

# Deutsche Vereinigung für Internationales Steuerrecht

Deutsche Landesgruppe der International Fiscal Association (I.F.A.)



Der Generalsekretär

Deutsche Vereinigung für Internationales Steuerrecht 11053 Berlin

An die Mitglieder der  
Deutschen Vereinigung für  
Internationales Steuerrecht

Unser Zeichen:  
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Datum:  
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## Termin 20.06.2009 !

### Ausschreibung der Nationalberichte für den IFA-Kongress 2011 vom 11. September bis 16. September 2011 in Paris (Frankreich)

Sehr geehrte Damen und Herren,

das Wissenschaftliche Komitee der IFA hat die Themen der Nationalbe-  
richte für den Kongress im Jahr 2011 in Paris festgelegt.  
Folgende Themenkreise werden im Mittelpunkt der Erörterung stehen:

- **Subject 1: Cross-border business restructuring**

Generalberichterstatter:

**Prof. Dr. H.K. KROPPE (Deutschland) und  
Mr. J.C. SILVA SANCHEZ-GAVITO (Mexiko)**

- **Subject 2: Key practical issues to eliminate double taxation  
of business income**

Generalberichterstatter:

**Prof. Gauthier BLANLUET (Frankreich) und  
Mr. Philippe J. DURAND (Frankreich)**

Die ersten Projektskizzen der Generalberichterstatter zu beiden Themen  
sind als Anlagen beigefügt.

**Der Vorstand der Deutschen Vereinigung schreibt hiermit die beiden  
vorstehenden Themen zur Bearbeitung durch die Mitglieder der  
Deutschen Landesgruppe der IFA allgemein aus.**

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Die IFA erwartet, dass Nationalberichterstatter ausgewählt werden, die spezifische Kenntnisse über das zu diskutierende Thema besitzen und über die Fähigkeit verfügen, einen genauen und ausgewogenen Bericht über die steuerliche Behandlung der damit zusammenhängenden Fragen aus deutscher Sicht vorzulegen.

Ein Zwischenbericht über den Stand der Arbeit wird zur Mitgliederversammlung der Deutschen Vereinigung im Frühsommer 2009 erwartet.

Die Berichte müssen spätestens bis zum 15. Oktober 2010 fertig gestellt und den Generalberichterstattern übergeben werden. Sie werden zusammen mit den Generalberichten in den Cahiers zum Jahreskongress 2010 veröffentlicht.

Es wird erwartet, dass die Nationalberichterstatter sich an den vorgegebenen Zeitrahmen halten. Der ausgewählte Nationalberichterstatter sollte an den vorlaufenden IFA-Kongressen (Vancouver 2009 und Rom 2010) teilnehmen, da dort erste Zusammenkünfte mit den Generalberichterstattern und den anderen Nationalberichterstattern erfolgen. Ein über die deutsche Konzeption voll informierter Vertreter kann benannt werden. Die IFA gibt zu überlegen, ob in die Vorbereitung (research and collecting informations) der Nationalberichte auch Mitglieder von YIN (Young IFA Network) eingebunden werden können.

Der Bericht soll in englischer Sprache vorgelegt werden. (Nach Rücksprache mit der IFA kann er in Ausnahmefällen auch in deutscher Sprache abgefasst werden.)

**Wir bitten Sie, uns Ihr Interesse an der Abfassung eines der Nationalberichte anzuzeigen oder eine geeignete Persönlichkeit zu benennen, die zur Übernahme dieser Aufgabe bereit ist.**

**Die Benennung sollte bis zum 20. Juni 2009 gegenüber der Geschäftsführung erfolgen.**

Mit freundlichen Grüßen



H.-J. Müller-Seils  
(Generalsekretär)

2 Anlagen

IFA – Paris Congress – 2011

## Main Subject 1

### Cross-border business restructuring

General Reporters:

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#### I. Presentation of the topic

Business restructuring can be defined as the cross-border redeployment of functions, assets and / or risks within a multinational enterprise (MNE). It could entail a reallocation of “profit potential” among the legal entities of the MNE.

Business restructurings are a necessity for MNE´s to respond to market needs and are a consequence of the competition they face. Since the mid 1990's, business restructurings have often been accomplished by or included the conversion of full-fledged distributors into limited-risk distributors, conversion of full-fledged manufacturers into contract-manufacturers or toll-manufacturers, rationalization and / or specialization of operations, transfers of intangible property rights to a central entity within the group, etc.

As opposed to initial structuring, business restructuring implies an evolution, or a departure, from an existing business structure to a new allocation of functions, assets or risks. This topic is aimed at exploring the specific tax issues that could arise from a change from the existing to the new structure in an international context, both in the exit country – where functions, assets and/or risks are reduced – and in the entry country – where they are increased. Third countries may also be involved in the business restructuring and their tax consequences.

Business restructurings raise various types of tax issues, including but not limited to:

- exit taxes
- transfer pricing (article 9 of the model tax treaty)
- existence and tax basis of the assets of a Permanent Establishment (articles 5 & 7 of the model tax treaty)
- VAT, stamp duties or other indirect taxation.

For the sake of unity and focus we will deal only with the specific issues triggered by the reallocation of functions, assets or risks from an existing structure to a new one in an international context. In certain jurisdictions or situations, the new structure could

be entirely respected, without taking into account the previous one. In other situations or jurisdictions, the change could be a taxable event, or its consequences could be disregarded for tax purposes or otherwise altered in consideration of the preexisting structure. Where this results in any adverse tax outcome in one country (generally the exit country), what remedies are available (in the entry country or elsewhere)?

## **II. Illustrations**

Three examples will be used to illustrate the application of the relevant concepts:

1. A marketing company or distributor becomes a commissionaire or a low risk distributor. For example, a full-fledged distributor in charge of distributing finished products provided for by a manufacturer in its country or region signs with an operating company ("the principal") a low risk distributor or commissionaire agreement. As a result, part of the functions and risks previously exercised and undertaken by the full distributor are transferred to the operating company and the new remuneration of the low risk distributor or commissionaire is reduced to the level appropriate to its new reduced role.
2. A similar shift from full-fledged manufacturer to low-risk toll- or contract-manufacturer.
3. Centralization of intangible property rights and research and development (R&D) activities in a specific company. In this case, the ownership of newly-created intangibles are located in a specific "IP company" which grants licenses to other companies in the MNE for a royalty.

The tax issues could be addressed around two "events" or "time periods": tax issues posed by the restructuring itself (the most complex part of the analysis), and tax issues relating to the post-restructuring activities of the participants.

The Branch Reports should address these issues from both the "exit" country and the "entry" country standpoints and examine whether there are tax issues that arise in an international context that would not appear in a domestic situation.

## **III. At the time of the restructuring**

1. Transfer of risks and functions:

Business restructuring typically involves risk re-allocations that may be accompanied by a transfer of "profit potential". This is based on the theory that the assumption of increased risk should be compensated by an increase in the expected return. One should then question whether such a transfer should entail any compensation from one party to the other (and, if so, from which to which...).

In practice, there is often a trade-off for the restructured entity between the assumption of riskier activities with possibly higher but also more volatile profit potential, in place of less risky activities with lower but stable or even guaranteed profit potential. A further question is the extent to which such a trade-off is made on arm's length

terms, depending on the historical results, their historical volatility, and the future profit and loss expectations for the transferor and transferee.

2. Transfer of intangible assets:

How does the arm's length principle apply to transfers of intangibles?

In what circumstances does the reduction in profit potential that may follow from a business restructuring entail the transfer of an intangible asset that should be compensated for an arm's length price (e.g. goodwill, local marketing intangibles, "business opportunities", etc)? What valuation method could be used to determine the arm's lengths remuneration for the transfer of such intangibles?

A related question is whether, when tax is assessed in the "transferor" country on a (deemed) transfer of an intangible asset, the country of the "transferee" will recognize a tax basis for the (deemed) transferred asset.

Other tax issues: stamp duties, impact on retained earnings, etc.

3. Termination or substantial renegotiation of existing arrangements:

In what circumstances should the termination or substantial renegotiation of existing arrangements be indemnified on arm's length terms and conditions? Is it sufficient to refer to contractual terms, or should one consider what independent parties would have done at arm's length when modifying the arrangements?

4. Recognition of the actual transactions undertaken:

Are there circumstances where a tax administration is entitled to disregard a business restructuring transaction for tax purposes? What is the relationship between the transfer pricing recognition rules found in paragraphs 1.36-1.41 of the OECD Transfer Pricing Guidelines, treaty obligations, and domestic anti-abuse or recharacterisation rules? To what extent may a tax administration claim that a taxpayer has not taken a clearly more attractive option and assess taxes on this hypothetical option?

How far should related party contracts be respected by tax authorities in their tax examinations?

5. Even where private contracts are respected, would specific provisions or a general principle of full or partial termination of business trigger a taxable event, or the loss of certain tax attributes (such as business losses (NOLs), acceleration of profit recognition, etc)?

6. In the case of the transfer of intangibles to a foreign related party, is it relevant to the tax analysis that the transferee may be situated in a low tax jurisdiction? That the transferee may have personnel and exercise functions? That the transferred intangibles may be "crown jewels"? That the transferor continues to be involved in the development or exploitation of the transferred intangibles?

7. In the case of a conversion of a "full-risk" activity into a "limited-risk" activity, are there circumstances where the tax administration could disregard the restructur-

ing on the grounds that it would not have happened if the parties were dealing at arm's length?

In general: would independent parties have revised their existing arrangements in this way? Is the business restructuring itself an arm's length transaction? Are there cases where the tax administration could disregard the restructuring on the basis of the hypothetical assumption that an independent party dealing at arms' length would not have entered into it?

8. Double taxation relief. Where a taxable event occurs in either the exit or entry country, will a remedy be available in the other country? in a third country ? at consolidated group level in the top parent company's country ?

9. On all the above points, Branch Reporters could describe any relevant experience or trend in this regard in their jurisdictions.

Branch Reporters from the EU may indicate whether and why any of the tax measures applicable in their jurisdiction are compatible with or contradict the freedom of establishment or the free movement of capital within the Union. Branch Reporters from jurisdictions with other forms of regional economic union may also refer to such international requirements.

#### **IV. After the restructuring**

1. A main issue is whether the remuneration for the post-restructuring activities is in conformity with the arm's length principle. The main subject of dispute in this regard is whether the restructured entity still owns, legally or in some jurisdictions economically, some intangibles that need to be remunerated. For instance, does a former distributor that was converted into a commissionaire retain ownership of local marketing intangibles that need to be remunerated over and above a typical commissionaire fee? If so, does this create a tax advantage for new entrants compared to commissionaires that result from the restructuring of a pre-existing arrangement?

Conversely, in what circumstances could a former full-fledged manufacturer, which is converted into a contract or toll manufacturer, be regarded as having retained some valuable intangibles such as know how or confidential information regarding the supply of raw material, semi-finished and finished goods or the manufacturing process, which intangibles should be remunerated above a typical cost-plus fee?

Where there is a transfer of intangibles, what is the treatment of related tangible assets and personnel?

Where the functions transferred consist of intra-group services (such as marketing, accounting, or foreign exchange risk management), for which there are few, if any, uncontrolled comparable prices, what transfer pricing method is available or recognized?

2. A similar issue is whether the principal could be deemed to have a permanent establishment in the country of the low-risk distributor or manufacturer.

3. More generally, there is a question whether arrangements that result from a restructuring should be treated the same as arrangements that are implemented as such from the beginning, or whether the mere fact that arrangements result from a restructuring can justify a different tax treatment under arm's length principle.

The Branch and General Reports could address the above theoretical issues and illustrate them around the two practical cases described in Section II above.

#### **V. Relevant procedural issues**

1. To the extent they are relevant to the tax treatment of the business restructuring transaction, either in the exit country or in the entry country, are there any procedural aspects worth mentioning?

2. Where a tax procedure is initiated, or a reassessment is made, presumably in the exit country, against a business entity that transferred functions, risks or assets to a foreign entity, does the tax administration need to inform that foreign entity of its intention to challenge the tax consequences of such transfer? Is the foreign entity invited or enabled to present its defence? Are such procedural rights dependent upon the existence or the language of a double taxation treaty or any other international instrument?

**IFA – Paris Congress – 2011**

**Main subject 2**

**Key practical issues to eliminate double taxation of  
business income**

Generalberichterstatter:

Prof. Gauthier BLANLUET (Frankreich) und  
Mr. Philippe J. DURAND (Frankreich)

In designing international tax rules, policy makers are regularly inclined to re-examine and potentially reconsider the respective strengths and weaknesses of the methods for relief of international double taxation.

For several years, the United States has been engaged in a fundamental review of its rules for taxing foreign business income. Alternatives for reform have been examined in 2005 by the President's Advisory panel on federal tax reform; in 2006 by a Task Force convened by the American Bar Association; and in December 2007 by the Treasury Department. The main proposals would consist in exempting active foreign business income and curtailing deferral on foreign business income earned through foreign corporations.

Other countries applying a credit method have partially moved to an exemption method or are currently in the process of evaluating certain aspects of their domestic system.

Within the European Union, the issue has often been raised because of a potential conflict between the credit method and the EC market's freedoms. Since 2000, a number of countries such as Germany, Italy or Finland have abandoned their imputation system for certain classes of income such as dividends and/ or capital gains on substantial shareholdings. Most recently, the UK treasury issued a discussion document inviting to comment on a proposed exemption for foreign dividends received by large and medium-sized UK companies. Interestingly enough, other countries, such as France, have considered an opposite move in the past, which could have led to the adoption of a direct or indirect credit system for certain types of foreign income.

More generally, credit or exemption systems currently in place could be wholly or partly re-examined in light of recent shifts in the international economic environment. Current methods for relief of double taxation may well be affected by the globalization of world economies, the increasing mobility of businesses and the growing competition among countries for economic activity. The persistence of these new trends could result in important reforms to come.

However, although highly current and international in nature, the debate seems to have remained largely confined within domestic borders so far. The main international initiative to date has come from the OECD. The Secretariat has organized in 2007 a roundtable on practical differences between the exemption and credit systems. Discussions were led by Germany, the UK and Chile.

In that perspective, the proposed approach would be to review and evaluate the various systems applicable among the reporting countries. The objective would be to (i) reach a thorough understanding of the structure and operation of an exemption and credit system for foreign business income, (ii) make a presentation of the typical features of each system, and (iii) focus on practical problems and on ways to mitigate the difficulties through the adoption of hybrid systems.

## Scope

- Broad conceptual issues of tax policy should not constitute the most substantive part of the proposed subject. In particular, we would not propose to consider in any depth the conceptual distinction between capital export neutrality and capital import neutrality as a supporting rationale for adopting an exemption or credit system. This is mainly because (i) there is and will likely be no sufficient evidence to reach a consensus on what form of neutrality is in the best interest of the reporting countries in general, and a given country in particular and (ii) applicable rules are never implemented in a way which fully achieves the theoretical concept of neutrality.

- We would not discuss issues relating to the jurisdictional basis of taxation and the appropriate allocation of the tax base between source and residence (see Buenos Aires Congress 2005). Conflicts in the attribution of income could be mentioned but only insofar as they raise double taxation relief issues (see Kyoto Congress 2007).

- We would also suggest narrowing down the scope of the subject to the treatment of business income. Certain categories of income would be more specifically discussed. (i) Active foreign business income earned through a foreign branch or permanent establishment (legal double taxation issues); (ii) Non-portfolio dividends received by a substantial resident corporate shareholder from a non resident or foreign company (economic double taxation issues); (iii) Other passive foreign source income, such as interests, royalties and portfolio dividends; and (iv) Real estate income. Rules applicable to individuals would not be considered.

- CFC rules would not be reviewed in detail. However, it would be useful to consider why CFC rules are implemented in both exemption and credit systems, and how they interact with such systems.

## Main Objectives

The proposed approach would be to conduct a practical assessment of the currently applicable systems, with a view to (i) evaluate how the current rules are applied in practice, (ii) identify practical issues raised by these rules and (iii) consider their effects, whether actual or expected. Such an assessment may show that, beyond con-

ceptual differences, both the credit and exemption systems raise common issues and, under certain circumstances, lead to similar results.

## **Classification**

The basic and traditional approach consists in drawing a bright line between countries which have decided to tax on a territorial basis and others which have opted to tax on a worldwide basis. Countries of the first group apply an exemption system and are in principle not confronted with the issue of relief for international double taxation. Countries of the second group have to deal with double taxation of foreign income by providing a credit for foreign tax on such income.

This description is highly theoretical. Many countries implement a combined credit/exemption system. The combination may however differ significantly from one country to another country.

A classification of the various applicable methods would essentially consist in identifying the respective scope of the exemption/credit rules in each domestic system, depending on, mainly, (i) the types of income (active/passive; business/non business) (ii) the sources of income (treaty/non treaty countries), (iii) the tax treatment of the income at source (taxed/exempt) or (iv) the identity of the taxpayer earning the income (direct/indirect foreign tax credit).

## **Practical Issues**

A first set of issues derives from potential conflicting views between the residence country and the source country with respect to, for example, (i) the income characterization, (ii) the source of income, (iii) the taxpayer identification, (iv) the determination of the taxable income, or (v) the nature and/or amount of creditable foreign taxes.

A second set of issues relates to technical deficiencies inherent to a given system. These technical deficiencies have a distorting effect on economic decisions and may adversely impact the tax competitiveness of the relevant jurisdiction. They may also have implications on a wide variety of issues, such as for example tax planning, repatriation of foreign earnings, compliance and administrability.

### **I. Income Characterization**

In a credit system, foreign taxes may not be creditable because the residence country gives to an income a qualification which is different from the qualification given by the source country. For example, one country treats the income as a dividend while the other qualifies it as an interest (hybrids, thin capitalization rules). Similarly, the source country taxes a deemed income (eg. a constructive dividend) which is not recognized as such by the other country; or the source country collects the tax on accrual basis whereas the residence country grants a credit on a cash basis only.

In an exemption system, income characterization is particularly relevant if the exemption is limited to active business income earned through a permanent establishment to which the income is attributable, or to dividends paid out of active business income earned by foreign corporations. Dissenting views between the home country and the source country may lead to double taxation or double non taxation situations.

Characterization issues also exist in combined exemption/credit systems if the distinction between the exemption and credit method depends upon the nature of the income. Typically, an exemption may apply to certain categories of income only (eg. participation exemption), and raise tax crediting issues of foreign withholding taxes.

## **II. Source Rules**

Sourcing income is a common concern to both exemption and credit systems. It determines which country has a primary taxing jurisdiction and which country allows relief from double taxation.

Home country source rules which are inconsistent with foreign rules for taxing the income at source can result in international double taxation or international double non taxation. This is particularly the case when source rules are based on the characterization of income and there is a conflict about the nature of the income between the residence country and the source country.

Inappropriate source rules may cause home tax erosion by exempting too much income or permitting excessive tax credits for income which has not been taxed at source. They may also treat too little income as foreign source and therefore cause international double taxation by not allowing exemption (in a territorial system) or not granting a foreign tax credit (in a worldwide taxation system).

## **III. Taxpayer Identification**

In a credit system, applicable rules allow the foreign tax credit to the taxpayer that is liable for the tax under foreign law. However, many countries apply an indirect credit method whereby a tax credit is allowed for taxes paid by foreign corporations on the income out of which a dividend is paid to the resident taxpayer.

In certain countries such as the U.S., inconsistent classifications of foreign entities may result in the segregation of foreign taxes and foreign income so that foreign taxes are used for cross-crediting purposes.

In other situations, international double non taxation may be caused by the existence of disregarded entities. Income generated through such entities may escape taxation in the source country and at the same time benefit from an exemption or a tax credit in the home country.

## **IV. Determination of the taxable income – Allocation of deductions**

The determination of the taxable income and the proper allocation of expenses and losses is one of the main sources of inconsistencies leading to aggressive tax planning or unrelieved international double taxation.

In a credit system, the treatment of expenses, in particular for interest and R&D, is an essential part of determining the foreign tax credit limitation. Allocation of expenses to foreign income reduces the foreign tax credit limitation whereas allocation of ex-

penses to domestic income increases the limitation. This obviously leaves room for a number of tax planning opportunities. Typically, interest deductions incurred for the purposes of the foreign operations may under certain circumstances be used against domestic income, even if the taxpayer uses the timing flexibility offered by deferral rules to manage repatriation of foreign profits.

In contrast, under properly designed exemption systems, there is an incentive towards pushing-down expenses abroad. This is because the deduction of expenses is disallowed in the residence country on the basis that such expenses are incurred to earn exempt income. However the expenses may also be disallowed in the source country, in which case the taxpayer is faced with a failure to eliminate double taxation.

The use of tax losses raises similar issues. The inability to impute foreign losses against domestic income has long been viewed as one of the principal disadvantage of an exemption system. On this point, the difference with the credit method may not be highly significant, in particular where the applicable credit rules provide for a recapture as foreign income of domestic losses that offset foreign income.

## **V. Foreign Taxes**

A foreign tax credit is basically allowed only for foreign income taxes that have the character of an income tax under domestic rules. A country that applies an exemption system may also decide that exemption is limited to income that has been subject to a foreign taxation comparable to the domestic tax that would have been paid on the income had it been taxed in the home jurisdiction.

Problems arise when the income has been subject to a tax at source collected by a public authority that is not the State itself (local, social...) or that does not satisfy the comparable tax criteria under the tax treaty or under domestic rules.

## **VI. Foreign Tax Credit Limitations and Related Issues**

A significant issue in the foreign tax credit limitation is the effect of losses on the limitation. Rules may restrict the ability to use and preserve foreign tax credit when the taxpayer is in a loss position. If the imputation of the tax credit may not be deferred on future profits, it may be lost, reimbursed in cash or treated as an expense (increasing the carry forward losses). Where foreign tax credits are lost or deferred, the corresponding foreign source income may or may not still be included for its gross/net amount in the taxable base.

More generally, a tax credit system also normally provides for specific allocations or limitations when the recipient is an entity which is not subject to tax in the residence country, for example a partnership, a non for profit organization or a member of a tax consolidated group.

Other limitations may of course apply, which have the effect of limiting the tax credit to the amount of domestic tax payable on the net income received. Limitations often require a categorization of the income based on its nature and/or its source.

## **VII. Timing Issues – Deferral**

The traditional drawback of a credit system is that it discourages the repatriation of foreign business income. Until the income actually repatriated, the income is subject only to foreign tax. The system works as an incentive to shift income to low-taxed countries and reinvest funds offshore, subject to applicable CFC rules. It makes the credit system substantially elective and generates undue cross-crediting opportunities.

Because the deferral rules are complex and encourage taxpayers to engage in heavy tax-distorted planning, proposals have been made in the U.S. to end deferral of domestic tax on income of a foreign controlled corporation.

## **VIII. Impact on Tax Treaties**

A significant shift from one system to another, either from credit to exemption or from exemption to credit, would likely have potentially disturbing effects on the applicability of certain existing tax treaty provisions. A number of impacts on applicable tax treaties could be identified, which would vary depending on the contemplated changes in the method for relief of international double taxation. In certain circumstances, a reform might therefore result in an actual increase in the risk of international double taxation. The need to renegotiate treaties to avoid that risk may have a deterrent effect on the willingness of policy makers to make that move.

## **IX. Compliance and Administrability**

Credit systems impose a substantial administrative burden on taxpayers and the government. Rules are often perceived as being too difficult for the taxpayer to manage and too complex for the government to audit effectively. The key sources of complexities are (i) the inherent difficulty to define income and compute such income in accordance with domestic tax rules (ii) the implementation of tax credit limitations rules that may either increase or limit tax benefits (iii) the high degree of electivity which intensifies compliance and indirectly generates sophisticated legislative responses to combat tax avoidance.

Exemption systems are understood to be simpler in terms of compliance and administration. However, in certain countries and under specific circumstances, the exemption may be limited to certain qualifying types of income and be further restricted to income subject to a foreign tax comparable to domestic tax. In such cases, the method for relief could also be complex to understand and manage.

A fair assessment of the complexity of the respective applicable systems would require additional information on (i) the tax return process (foreign income disclosures; recalculation requirements applicable to foreign income), (ii) tax treaty formalities (residency certificates, affidavits), (iii) tax audits (frequency, scope and methods of investigation, exchange of information process, coordination between tax authorities) and (iv) any statistic data on costs of raising revenue, the negative or positive impact of each system on tax revenues, or the costs of transitioning from one system to the other.