tax partner and 21-year firm veteran who spent eight years in Europe as a U.S. Tax Desk and led the Europe/Middle East/Africa U.S. Desk network; Alberto R. Lopez, who leads the firm’s Latin American Business Center; Karen S. Holden, a principal in the international tax practice based in Philadelphia and former U.S. Tax Desk in Amsterdam from 1994 to 1998; and Lisa C. Lim, a 23-year firm veteran and leader of the Asia Pacific Business Group who spent six years in Asia and was the firm’s Director of International Tax Services, Asia-Pacific from 2003 to 2005. David M. Benson, a principal in the National international tax practice

One New York Plaza, 34th Floor
New York, New York 10004
T 212.404.8600
F 212.404.8660

Monmouth House
58-64 City Road
London EC1Y 2AL, United Kingdom
T +44 20.7.369.7000

xbsolutions.com



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also participated, and two Ernst & Young Desk alumni rounded out the panel—J. Stephen Barrett, a former E&Y international tax partner, Deputy Tax Director, Barclays, who started the third Tax Desk in New York, the U.K. Desk; and Michael J. O'Connor, who ran the Canadian Desk in London from 1993 through 1995 and is now Senior Vice President, Taxation, Sun Life Financial Inc. in Toronto. Joining them was Robert Gallagher, Managing Editor of JOIT. The views expressed herein are those of the speakers and do not necessarily reflect the views of Ernst & Young or any other member firm of Ernst & Young Global Limited. Likewise, the views expressed by Messrs. O'Connor and Barrett are their own and do not represent their professional affiliations.

The following discussion not only includes their perspectives on the experience of working as the Ernst & Young Foreign Desks but also describes how the Desk program paralleled the emergence of international tax issues and the development of the global economy.

Philip: When the U.S. Desks began in Europe during the early 1980s, their focus was heavily weighted towards U.S. multinationals with significant European presence and subsidiary operations. U.S. MNCs [multinational corporations] have historically needed a global perspective because of the U.S. foreign tax credit regime, which has an impact on their global earnings and effective tax rate and influences their ability to tax-effectively repatriate overseas cash to the U.S. It was important to minimize excess foreign taxes and avoid inadvertent transactions or activities that might create tax headaches back in the U.S. These and other factors largely drove the need to have U.S. tax advisors on the ground working directly with European and U.S. tax executives within our clients' global organizations.

With the passage of time, European and Asian multinationals began to evolve their tax perspectives and adopt a more global approach. U.K. companies also had to deal with their own foreign tax credit system, and, although it was not quite as limiting as the U.S. system, it did push them towards a more global perspective. Because of the participation exemption systems of many

continental European jurisdictions, these multinationals may not have had the same degree of urgency in fully understanding the details of activities and tax positions that were occurring abroad. When foreign earnings were repatriated, the dividend income was generally exempt from taxation, so these companies often took a more decentralized approach and may have felt less immediate pressure to address tax planning from a global perspective.

Dave, since you're the most senior member of this panel, let's begin by having you reflect on the early '80s and give us your historical perspective and insight as to how things have evolved to where we are today.

David: I suppose I do have that perspective, Phil, since I may be the only one in the group who was out of high school at the beginning of the period that we're talking about! In any case, in the mid-'70s and early '80s, I spent about seven years at the IRS in Washington working on international tax issues. At the time, international was only a small part of the National Office Chief Counsel group and of the organization as a whole.

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That was before the 1986 Tax Act in the U.S., which was such a seminal event. It reduced the corporate tax rate in the U.S. from 46% to 34%, and that alone put tremendous pressure on U.S. companies' ability to use foreign tax credits. But the '86 Act also substantially tightened the foreign tax credit regime itself, by increasing the number of baskets and changing the expense allocation rules. Not only that, the Subpart F rules were also changed, making deferral tougher to maintain in many cases. All of this had the effect of pretty much forcing U.S. multinationals to reduce their foreign taxes, which at the time were generally imposed at much higher rates than the new U.S. 34% rate. So the '86 Act kind of crystallized the global aspect of planning from a U.S. perspective. Since then, of course, there's been explosive growth in business in general and in the need for tax services in particular. I went to work in Europe just after the '86 Act was passed. It was a very interesting time to be working with U.S. companies having operations on the continent, as well as European companies investing into the U.S. European rates began coming down and

transfer pricing started to become a critical element of planning for all multinationals. It was also the first time that this thing called the European Union began to matter from a tax standpoint and we've all seen the significance of that organization grow enormously with the various Directives and, more recently, momentous European Court of Justice cases.

Stephen: I'd like to take up from a point that Phil made about the participation exemption for most continental European countries. Of course the U.K. didn't have, and still doesn't have, a participation exemption and relies on the foreign tax credit to help mitigate double taxation. In 1981, the U.K. Inland Revenue issued a consultative document and initiated the controlled foreign corporation [CFC] tax regime. That document was a yellow-bound tome that became known as "the Yellow Peril." It was very complex and incredibly difficult to understand. It was really new stuff that culminated in the CFC rules coming into the U.K. system in 1983. That demonstrates what a stark difference it would be looking at things from a U.K. perspective rather than from those countries that have a participation exemption and no CFC regime.

And when you bear in mind that at that time the U.K. corporate tax rate was 52%, it was a really big issue for multinationals headquartered in the U.K. It's also fair to say that the U.K. already had something like 100 double tax treaties. It's important to remind people of the economic environment at that time. When Margaret Thatcher came to power in 1979, U.K. inflation was running at around 27%. So the U.K. system had all sorts of quirky aspects that you just wouldn't find in a different sort of environment.

Philip: That's also interesting when you think about the countries where the Foreign Desk program expanded rapidly. The U.S. and the U.K. were early leaders of that practice, both having a foreign tax credit system and CFC regime. Each country needed to have the other's tax professionals in their country working with the head office tax executives advising on tax implications arising from cross-border operational activities and expansion plans.

Lisa: While I was still in the U.S. during the 1980s, I had the good fortune of working with a lot of the Japanese inbound investors

to understand their perspective. It was the age of the Japanese powerhouse. Japanese companies were dominating the electronics sector. Everything was very Japanese-centric at that time. The manufacturing was performed in Japan. The R&D activities were in Japan and they took pride in reporting the bulk of their income in Japan because all the functions and risks were in Japan. And then the Japanese currency began to appreciate against the U.S. dollar.

Philip: And it appeared that the Japanese companies didn't seem to mind having their earnings taxed at relatively high Japanese income tax rates.

Lisa: Over time, they did change their business models because they were concerned when their foreign subsidiaries reported losses while profits were reported in Japan. This was the age when the IRS started looking at the transfer pricing of Japanese multinationals.

Karen: I remember a 60 Minutes show at that time on transfer pricing and it was all focused on Japan and the carmakers. So the idea began to hit the public consciousness with 60 Minutes describing transfer pricing for the average person. That must have been just after 1986, when I worked for the IRS. The international group, which started in the late '80s, actually showed that clip to us as indoctrination for IRS chief counsel attorneys to get everybody on board as they started the transfer pricing practice.

Lisa: Japan, of course took the lead from the IRS. Since the IRS was auditing Japanese inbounds in the U.S., Japan decided to audit the U.S. outbounds in Japan. This period led to significant growth in bilateral advance pricing agreements [APAs] because it was getting to be unbearable when singular adjustments were being made in just one jurisdiction. In that period, we also saw Japan move manufacturing

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to Southeast Asia and both manufacturing and R&D activities to the U.S. to become more global and customize their products for the non-Japanese consumers.

Philip: What's also interesting about transfer pricing is that, as a subset of international tax, it's a global taxing concept that multiple

jurisdictions had to contend with. Because the rules in each country didn't, and to some degree still don't, necessarily match, the concept and benefits of the APA evolved as multinationals became more global.

Lisa: That's a very good point, Phil. In the late 1980s, a lot of the Japanese inbounds were facing significant adjustments from the IRS; if they had not approached the Japanese Competent Authority, they would have been subject to double taxation. This would have resulted in exorbitant tax rates. By going into an APA program, they had the ability to have the Japanese competent authority and the U.S. competent authority reach an agreement on what is an arm's-length transfer pricing policy, and could generally roll the results back to prior years.

Obviously the U.S. and Japan were at the forefront. The Korean multinationals were the next to be hit in the U.S. because of the major brand names that we all see and know. Because of the automakers, appliance makers, and electronics manufacturers, Korea was the next to embrace the APA program, bilateral as well as unilateral. Then, more and more multinational companies were considering how to align their supply chains with tax efficient approaches, which in Asia generally involved the use of "principal" or entrepreneurial companies in a tax-friendly jurisdiction like Singapore. And who are the countries affected by this? Korea, Japan, and Australia, because there were movements of functions, risks, and people to Singapore or other low-taxed jurisdictions. Again, tax assessments were raised against the multinationals. Singapore has been very active in the last one to four years negotiating mutual agreement procedures and now negotiating and concluding bilateral APAs with these jurisdictions. In essence, APAs are now very much embraced in Asia as an efficient way of managing tax controversy. In fact, China has been inviting companies to negotiate APAs and has concluded three bilateral APAs that include the U.S., Japan, and Korea.

David: Lisa, it's fascinating to think of where we are today in transfer pricing and APAs versus where we were 25 years ago when transfer pricing was not such a hot topic in the U.S. and was not at all on the radar screen in the rest of the world. Now look

what it's come to.

Lisa: Yes, in fact the Ernst & Young [global transfer pricing] survey indicates that transfer pricing is the number one topic on the minds of a lot of tax directors.

Philip: Let's now look back at Europe with Karen's perspective, and then we'll get Michael's view as a Canadian who was based in London. Karen, what was it like when you were in Holland and what were the concerns of that client base?

Karen: The time period around 1986 was interesting. About the same time the U.S. corporate rate went down, the Dutch in particular, as well as others in Europe, figured out ways to help U.S. multinationals get their foreign rates down—I think that was the golden age of the Dutch rulings. Many tax incentives were being offered in Europe during that time, so a lot of U.S. companies started using places like the Netherlands for their royalty flows, withholding tax planning, and other reductions of the foreign tax rate on their operations. And I think that's where the need for some of the Desks in Europe grew.

It was strange when I got there. That was shortly after the new [1992] U.S.-Dutch treaty changed, so the ability to use the Netherlands as a place to help with withholding tax planning and other tax requirements changed significantly. It had the first Limitation-on-Benefits provision put into a treaty. It still isn't as favorable as some of the later ones. And it shocked people.

Tax directors faced a tremendous amount of work trying to adjust. There was a lot of overlaying with U.K. multinationals as well using Dutch holding companies. So I think the atmosphere at that point started to change in Europe. Maybe it was combined with transfer pricing and the growth of the European multinational market. The Dutch Minister of Finance, in particular, came out and said "We're not going to give these rulings so freely anymore

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and we're going to start thinking about Dutch multinationals.' So it became a little more difficult to do that kind of planning. And the EU added pressure to call for harmonization, for curtailing beneficial tax regimes, and for

less competition between the players there.

Things really did start to shift a bit. Rulings were still issued, though they weren't as easy to get. And the countries were beefing up their internal regimes to protect their tax base in whatever ways they could. Originally, U.S. multinational tax directors were focused on U.S.-outbound investments through the Netherlands into Europe. That shifted more to the foreign multinationals, the big Dutch multinationals, and focused on their tax planning, their tax position, and what things could they do.

Philip: What was your experience with the tax directors of the Dutch multinationals and their perspective on global tax planning?

Karen: They didn't have as much pressure on effective tax rate [as U.S. companies] with the participation regime that they had, but transfer pricing started to put pressure on them. As transfer pricing rules became more robust, that led to expansion into some of the developing countries where the regimes weren't as certain. So global competitiveness came into play and became important.

It was an education process on all sides. I think the service-provider side of things was very interesting because of cultural differences between U.S. people coming over and the approach of U.S. multinationals versus foreign multinationals. The Foreign Desk program required that you get sensitized, especially as a young professional, to other cultures. And that was also important because understanding how you would go about serving another company in a different culture can be brought back to your own country to mean greater understanding and appreciation for global business.

Stephen: You can't over-emphasize the difference in the cultural approach to the practice. When I came to New York in 1991, it was just a breath of fresh air for me because of the willingness of U.S. multinationals at that time to engage with folks who had really deep knowledge of the foreign tax system was just overwhelming. I was pushing against an open door all of the time and I found that quite different from my previous environment.

The position of a tax director in a U.S. multinational then was significantly higher up the chain than it was in the U.K. and

probably in the European environment as well. People were much more interested in tax. My general impression was that they wanted to engage in dialogue because tax was important to them. This completely changed my attitude and approach as a tax professional, though I still brought my awareness of U.K.-based cultural requirements.

Karen: In the early days, I remember two big Dutch companies merging and I suggested to the partner that we could help them combine their U.S. groups. I said we should give this guy a call and go see him. And the partner said, "Oh, no, it's against our ethical rules to call him if he's not yet a client. If he calls me and asks, I'll let you know." It was an eye-opener.

Michael: Stephen, you being welcomed like that in New York reminded me of when I arrived in London in 1993. I was lonely. I felt like the Maytag repairman. Selling Canadian tax in London at that point in time seemed a disaster. Canada had the highest corporate tax rate as well as high personal rates, and the Canadian currency was sinking through the floor. I remember going to meetings and no one wanted to hear about Canada because most of the trade was U.K.-U.S. Shortly after I arrived, however, people started to sell their Canadian companies, and that generated a lot of business and made the Desk network really necessary.

Philip: Michael, was the majority of your time spent in the U.K. focused on Canadian disposition planning? What was the mix of your work?

Michael: It became a mix of dispositions and acquisitions. When I was in Toronto with Ernst & Young, I did a lot of transactions, M&A work. When I went to the U.K., I was told I wouldn't be able to do that kind of work anymore because that's not the kind of work that gets done on the Desk. I believed that for a while, but after three months and after taking 20 or so questions, a company calls something "significant." I got very lucky and started off with a fairly large acquisition that evolved into more work, both U.K. and continental, particularly with the Swiss. So, overall, there were a lot of dispositions, but of course someone was buying and someone was selling.

Philip: How did the Canadian perspective differ from the U.K. and others, say Switzerland? At the time, the U.K. didn't have the substantial shareholder

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exemption regime, so they still taxed gains on subsidiary share sales, as opposed to, for example, the Swiss system of participation exemption to eliminate gains from taxation.

Michael: What with the U.K. system, the inflation indexing, and the U.K. mixer [holding] companies, there were many complications. That was my introduction to real international tax. I observed then that the true beauty of international tax is that there isn't one. But many of the people in London at the time were really international tax people. They worked not so much with the U.K. domestic rules, but with the international rules—the OECD rules and the treaties and the treaty networks—and to a much greater extent than I was used to seeing in Canada because most of our operations were Canada-U.S.

The network of Desks and international tax professionals created a common language and a common understanding and probably accelerated the pace of development of the international tax area. We also had the time-zone advantage in London, given that there were people on the ground in the various countries and clients could talk to someone on their schedules. At that time, we were just getting into communicating with e-mail. Actually, I probably used a fax most of the time, but I do recall working with Telex ten years earlier.

Karen: I think our Telex number was on our letterhead until recently. But the on-site, in-person sharing of ideas improved everyone's understanding of international tax relationships. We always kind of laughed at international tax being like state and local tax on steroids because there was a greater tax rate disparity between countries. But the most important thing was to become familiar with all the rules—know the German rules and how they interact with other countries well enough to talk about them if the German guy isn't available.

Philip: Even with the evolution of information technology, nothing replaces face-to-face personal interaction, especially when

you're working through complex business issues and trying to solve the related tax problems. Then and today, the most productive meetings I've participated in have been those where we have the relevant country tax advisors and the client in a room together, collectively working as a team. The ability to efficiently resolve complex issues and develop action steps focused on implementation cannot be matched by conference calls, e-mails, or even video conferences, as useful as they sometimes are. These other means of communication can certainly supplement but cannot replace personal interaction.

Lisa, how did Asia's international tax needs evolve?

Lisa: The Desks in Asia emerged just in the last ten years. In the 1990s,

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the Desk in Japan handled the inbound needs of U.S. multinational tax directors. In those days, companies needed a go-between for U.S. multinationals and the Japanese advisors. The rest of Asia was heavily into incentives planning because Asia was attracting foreign multinationals to invest, build factories, create infrastructures, and construct airports, highways, high-rise office and residential buildings, hotels, and so forth. It was the period of unprecedented growth.

When I went back a second time in 2001, the landscape had changed because the multinationals that invested in Asia were looking for tax planning across Asia, including regional structuring and tax-effective supply chain tax planning. They needed advisors with a background in U.S. tax plus knowledge and on-the-ground experience with tax systems in Asia in order to marry the systems.

Alberto: In Latin America, the '80s were a big problem in terms of the economy. At that time, it was really all about managing cash and the financials for the company and not so much about the taxes. An example of the need for common language felt all over the world was when the check-the-box rules came out in the U.S. You heard "check the box" all over the world in English, and [everyone was] trying to understand what that meant and the different vehicles needed for companies in Latin America. I'm sure the

whole world was reacting to those rules, but the effect of the common language made that change very quick.

Stephen: Particularly back in those earlier days, when we came together to meet with a multinational tax director, it was astoundingly effective to have maybe 14 different countries in a room. In the recession years, around '91 to '94, multinational tax directors weren't traveling much. We tried relying on video conferencing, but it just doesn't work as well. Despite the growth in technology—computers, cell phones, e-mails, the Internet, etc.—it's still important to have people on the ground and able to work together.

Lisa: The Asian multinationals echo that trend because companies in China, Korea, Singapore, and Hong Kong are going outbound. They need to understand global tax topics like CFC rules and transfer pricing. Now they're facing global competition with European and U.S. companies and they need advisors on the ground who can talk the talk and walk the walk, stay current, and help them head in the right direction.

David: Now we have the best of both worlds. The in-person meetings and networks create the common language for technology to be used more effectively and with a better understanding.

Philip: Alberto, can you expand on your experience in Latin America?

Alberto: The '80s were not very exciting years in Latin America for foreign investment because of the recession and very high inflation. The Desk then had to do more with advising U.S. companies that historically were there in the '60s. There really wasn't much foreign investment or M&A activity into Latin America.

Then in the 1990s, Chile started to do very well, Mexico negotiated NAFTA, and there was an explosion of foreign investment into Latin America. Mexico was in front in terms of negotiating treaties and bringing transfer pricing rules into the system, with the rest of Latin America following and borrowing from Mexico as well as from other systems. For instance, the transfer pricing rules were adopted first in Mexico, and then most other Latin American countries used the Mexican rules as a guide for their own rules.

As of 1992-93, it was very exciting to be based in Latin America on the Desk or in New York doing Latin American tax because there was a lot of interest in investments. Many companies moved operations to Mexico with the maquiladora regime and there was a lot of M&A activity. Even after the '94 devaluation in Mexico, the M&A-type activity continued because there were a lot of non-Mexican companies that saw this as an opportunity to buy cheap operations in Mexico and get into the market. In those years, things really started to pick up and we were extremely busy.

TRANSPARENCY AND GLOBAL COOP-ETITION

Philip: Let's discuss the added complexity resulting from the evolution of the global tax system and the move towards more and more transparency, and then share your thoughts regarding the concept of tax harmonization.

Stephen: Just going back to 1983, the U.K. had the entirety of our tax legislation contained in one large book that was about three inches thick. Now we have four large books that are at least as thick. I remember there was one point where they were attempting to keep all of the tax legislation in one volume, so they reduced the thickness of the paper.

A perfect example of the changes in complexity in the U.K. tax system is the "tax nothings" that used to exist, or the federally untaxed single-member limited liability companies [LLCs] that elect not to be treated as associations. A typical example would be the change in value of a long-term liability.

In 1986, the U.K. embarked on a consultative process to try to bring these tax nothings into the U.K. tax regime. That effort took seven years because nobody could agree on the basis on which they should be included. We then had a codified system that was incredibly complex, for example, for changes in value associated with foreign exchange being within the tax system. Though it was codified, it wasn't aligned with U.K. accounting systems.

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Instead, the Inland Revenue was very concerned that anything that was an

accounting-based tax system would be abused, so we were left with this band-aid version of recreating accounts purely for tax purposes. That led to another change that aligned those first changes in value with an accounting system. Well, that's come full circle, with additional complications generated through IFRS and fair-value movements.

Philip: Stephen, now that you are the tax officer within a global financial services company, what's your view on what the increased complexity has meant for the awareness and the importance of the tax department in running the day-to-day operations so that the business groups avoid tax pitfalls as the company continues to grow?

Stephen: None of the issues are unique to any one particular company or sector. Right across the board in the U.K. environment, the increased complexity of the tax system has meant that the prominence of tax within U.K. multinationals is much higher than it used to be. Compared with earlier times, the U.K. tax environment has moved up the chain, more in line with that of the U.S. And it's an important topic. You don't have to go much beyond FIN 48 ["Accounting for Uncertainty in Income Taxes"] to understand just how important it is. Tax is more prominent in all multinationals for a variety of reasons, and I only see that trend continuing. It emphasizes the need for real internal expertise and appropriate interaction with advisors.

This also led to specialization. Years back, tax was tax. Certainly in the U.K. environment, the accounting firms didn't even distinguish between auditors and tax guys, so "specialization" was an auditor who began practicing tax. We now have real niche areas of specialty to address a very complex tax system. One might hope that with the convergence of tax and accounting, you take some of that complexity out, but the devil is always in the details.

David: It's not just a case of "tax gone wild"; it's a reflection of the global business environment and governments' reactions. This may increase with some of the convergence issues as well. Governments are concerned about protecting the tax base when another country does something to encourage a particular behavior. The other

countries then feel that they have to change their systems, and typically complicate them, in order to address the ramifications.

Lisa: Let me echo that too for North Asia. For example, Japan introduced tax-free reorganizations a couple of years ago. Korea followed the same path as the Japanese rules. Japan then allowed partnerships to operate in Japan. Korea now has draft legislation that's going to be effective in 2009. China is another country that has been watching its neighbors. Until recently in China, the focus was really inbound and the growth of state-owned enterprises. As a result, there were two separate tax regimes. For the foreign multinationals going into China, tax planning consisted of getting the best incentive possible. There was no dividend withholding tax. Now, China passed its tax reform effective January 1, 2008, and with this comes anti-abuse provisions. Thus, if you don't have substantiated business reasons, your tax planning can be overturned. Transfer pricing has also been codified. CFC rules are now in the legislation, thin cap has been introduced, and withholding taxes have been reinstated. China is basically saying, now that you're all invested in the country, we want to be on a level playing field with other industrialized nations, so we're going to move our legislation to be similar with the West. And that means "complex."

David: Looking back, transfer pricing played a large role in the escalation. When the U.S. was pretty much the only country with highly developed transfer pricing rules and then disclosure and penalty provisions, I think a lot of other countries figured out that if a U.S. company could concentrate on making sure the U.S. side was safe, they were less concerned about what exposures they might have in other places. Those governments figured out they needed to close those holes pretty quickly.

Stephen: I saw a surprising statistic the other day. The U.K. didn't get its transfer pricing documentation requirements until around 1999 and we were the eighth country in the world. Countries like Brazil, Mexico and Korea introduced transfer pricing documentation requirements before the United Kingdom.

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David: Now most countries are focused on those things. Again, they see that if others have it, they'd better have it too, or they're going to lose.

Lisa: We also see increased tax audit activity. In the '80s and '90s, corporations didn't always consider the complexity of a tax audit. Nowadays, we address every tax planning idea with an eye towards mitigating potential controversy. For example, we look at the business purpose and the substance to make sure that the planning is sustainable and in keeping with the need for transparency.

Karen: FIN 48 brought that to light. With complexity comes increasing risk for companies, particularly with the transparency rules. The expectation is that you identify the risk and measure it against the "more likely than not" standard; you also must consider the jurisdiction and whether it's a country that will negotiate a settlement. You need to assess an issue in terms of its entire "tax life cycle" of planning, accounting and controls, reporting and compliance, and controversy. Obviously, that's not easy to do, given that much of the current rash of restatements is because of incoming tax accounting errors. One of the biggest areas of expansion for our Desk network is the addition of income tax accounting professionals to help foreign multinationals understand and implement FAS 109 [Accounting for Income Taxes] as well as assist our U.S. multinational clients with deferred tax issues and other complexities of tax reporting for their foreign subsidiaries.

Alberto: Mexico is a good example of what can happen with such sophisticated regulations. Even the government realized that their own tax system was so sophisticated and complex that it gave rise to a lot of planning opportunities that were actually very difficult to attack from a technical perspective. As of 2008, Mexico will have a flat tax that pretty much says you're going to be taxed on a gross revenue basis with some selected deductions. The government tried to go back to the basics. It realized that in a very sophisticated environment, taxpayers were using a lot of good tax planning that was at cross-purposes to the point of the laws. I wonder whether other countries are going to try to do the same just to compete with the countries

that enact a flat tax.

Philip: The U.S. Desk program certainly expanded to address the growing complexity of the U.S. and global tax systems. The Desks began with U.S. corporate international tax professionals, but now include many other specialty areas, such as transfer pricing, real estate, Subchapter C and M&A, tax due diligence, tax accounting, state and local tax, capital markets, and even IRS practice and procedure—all on the ground in Europe, Asia, and the Americas helping multinationals with the broad array of U.S. and foreign tax matters.

Speaking of tax accounting, let's discuss what we think the added transparency might mean to companies. What has FIN 48 done to increase the transparency of a company's global tax position and where do we think this added transparency might lead?

Karen: It's opened dialogues for companies between home offices and their foreign affiliates. They've had to understand in great detail what the risks are. If they don't have a tax guy as controller, can they trust that risks have been assessed appropriately and at the right level? I think that's been key. And I think with respect to Latin America and Asia, sometimes when we say "speaking the same language," we're not just talking about translating the words. We've had to translate the tax positions and what the real risks are as well.

Philip: We've gone from the FAS 5 ["Accounting for Contingencies"] world where companies tended to aggregate various positions and then make a judgment call about the overall tax position to FIN 48, which requires more of an item-by-item analysis and an understanding of the entire life cycle of each item.

Lisa: I have an anecdote regarding China because, as all of you know, China is definitely maturing in terms of its perspective on tax. Historically, China has been very welcoming. You don't see a lot of tax audit activity. Whether you get audited or not has often depended on your relationship with the local authorities. But China has introduced tax reform and published positions on treaty interpretations. I spoke with our Chinese colleagues recently about a transaction that a client implemented and we performed a FIN

48 analysis. The analysis that came back was based on local practice. We had to share with our colleagues in China that FIN 48 assumes full disclosure of facts and full interpretation of the law. So it's based not on practice but on being audited by the tax authorities, having full disclosure of the facts, and the tax authorities applying what's written in the law. That was a very interesting discussion because it represents a real paradigm shift.

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Alberto: I would echo that for Latin America. "More likely than not" in the U.S. may be something very different from "more likely than not" in Brazil. So not only do we spend a lot of time on the specific issues, we also explain what the rationale for the standard is just to make sure that the standard is applied similarly all across the world.

Philip: Michael, what's your view on U.S. GAAP and the impact FIN 48 has on your practice?

Michael: I've worked in a U.S. GAAP environment most recently and it's interesting to hear the discussion on this. In my mind, it's all about communicating properly and accurately to the audit committee and to the finance people. So I think the tax department is taking a big role now in communicating things that ten years ago people wouldn't be bothered with trying to understand outside the tax function. People would just accept that the tax department was doing its job, but now there's greater visibility into the tax department. You have to build that transparency, which leads to possibly better measurement and more accountability placed on people in the tax functions. So I think that while FIN 48 may be a challenge to implement, it can lead to better communication and discussion on issues.

Philip: Michael, do you feel that the tax department is interacting more closely with the various business units?

Michael: That's difficult to say. I think the tax department as a corporate function acts more as a control environment over the broader business group activities, at least from a tax perspective. That leads to a higher degree of trust by the tax authorities, and elevating the level of trust creates a much less adversarial relationship.

Philip: Are we saying that FIN 48, like everything, will evolve?

Karen: I think it will continue to evolve, particularly if you look at IFRS [International Financial Reporting Standards], which doesn't have the FIN 48 concept. The questions are how will you fit those two things together and would it be adopted in the same way?

Philip: It's interesting when you think about the evolution toward IFRS and the application of FIN 48. When you take FIN 48 and the concept of transparency, which in principle is good, and you soften some of the rules-based aspects with more of the principle-based aspects of IFRS, will the result be a workable middle ground?

Lisa: From an Asian outbound perspective, the U.S. SEC rules have increased the burden on companies that list on the New York Stock Exchange. In the last five years, we've seen the globalization of the capital markets, the rise of the European and Asian stock exchanges, as well as a number of Chinese, Hong Kong, and Taiwanese companies doing IPOs. Many of them are listing in Asia or in Europe rather than coming to the U.S.

Philip: Alberto, what impact is FIN 48 having in Latin America regarding the need to look at the various tax exposures, including the requirement to apply the rules on a full-disclosure basis as opposed to merely relying on a good relationship with the local tax inspector?

Alberto: The bigger multinationals are in Brazil and Mexico, and when they go to market for funding, they're looking more and more to London or Europe rather than the U.S. There are major multinationals in Mexico, for instance, that have securities placed in the New York Stock Exchange and they're reconsidering even those placements, based on all the additional compliance rules they have to follow. Again, there is a major shift in the work that local subsidiaries need to do when they're owned by U.S. multinationals to make sure all the same standards apply throughout the region.

Philip: Let's talk about tax harmonization and where we think that's going. Is it just wishful thinking or could it become a reality? If not reality, would greater transparency perhaps be the compromise?

David: A little more than 20 years ago, when I hit the ground in Brussels and the EU was just emerging on the tax side, there was a lot of talk about harmonization within the European Union and we see how long that's taken. But I think it really is starting to come to fruition. You have to wonder whether all these experiences led up to the initial proposals that are or are becoming realities today—the parent-subsidiary

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Directive, the proposal for a cross-border loss-sharing Directive, potential base harmonization, and so on, will potentially accelerate the trend along with some things on the accounting side, transfer pricing, globalization, etc. I see it as a back-to-the-future kind of thing.

Lisa: I would say in Asia it's going to take longer. The countries very much operate on their own. Southeast Asia, for example, has gathered together to form a trade pact, but it's more for trade than tax harmonization. The countries are still very nationalistic in a way—nationalistic and competitive—so they'll adapt each other's legislation to the extent that they feel they need to. But I don't see harmonization happening in Asia in the next five years. Perhaps in the next 15 to 20 years. If it took Europe 20 years, I would say it's going to take Asia at least as long.

Stephen: Yes, and it's really taken Europe more than 20 years because, in some respects, we're not there yet. It's a very, very long journey with not necessarily an end game. But what you will see is conversion at some levels—tax regimes that are based on IFRS, for example. Tax regimes reacting to the judgments made by the European Court of Justice is another aspect where we're bound to see some response, though not necessarily one that results in harmonization. While those things point towards convergence at some level, I would be surprised to see a huge degree of granularity. I think you'll have something at the "hundred thousand feet" level.

David: I agree, Stephen, but the very fact that we're even realistically talking about the potential for convergence is kind of interesting.

Michael: In Canada, even when we try to harmonize things across the provinces, it's

nearly impossible to do. So I don't think we'll ever see harmonization along the lines of what we might be thinking, because there are just too many cultural barriers. If you said to the U.S. people, "We're going to harmonize with Canada and we're going to bring in a national sales tax," can you imagine the revolt you would have? The trend in Canada has been to lower the corporate tax rate, lower individual rates, and then go more with consumption taxes. People are used to paying their taxes in a particular way, so achieving harmonization on a global basis and convincing people to pay taxes differently has to be a huge battle.

David: But when you look at some subsets, and the one I keep coming back to is transfer pricing, I think there's been

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tremendous "convergence" in the transfer pricing area over the last five years or so.

Philip: And we had a type of harmonization with the VAT, but that's just one particular tax regime and it certainly would be more difficult to apply to a corporate income tax regime. If we end up with a harmonization of tax accounting principles, whether it be GAAP or IFRS or some modified version, do we see this as a platform to facilitate broader tax harmonization or does that still fall in the category of "too hard to accomplish"?

Michael: One thing I can see working is if you had a common accounting model that everyone subscribed to on the corporate income tax side and it's all done on a consolidated basis. Then you turn everything over to the governments where you operate and say, "Okay guys, that's the income. Now go carve up the money between yourselves and bring us back how you want us to pay it." That to me would be harmonization and that would make things a lot easier. [Laughter.]

Alberto: The governments definitely are talking a lot more to each other, and they know they have to continue talking to stay ahead of the curve. I see more convergence in the future, but at the root of the convergence is, ironically, competition. To compete, governments are going to realize they need to start lowering their rates and broadening their tax base. This reform is likely to lead to tax laws that match more closely the laws and guidelines of other countries. But that

convergence may be based not so much on the government's having a discussion about what's best for the overall system as it is on just competing against each other.

Karen: I think you're right, Alberto. The competition is always going to be there and the difference will be in how the countries respond. With reduction of rates and without an expansion of the base, they're not going to be able to survive. The government needs to collect a certain amount of money to keep their countries going. So an across-the-board reduction to a 10% percent corporate tax rate means something is going up somewhere else. The world will be watching what happens with the flat tax in Mexico.

Lisa: And what's going to happen in the U.S. after 2008, because the U.S. [tax] rate right now is the second highest in the world.

Philip: So we're saying that true tax harmonization might be difficult to achieve, but that we can move down the path somewhat, aided by the harmonization of a global tax accounting system and methodologies. Do we see further transparency as a way to fill the gap? Are the various countries in essence saying, "If I can't get everyone on a harmonized tax basis, I at least want greater transparency so I have better insight into what my piece of the pie should be"?

Lisa: I see that in two developments in Asia. One is the introduction of anti-avoidance provisions and the other is the renegotiation of tax treaties to include Limitation-on-Benefits provisions. That's how they're trying to increase the transparency.

Karen: Treaties have gotten interesting, haven't they? There seems to be tax policy and transparency between countries in greater granularity in treaties than you might have expected to see 20 years ago. The treaties have gotten so complex that when a new one comes out, it can take months to figure out what's going on. That's another reason tax authorities have been talking to each other in more detail.

David: And we're seeing information exchange agreements with countries that you wouldn't have expected to see either.

Philip: What would we like the various tax authorities to do? Should they have

more resources with a greater awareness of international matters? Perhaps more people dedicated to competent authority proceedings?

Lisa: Let me start with Asia. What we have seen in a lot of the countries is the most sophisticated tax people are with the competent authority. When you are involved in competent authority procedure discussions, you're talking to people who understand multinationals and international taxation. They understand the treaties. But when it goes further down to the field [pg. 33]

auditor level, they may not be as well trained or have as much exposure to the issues. So international transactions may prolong the controversy process. The message here is really the need for more training.

Philip: Alberto, what are you seeing in Latin America?

Alberto: I would echo what Lisa said. The tax audit teams in the field are just not as sophisticated. The advantage, though, is that when you go to the international division, you are able to have technical discussions as to the merits of operations in that country. You want sophisticated people working in the government so that they understand the different transactions.

WHAT'S NEXT?

Philip: Now that we've reviewed the past 25 years and are coming to the present time, where do we see this going? What do we see as the big issues facing multinationals that our Desks are being asked to address? Where do we see the Desk program over time?

Lisa: We are finding Asian business more concentrated in key regional centers such as Shanghai, Singapore, Hong Kong, Beijing, Tokyo, Mumbai, and Sydney. As a result, you'll see our Desks replicate that approach. Also, five years ago, when I was in Asia, we had U.S. people on the ground serving primarily U.S. multinationals. Now, the growth is definitely focused on the Asian outbound. There's going to be a lot more demand for people who are sophisticated in terms of global planning. And there still will be a need to have everybody in the same room to brainstorm on global expansion and global acquisitions.

The other trend I see in Asia is the emergence

of the Asian private equity funds and sovereign wealth funds as major investors in the global market. Obviously, that brings a different set of dynamics because a lot of them are portfolio investors; but they still have the need for due diligence and for tax planning. I would say that what we see in Europe today, we're going to see in Asia very quickly because it has a very steep learning curve and the increased level of sophistication definitely will be required.

Philip: I agree. As the Asian multinationals continue to grow, we'll begin to see the Desks focus more heavily on advising those MNCs on outbound tax matters—for example, U.S. inbound. As the emerging countries and their economies continue to expand abroad, whether it be from Asia, Latin America, or Eastern Europe, having country-specific tax expertise based in the head-office locations will become more and more important.

David: We've been focused for so long on the company and doing global planning for the company and now what we've seen, particularly with private equity in the last couple of years, is an ownership paradigm change for the big companies themselves. These owners may have a different perspective from the previous, somewhat broader, public ownership. It makes you wonder where that's going to take things from the perspective of tax planning and the overall impact of those ownership paradigm shifts.

Philip: There's an even greater need for the PE [private equity] houses to be linked into a network of international and transaction tax advisors, as they tend to have leaner operations and limited in-house tax practices.

David: I think we'll see a lot more transaction tax expertise being folded into the Desks.

Lisa: I agree. We have transaction-focused Desk professionals, again because of the growth in Asia, the PE funds from Europe, and the U.S. funds and multinationals acquiring actively in China. You also have the Chinese forming their own PE funds because of the heated activity in China. The other thing is the emergence of the high liquidity in the Shanghai, Hong Kong, and Singapore stock markets, where you now have a lot of Asian multinationals with the currency

to undertake global acquisitions. That's definitely changing the way transaction tax is being viewed by a lot of these multinationals and what services are in demand.

Philip: When I moved from Amsterdam to London in January of 2003, we didn't have any transaction tax people and we did very little core transaction work with private equity houses. When I left three-and-a-half years later, well over a third of the practice was dedicated to transaction services, including having dedicated transaction tax [pg. 62]

specialists. And private equity continues to grow.

One other topic I'd like to touch on is permanent establishments and holding company structures, including how buffer companies can be used to help manage in-country permanent establishment exposures. Depending on the economic substance of the subsidiary buffer company, do we see tax authorities attempting to reach beyond the buffer into the parent company, with the majority of the profit, to capture some of that profit for local-country taxation?

Lisa: Well, we see India at the forefront.

Karen: I've heard that you may have a permanent establishment if you fly over India. [Laughter.]

Lisa: Yes, I would characterize India as the most aggressive. Korea also is very, very aggressive on the permanent establishment front because a lot of the buyers purchased distressed companies in the late 1990s and now they're selling their investments with very large profits. Korea has been after these buyers/owners, asserting that a permanent establishment was formed when they first acquired those companies, which would result in a tax on the capital gains in Korea upon disposition. Japan has followed a similar argument. The big question now is whether China would take a similar position because China has expanded its tax reform legislation to say that Chinese residency can be defined as management and control as well as incorporation.

Karen: It gives them an ability to look back to when they might have felt that their own tax regimes weren't as robust or their transfer pricing rules weren't quite there, then try to

get some of the profits they might've missed in the past.

Philip: This is an education issue for a lot of companies, isn't it? They often have business executives traveling abroad conducting business without thinking about whether a taxable presence is being created.

Alberto: That has been the trend in Latin America also, where the issue really comes after the country has attracted the foreign investment. When the countries were emerging, nobody quite brought this permanent establishment issue up because what they cared about was bringing investment into the country. Now that the investments are there, the effort is on collecting more revenue. And in this region there are many levels of sophistication. In Brazilian or Argentine legislation, for example, there is a very broad, gray definition and no clear understanding of what a permanent establishment is. In Mexico, on the other hand, there's a very clear definition, which is changed or limited by treaties. What you see in Mexico is a trend in the future to attack the intermediary holding companies for permanent establishments through Limitation-on-Benefits clauses in treaties. There's clearly a trend to look at principal/supply chain-type structures and to reassess whether there may be a permanent establishment for the nonresident entrepreneur.

Robert: There's one last topic I'd like some more detail about—the OECD—what it's doing, which countries have adopted its

policies, and whether there will be an OECD position paper or new guidelines. How much do you pay attention to the OECD and how much do you need further analysis on it?

Philip: I think it will vary by region.

Lisa: Yes, in Asia it's being looked at—in particular by North Asia—because Korea and Japan are members and obviously a lot of what the OECD puts forth is of interest. In the area of transfer pricing, for example, they basically adopted the OECD model across the region. The position papers on permanent establishments and revision to the OECD model treaty, all of these are followed very, very closely. India, however, doesn't follow OECD transfer pricing principles. You could lump North Asia, China, Japan, Korea, Hong Kong, Singapore as the ones following OECD principles and then you have India, again, on a stand-alone basis.

Alberto: Mexico is the only member of the OECD in Latin America. There is a rule that the OECD commentaries are binding for the government, so what the OECD says is very relevant. For the rest of the region, it's somewhat relevant because this helps understand some of the vague rules that are under domestic legislation. They're not binding, however.

Karen: I think in Europe the OECD has always been extremely relevant to what European countries are doing with treaties, so every pronouncement is carefully looked at. As each country adopts or doesn't adopt, I think the EU sort of moves a bit more in lock-step than might be the case elsewhere.

Philip: Well, this has been fantastic session. We appreciate the chance to reminisce and to share ideas and I'd like to thank the other panel members for taking the time to participate.

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About the Authors:

- Cym H. Lowell, partner in the Dallas office of Gardere Wynne Sewell, LLP.
- Peter L. Briger, founder and senior partner of Briger & Associates, New York, New York.
- Mark R. Martin, partner in the Houston office of Gardere Wynne Sewell LLP.

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+44 20.7.369.7000

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