Are tax laws BEPS compliant already

Panel Discussion moderated by

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Stats for the geeks!

- On Google (India) if you search
  - for "BEPS" - you get ~1,630,000 results
  - for "BEPS implementation" - you get ~168,000 results.
- In a 2016 global survey conducted by one of the Big4:
  - 92% believed tax structures are now under greater scrutiny
  - 92% expect significant changes as a result of BEPS
  - 93% expect the corporate tax compliance burden to increase substantially
- Interestingly, 75% believe that reputational risks are a concern for cross border planning – is this the 'Google Tax' syndrome???
- More interestingly, 55% of the respondents have already changed the way they conduct tax planning for cross-border transactions – whether the glass is half empty or half full ???

The need for discussion

- The BEPS Project delivered its final outputs in October 2015, two years after its launch in 2013, representing the most fundamental changes to international tax rules in a century.
- The overall aim of the BEPS measures is to close gaps in international tax rules that allow multinational enterprises to legally but artificially shift profits to low or no-tax jurisdictions.
- OECD and G20 countries developed the measures on an equal footing, with extensive engagement by developing countries and regional tax organisations.
- After the introduction, the focus shifted to designing an inclusive framework for monitoring and supporting implementation, and all interested countries and jurisdictions were invited to participate on an equal footing.
- ***In a short span of less than 18 months, are domestic tax laws BEPS compliant already?***

Panel Introduction

1. Canada and US – Robert Worthington
2. Germany – Oliver Biernat
3. India – Ashishkumar Bairagra
4. Spain – Carlos Fruhbeck
5. United Kingdom – Alan Rajah
6. **<u>And all of you !!!</u>**

So what is BEPS all about

- BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.
- Although some of the schemes used are illegal, most are not.
- This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level.
- Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

And the proposed solution?

- The BEPS package provides 15 Actions that equip governments with the domestic and international instruments needed to tackle BEPS.
- Countries now have the tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created.
- These tools also give businesses greater certainty by reducing disputes over the application of international tax rules and standardising compliance requirements.

Four minimum standards

- Action 5 – Harmful Tax Practices
- Action 6 – Treaty Abuse
- Action 13 – Transfer Pricing Documentation (CbC)
- Action 14 – Dispute Resolution

Has any of the countries not implemented any of these four action plans yet?

BEPS Update from Germany

Existing German Tax Rules already include many measures initiated by BEPS actions plans

- Sec. 1 para. 3 S. 9 f. AStG: Transfer of functions.
- Sec. 1 para. 5 AStG: Allocation of income of permanent establishments. Introduction of the "Authorized OECD Approach" (AOA) in 2013. PE's are treated like a separate legal unit for tax purposes, applying the "Arms-length-principle".
- Sec. 7 et seq. AStG (Foreign Tax Act): Anti-Abuse Rules against activation of foreign intermediary companies with little or now substance.
- Sec. 50d para. 3 EStG: against "Treaty Shopping" where German law overrides existing DTT's by not refunding or reducing withholding taxes for foreign companies if the indirect shareholders would not be entitled to get them.

BEPS Update from Germany

- Sec. 50d para. 9 EStG in order to prevent lower or non taxation of income, which may arise through conflicts of terminology.
- Sec. 4 h KStG: The "interest barrier" since 2008 to fight thin capitalization.
- Sec 8b para. 1 sentence 2 KStG in order to fight hybrid financial instruments (since 2013).
- Sec. 14 para. 1 S. 1 KStG: Introduction of a cross-border fiscal unity. Avoidance of double use of losses of companies in a fiscal unity, so-called: dual consolidated loss rule.

German Tax Rules are more or less sufficient to fight BEPS already. In order to avoid problems with other countries that may not accept such rules (e.g. Treaty –Overrides) Germany tries to include the abuse rules in new DTT's, e.g. as "Switch-Over", "Limitation-Of-Benefits" or "Subject-To-Tax-Clauses".

Action 1 – Address the Tax Challenges of the Digital Economy

- The Action 1 report concludes that the digital economy cannot be ring-fenced as it is increasingly the economy itself.
- The report analyses BEPS risks exacerbated in the digital economy and shows the expected impact of the measures developed across the BEPS Project.
- Rules and implementation mechanisms have been developed to help collect value-added tax (VAT) based on the country where the consumer is located in the case of cross-border business-to-consumers transactions.
- These measures are intended to level the playing field between domestic and foreign suppliers and facilitate the efficient collection of VAT due on these transactions.

Update from India

- India introduced its first measure on Action 1 in 2016
- Equalisation Levy introduced at 6% of the consideration paid for 'specified service' to a non-resident
- It is a withholding tax to be deducted and deposited monthly, so the onus to deduct and pay is on the Indian resident
- To reduce the burden on small players or consumers, the levy only applies if total payments, in a year, to one non-resident exceeds INR 100,000 (~Euro 1,400)
- 'Specified Service' is defined as follows:
  - Online advertisement;
  - Any provision for digital advertising space or facilities / service for the purpose of online advertisement;
  - Any other service which may be notified later.
- Service Tax already charged on Reverse Charge mechanism at 15%

Update from UK

- Introduced on 1st January 2015
- EU VAT directive applies
- Applies to the following services:
  - Telecommunications services
  - Broadcasting services
  - E-services
- Charge & account for VAT in each non-business customer's member state
- Register for VAT in each EU member state or
- Register for the Mini One Stop Shop (MOSS) system

Action 2 – Neutralise the Effects of Hybrid Mismatch Arrangements

- A common approach which will facilitate the convergence of national practices through domestic and treaty rules to neutralise such arrangements.
- This will help to prevent double non-taxation by eliminating the tax benefits of mismatches and to put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid.

Update from UK

- Introduced by Finance Act 2016
- Effective from 1 January 2017
- Applies to hybrid financial instrument
- Eg. Hybrid entity – UK LLP
- Part 6A targets hybrid mismatches in the following circumstances:
- Deduction/non-inclusion outcomes involving:
  - Hybrid Financial Instruments
  - Hybrid Transfers
  - Hybrid Entity Payers
  - Hybrid Entity Payees
  - Arrangements involving permanent establishments
- Who is likely to be affected:
  - Groups with a UK or overseas parent
  - Involved in cross-border or domestic transactions
  - Transactions between UK and other jurisdiction
- Replaces the tax arbitrage regime

Update from Spain

- New CIT law approved in November 2014 introduced an anti-hybrid rule whereby a payment to a related party will not be deductible if, at the recipient level, it is either not treated as income or it is exempt or taxed at a nominal rate of less than 10%. Article 15 j) CIT.
- Likewise, interest accrued under profit participating loans will no longer be deductible by the Spanish payer. Under the new tax rules, these instruments no longer follow the accounting treatment (debt) but the legal treatment (equity) to the extent that the financing is granted by a related party after June 2014. Article 15 a) CIT.

Action 3 – Strengthen CFC Rules

- The recommendations are not minimum standards, but they are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries.
- It identifies the challenges to existing CFC rules posed by mobile income such as that from intellectual property, services and digital transactions, and allows jurisdictions to reflect on appropriate policies in this regard. The work emphasises that CFC rules have a continuing, important role in tackling BEPS, as a backstop to transfer pricing and other rules.

Update from Canada

- Canada has had CFC rules since 1972 – partly consistent with BEPS, mostly not.
- Fairly robust anti-deferral regime for passive income.
- Historically, Canada has used the exemption system in its CFC rules as a bargaining chip to negotiate tax treaties and tax information exchange agreements (TIEAs).
  - Result: 103 treaties and 30 TIEAs; and
  - Active business income from treaty or TIEA countries can generally be paid by a CFC to Canada tax-free.
- Seems unlikely that Canada will support Action 3.

Update from the United States

- The US is concerned that about $2 trillion is currently "trapped" offshore.
- The "Blueprint" for tax reform proposes cash may be repatriated at a rate of 8.75% (or 3.5% for non-cash assets), with tax payable over 8 years.
- This approach runs counter to BEPS Action 3 – it moves towards a more territorial tax system.
- The Blueprint also calls for substantially lower corporate tax rates (perhaps 20%) and a VAT-like border adjustment tax.

Action 4 – Limit Base Erosion via Interest Deductions and Other Financial Payments

- The common approach aims at ensuring that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities and fostering increased coordination of national rules in this space.

Update from UK

- Draft legislation issued in December 2016
- Expected implementation date: 1 April 2017
- Restrict corporate interest tax deduction
- To lower of 30% of EBITDA
- OECD recommends 10% to 30%
- Consider:
  - Group ratio
  - De-minimis limit
  - Exculsion for funding public-benefit projects
  - C/f (or c/back) of disallowed interest
- Separate rules for insurance & banking sector
- What should business be doing:
  - Reassess their capital structure
  - Focus on surplus cash
  - Consider future acquisitions where debt finance is involved

Update from Spain

- Article 16 of CIT Law.
- The amount of net deductible financial expenses in the tax period is generally reduced to 30% of operating profit (similar to earnings before interest, taxes, depreciations, and amortization [EBITDA]) for the year.
- financial expenses of less than EUR 1 million are deductible regardless of the 30% limit.
- For such purposes, net financial expenses are considered to be the excess of financial expenses with respect to income deriving from the assignment of capital to third parties accrued in the tax period.

Update from Spain

- For companies taxed under the tax consolidation regime, the deduction limit will refer to the tax group.
- Limits on the deduction of financial expenses do not apply to insurance companies or to credit institutions.
- Limits on the deduction of financial expenses are not be applicable for dissolved companies for the tax period in which they are dissolved, unless the company is dissolved as a result of a restructuring operation.
- Financial expenses that have not been deducted due to the application of this limit can be deducted in subsequent tax periods for an unlimited period of time..

Action 5 – Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

- The Action 5 report sets out a minimum standard based on an agreed methodology to assess whether there is substantial activity in a preferential regime.
- In the context of IP regimes such as patent boxes, consensus was reached on the "nexus" approach.
- This approach uses expenditures in the country as a proxy for substantial activity and ensures that taxpayers benefiting from these regimes did in fact engage in research and development and incurred actual expenditures on such activities.
- The same principle can also be applied to other preferential regimes so that such regimes would be found to require substantial activities where they grant benefits to a taxpayer to the extent that the taxpayer undertook the core income-generating activities required to produce the type of income covered by the preferential regime.

Update from Germany

- On 25th. Jan. 2017 the German government introduced a draft bill re. BEPS action plan no. 5 (harmful tax practices)
- The aim is to tax profits in the country, where the activity that creates the value, takes place and not in the country, that offers the maximum tax benefits.
- It concerns “harmful” tax practices which are possible with IP-Boxes, license- boxes or patent boxes.
- Following the “Nexus-approach”, this shall be done by reducing the tax deducibility of royalties and other expenses for granting rights to related parties, which are subject to no taxes or low taxes (less than 25%) in the country of the recipient. The higher the tax rate of the creditor the more the debtor can deduct from his taxable income.

Update from India

- India introduced for the first time, a preferential 'patent box' regime in 2016 to counter harmful practices adopted by transfer of income / patents to low / no tax jurisdictions.
- Royalty income received in respect of a patent developed and registered in India shall be taxed at a preferential rate of 10% (instead of 30%) on the gross amount of the royalty.
- No expenditure or allowance to be considered since tax is on gross basis.
- Claimant should be the true and first inventor of the invention and whose name is entered on the patent register as the patentee in accordance with (India) Patents Act, 1970

Action 6 – Prevent Treaty Abuse

- The new treaty anti-abuse rules included in the report first address treaty shopping, which involves strategies through which a person who is not a resident of a State attempts to obtain the benefits of a tax treaty concluded by that State
- Other changes to the OECD Model Tax Convention have been agreed to ensure that treaties do not inadvertently prevent the application of domestic anti-abuse rules.
- A clarification that tax treaties are not intended to be used to generate double non-taxation is provided through a reformulation of the title and preamble of the Model Tax Convention.

Update from Canada

- Pre-BEPS, Canada announced their intent to deal with treaty shopping in response to several taxpayer-friendly treaty cases.
- Canada supports Action 6 in principle, but no changes to treaties have been announced.
- BEPS-inspired domestic back-to-back financing rules for withholding tax enacted in 2016.

Update from India

- In 2016, India re-negotiated and issued crucial modifications, to prevent treaty abuse, to three important treaties – Mauritius, Singapore and Cyprus.
- Concept of Service PE introduced
- Interest income to be taxed in Source Country at 7.5%
- Capital Gain on sale of shares (acquired after 1st April 2017) to be taxed in Source Country at 50% of applicable rates until 31st March 2019 and at the applicable rates after 31st March 2019
- Other Income to be taxed in the Source Country

Update from the United States

- Historically the US has used domestic anti-conduit rules and limitation on benefits (LoB) provisions in its tax treaties.
- The US revised its model treaty with a similar approach as BEPS Action 6, with a few differences:
  - US LoB applies to "inverted" (expatriated) companies; and
  - US model has no "principal purpose" test.
- New US model treaty includes "Article 28" which terminates the Articles relating to dividends, interest, royalties, and "other income" (Article 21) if other country's tax rates fall below a 15% threshold.

Action 7 – Prevent the Artificial Avoidance of PE Status

- The report includes changes to the definition of permanent establishment in Article 5 of the OECD Model Tax Convention, which is widely used as the basis for negotiating tax treaties.
- These changes address techniques used to inappropriately avoid the tax nexus, including via replacement of distributors with commissionaire arrangements or via the artificial fragmentation of business activities.

Update from Germany

- BEPS action plan no. 7 is introduced indirectly by changing the double taxation treaties. See article 5 chapter 8 of the new DTT Germany- Australia:
- "…Notwithstanding the provisions of paragraphs 1 and 2 (a P. E. is the following…) but subject to the provisions of paragraph 9 (independent agents), where a person is acting in a Contracting State on behalf of an enterprise and
- a) in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

i) in the name of the enterprise, or

ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

iii) for the provision of services by that enterprise, or.

Update from Germany

- b) manufactures or processes in a Contracting State for the enterprise goods or merchandise belonging to the enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 6 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph."

Update from India

- In 2015, India had introduced the principle of "Place of Effective Management" (POEM) to apply from 1st April 2016
- After a lot of debate between the effectiveness of POEM v/s. CFC, on 24th January 2017, India introduced the guiding principles for determination of POEM.
- A non-resident company whose POEM is India, will now be taxed in India on its global income.
- POEM test is based on active v/s. passive income, % of total assets situated in India, % of total number of employees working in India, % of total payroll expenses spent in India.

Actions 8-10 – Assure that Transfer Pricing Outcomes are in Line with Value Creation

- Action 8 looked at transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are often hard-to-value. Misallocation of the profits generated by valuable intangibles has heavily contributed to base erosion and profit shifting.
- Under Action 9, contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks.

Actions 8-10 – Assure that Transfer Pricing Outcomes are in Line with Value Creation

- Action 10 has focused on other high-risk areas, including the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

Action 11 – Measuring and Monitoring BEPS

- Action 11 assesses currently available data and methodologies and concludes that significant limitations severely constrain economic analyses of the scale and economic impact of BEPS and improved data and methodologies are required.
- Noting these data limitations, a dashboard of six BEPS indicators has been constructed, using different data sources and assessing different BEPS channels.
- These indicators provide strong signals that BEPS exists and suggest it has been increasing over time.

Action 12 – Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements

- The Action 12 report provides a modular framework of guidance drawn from best practices for use by countries without mandatory disclosure rules which seeks to design a regime that fits those countries' need to obtain early information on aggressive or abusive tax planning schemes and their users.
- It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

Update from UK

- Not expected to implement specific rules
- Has sufficient powers to require information

Action 13 – Re-examine Transfer Pricing Documentation

- The Action 13 report contains a three-tiered standardised approach to transfer pricing documentation, including a minimum standard on Country-by-Country Reporting. This minimum standard reflects a commitment to implement the common template for Country-by-Country Reporting in a consistent manner.
- First, the guidance on transfer pricing documentation requires multinational enterprises (MNEs) to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies in a "master file" that is to be available to all relevant tax administrations.

Action 13 – Re-examine Transfer Pricing Documentation

- Second, it requires that detailed transactional transfer pricing documentation be provided in a "local file" specific to each country, identifying material related-party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions.
- Third, large MNEs are required to file a Country-by-Country Report that will provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued and other indicators of economic activities. Country-by-country reports should be filed in the ultimate parent entity's jurisdiction and shared automatically through government-to-government exchange of information.

Update from Germany

- Introduction of the Country by Country Reporting as of Jan 1st. 2017 in Sec. 138a AO (General Tax Code).
- Besides description of business transactions the new obligation for the local file now also includes description of the economic and legal basis for an intercompany agreement that is in line with the arm's length principle. It also includes the Masterfile (see OECD-final report to action no. 13).
- Companies must meet the following TP requirements if they exceed:
  - 0 €: Prove that transfer prices are at arm‘s length: all companies with intragroup deliveries or services.
  - Local file: German company‘s intra–group turnover exceeds either 5 million € deliveries or 500,000 € services.
  - Master File: Total group exceeds 100 million € group turnover.
  - CbCR: Total group exceeds 750 million € consolidated group turnover.
- Apart from that, nothing new has been officially implemented by the Federal Ministry of Finance in Germany re. BEPS.

Update from UK

- Came into force on 18th March 2016
- Accounting periods starting on 1st January 2016
- Global allocation of MNE's income, taxes & other activities
- Master file – specific info for all MNE group members
- A local file – material transactions of the local taxpayer
- Applies to MNE with turnover of Euro 750 m
- Issues:
  - Different implementation dates for other countries
  - Relaxation of OECD recommendations
  - Not all countries have signed up

Update from Spain

- Transfer pricing documentation

New documentation and reporting requirements were enacted in July 2015. It is unclear whether further changes will be made. Applicable from January 2015.

- CbC Reporting

CbC reporting requirements were enacted in July 2015.

Spain is one of the countries that signed a multilateral competent authority agreement for the automatic exchange of CbC reports. Applicable from January 2016.

Action 14 – Make Dispute Resolution Mechanisms More Effective

- Recognising the importance of removing double taxation as an obstacle to cross-border trade and investment, countries have committed to a minimum standard with respect to the resolution of treaty-related disputes. The commitment also includes the establishment of an effective monitoring mechanism to ensure the minimum standard is met and countries make further progress to rapidly resolve disputes. In addition, a large group of countries has committed to quickly adopt mandatory and binding arbitration in their bilateral tax treaties.

Action 15 – Develop a Multilateral Instrument

- The Action 15 report explores the technical feasibility of a multilateral instrument to implement the BEPS treaty-related measures and amend bilateral tax treaties.
- It concludes that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly.
- Based on this analysis, a mandate has been developed for an ad-hoc group, open to the participation of all countries, to develop the multilateral instrument and open it for signature in 2016.
- So far, about 90 countries are participating in the work on an equal footing.

Stop press from India!

- In the recently announced finance budget, India has implemented two more BEPS action plans.
- If a primary adjustment is made under certain circumstances, a secondary adjustment will have to made too. E.g. if a primary adjustment exceeding INR 10 million has been made and the funds have not been brought back into India, the amount of adjustment will be treated as an advance liable for an interest (secondary) adjustment too.
- Thin capitalization rules finally introduced if interest payment to AE exceeds INR 10 million. Interest deduction will be limited to 30% of EBITDA, but excess interest will be allowed to be carried forward for 8 years, and be claimed as a deductible expense in any of these 8 years to the extent of the same 30% of EBITDA rule in the respective years.

Reference reading

- http://www.oecd.org/tax/beps/beps-actions.htm
- http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm

Thank you for your participation!

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