



THE FUTURE OF TAX PLANNING: TRANSPARENCY AND SUBSTANCE FOR ALL?

Friday, 26 February 2016

9.00AM - 12.00PM

Conrad Hotel, Hong Kong



THE DRIVE TOWARDS TRANSPARENCY: CHALLENGES AND OPPORTUNITIES IN INTERNATIONAL TAXATION

Anil Kumar Puri

Ernst & Young Tax Consultants Sdn. Bhd.

26 February 2016

Discussion topics



▶ **OECD's BEPS ACTION PLANS**

▶ **SELECTED BEPS-RELATED DEVELOPMENTS**



OECD's BEPS ACTION PLANS

BEPS: Changing business environment

New reality for global economy

Business trends

- ▶ Globalization/ regionalization
- ▶ Digital economy
- ▶ Expansion into new markets as trade barriers ease
- ▶ Increasing complexity of value chains and intra-firm trade
- ▶ Greater specialization in business functions

- ▶ **More attention** by governments, media and nongovernmental organizations on the international tax profiles of MNCs
- ▶ **More complexity** in tax laws **and information reporting obligations**
- ▶ **More information sharing between governments**
- ▶ **More robust audits** and more controversy

Government issues

- ▶ Balancing investment stimulus and fiscal prudence following the global financial crisis
- ▶ Differential emerging markets growth
- ▶ Political concerns about perceived tax avoidance
- ▶ Public questions about the fairness of tax burdens

BEPS action plans: Addressing transparency and substance

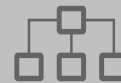
1 Address the tax challenges of the digital economy



2 Neutralise the effects of hybrid mismatch arrangements



3 Strengthen CFC rules



4 Limit base erosion via interest deductions and other financial payments



5 Counter harmful tax practices taking into account transparency and substance



6 Prevent treaty abuse



7 Preventing the artificial avoidance of PE status



8 Consider transfer pricing for intangibles



9 Consider transfer pricing for risks and capital



10 Consider transfer pricing for other high-risk transactions



11 Establish methods to collect and analyse data on BEPS and actions to address it



12 Require taxpayers to disclose their aggressive tax planning arrangements



13 Re-examine transfer pricing documentation



14 Make dispute resolution mechanisms more effective



15 Develop a multilateral instrument



Action 5: Counter harmful tax practices

Snapshot of BEPS recommendations

- ▶ The OECD deliverable is a revamp of the work on harmful tax practices, with a priority and renewed focus on:-
 - ▶ Requiring **substantial activity** for a preferential regime;
 - ▶ **Improving transparency**, including compulsory spontaneous exchange of information on certain taxpayer-specific tax rulings

Possible impact

- ▶ Tax rulings/incentives need to be reviewed to determine whether they could be characterized as harmful tax regimes
- ▶ Local tax laws may change pursuant to this Action plan and the impact of any such changes will need to be assessed.
- ▶ Release of information to tax jurisdictions involved in value/supply chain where ruling has influence will increase overall scrutiny.

Action 5: Counter harmful tax practices

Substantial activity

- ▶ Rules regarding the level of activity required for a preferential regime (e.g. a patent box regime) to be considered to be supporting real economic activity, as opposed to being a “harmful tax practice”
- ▶ Substantial activity criteria:-
 - ▶ Modified nexus approach (Need to be engaged in R&D activities in country)
 - ▶ No new entrants should be permitted to harmful regimes after 30 June 2016
 - ▶ The grandfather period may not be longer than five years after the date the existing harmful regime is closed to new entrants.
 - ▶ Different rules discussed for non-IP regimes

Increased transparency

- ▶ Framework for the compulsory, spontaneous exchange of information on certain rulings
 - ▶ Preferential regimes
 - ▶ Unilateral advance pricing agreements (APAs) or other cross-border unilateral rulings in respect of transfer pricing
 - ▶ Cross-border rulings providing for a downward adjustment of taxable profits
 - ▶ Permanent establishment rulings
 - ▶ Related party conduit rulings
- ▶ Member countries to start exchanging information from April 2016

Action 6: Prevent treaty abuse

Snapshot of BEPS recommendations

- ▶ Changes to OECD Model Treaty to address the inappropriate granting of treaty benefits. 3-pronged approach:
 1. Anti-treaty shopping provisions
 - ▶ Combined approach of principal purpose test (PPT) and limitation on benefits (LOB) rule
 - ▶ PPT alone
 - ▶ LOB rule, supplemented by specific anti-conduit rules
 2. Clarification of treaty purpose
 - ▶ Changes to title and preamble of treaties
 - ▶ Purpose of treaty is to avoid double non-taxation, as well as eliminate double taxation
 3. Tax policy considerations in treaty relationships
 - ▶ Further work required, as the US Model Treaty LOB is being revised

Key considerations

- ▶ Is there sufficient substance and business purpose for holding companies, finance companies, IP companies, principal hub companies and trading companies?
- ▶ If not, treaty benefits, including reduced withholding taxes, may be denied.

Action 6: Prevent treaty abuse

▶ Text of PPT:

“Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.”

▶ Commentary on PPT:

“[O]btaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction.”

“[W]here an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit.”

Action 12: Disclosure Requirements

Snapshot of BEPS recommendations

- ▶ The report provides a series of options that enables countries to design a regime that fits their need to obtain early information on aggressive or abusive tax planning schemes and their users.
- ▶ Includes recommendations on
 - ▶ Who should have the obligation to report
 - ▶ The type of hallmarks
 - ▶ When the obligation to disclose should be triggered; and
 - ▶ The introduction of penalties to ensure compliance with mandatory disclosure regimes
- ▶ Design recommendations, but not a minimum standard
 - ▶ More moderate approach to broad disclosure of international tax schemes than in OECD's earlier discussion draft

Possible impact

- ▶ Local tax laws may change pursuant to this Action plan, requiring additional disclosures.
- ▶ Likelihood of success of tax positions must be carefully assessed by taxpayers given the increased scrutiny.
- ▶ Financial statement implications of tax positions in light of this Action?

Action 13: Re-examining transfer pricing documentation

Master file

Broad information about the MNC's business, transfer pricing policies and agreements with tax authorities in a single document available to all tax authorities where the MNC has operations

Local file

Detailed information about the local business including related party payments and receipts for products, services, royalties, interest etc.

CbCR

Broad information about the jurisdictional allocation of profits, revenues, employees and assets

CbCr template

A model template for the Country-by-Country Report

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

CbCr template

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:														
Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)											
			Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant
	1.													
	2.													
	3.													
	1.													
	2.													
	3.													

² Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

Table 3. Additional Information

Name of the MNE group:
Fiscal year concerned:

Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the country-by-country report.



▶ SELECTED BEPS-RELATED DEVELOPMENTS



Multilateral Competent Authority Agreement (MCAA)

- ▶ Various countries have signed the MCAA for the automatic exchange of Country-by-Country (CBC) reports.
- ▶ MCAA sets out parameters for the automatic exchange of CbC reports among jurisdictions.
- ▶ Multilateral framework agreement that provides a standardized mechanism to facilitate the automatic exchange of reports
- ▶ Information will be exchanged between tax administrations , giving them a global view of key indicators of how multinational groups structure their operations.
- ▶ Will have an immediate impact in boosting international co-operation on tax issues.

EU response to BEPS

- ▶ EU has already introduced legislation towards implementing BEPS recommendations tailored for the EU context:
 - ▶ Exchange of rulings between EU member states
 - ▶ Introduction of hybrid mismatch rule and general anti-avoidance rule (GAAR) in the Parent-/Subsidiary (P/S) Directive

Selected EU developments

Action 5: state aid

- ▶ State aid investigations look into potential harmful tax competition between member states.
- ▶ High profile investigations into specific tax rulings have been launched by the European Commission and certain rulings have been held to provide ‘unlawful state aid’.
- ▶ European Commission: rulings endorsed “artificial and complex methods” that do not reflect “economic reality,” and transfer prices do not correspond to “market conditions”.
- ▶ If a ruling is determined to constitute unlawful state aid, the EU member state that issued the ruling will be forced to recover the state aid from the taxpayer (along with interest) going back 10 years.

UK - Diverted profit tax (DPT)

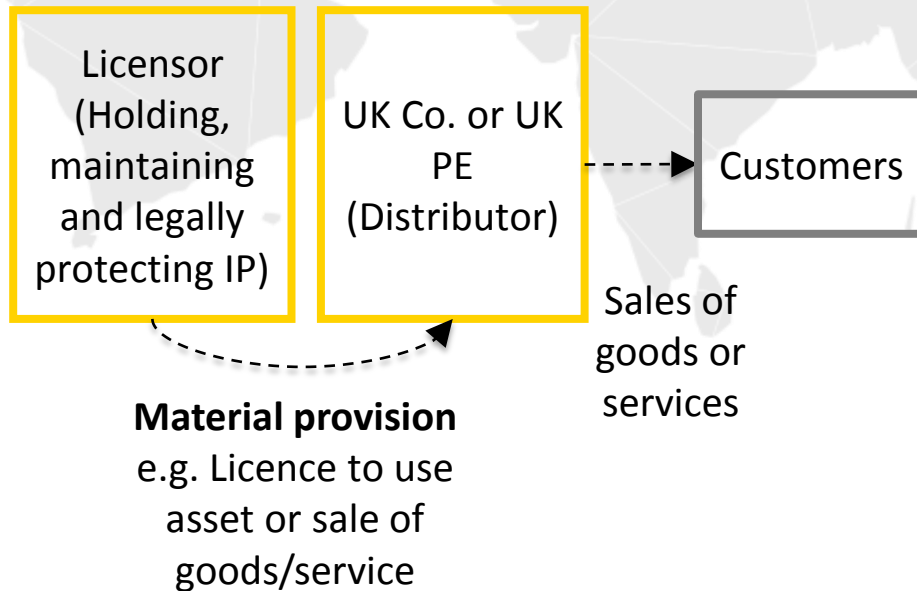
Diverted profit tax (“DPT”)

- ▶ A new tax, charged at 25%
- ▶ Entered into force on 1 April 2015
- ▶ Anti-avoidance measure aimed at perceived abuses involving lack of economic substance or avoiding UK permanent establishments
- ▶ Wider than transfer pricing
- ▶ Designed to give HMRC greater access to information
- ▶ Taxpayers need to be comfortable not only that this does not have a DPT liability but also that there is no duty to notify as conditions for notification are wider.
- ▶ Advance Pricing Agreements (APAs) may provide some comfort.

UK – DPT: Where it may apply

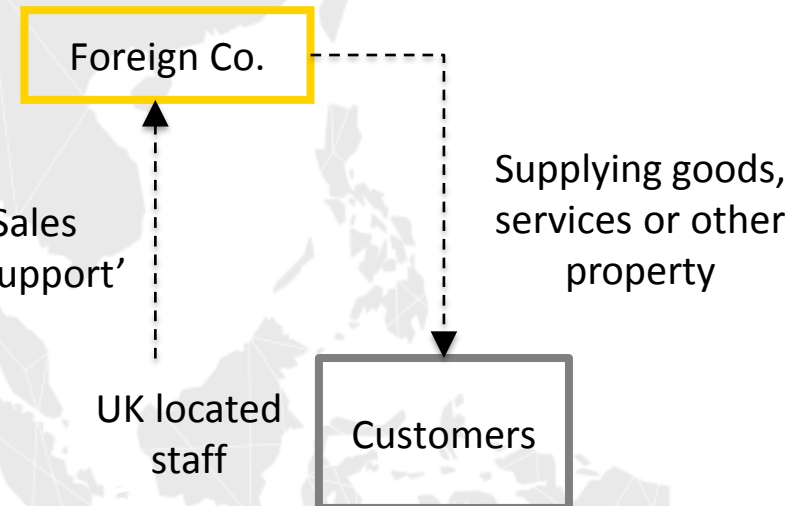
1. Involvement of entities or transactions lacking economic substance

Example:

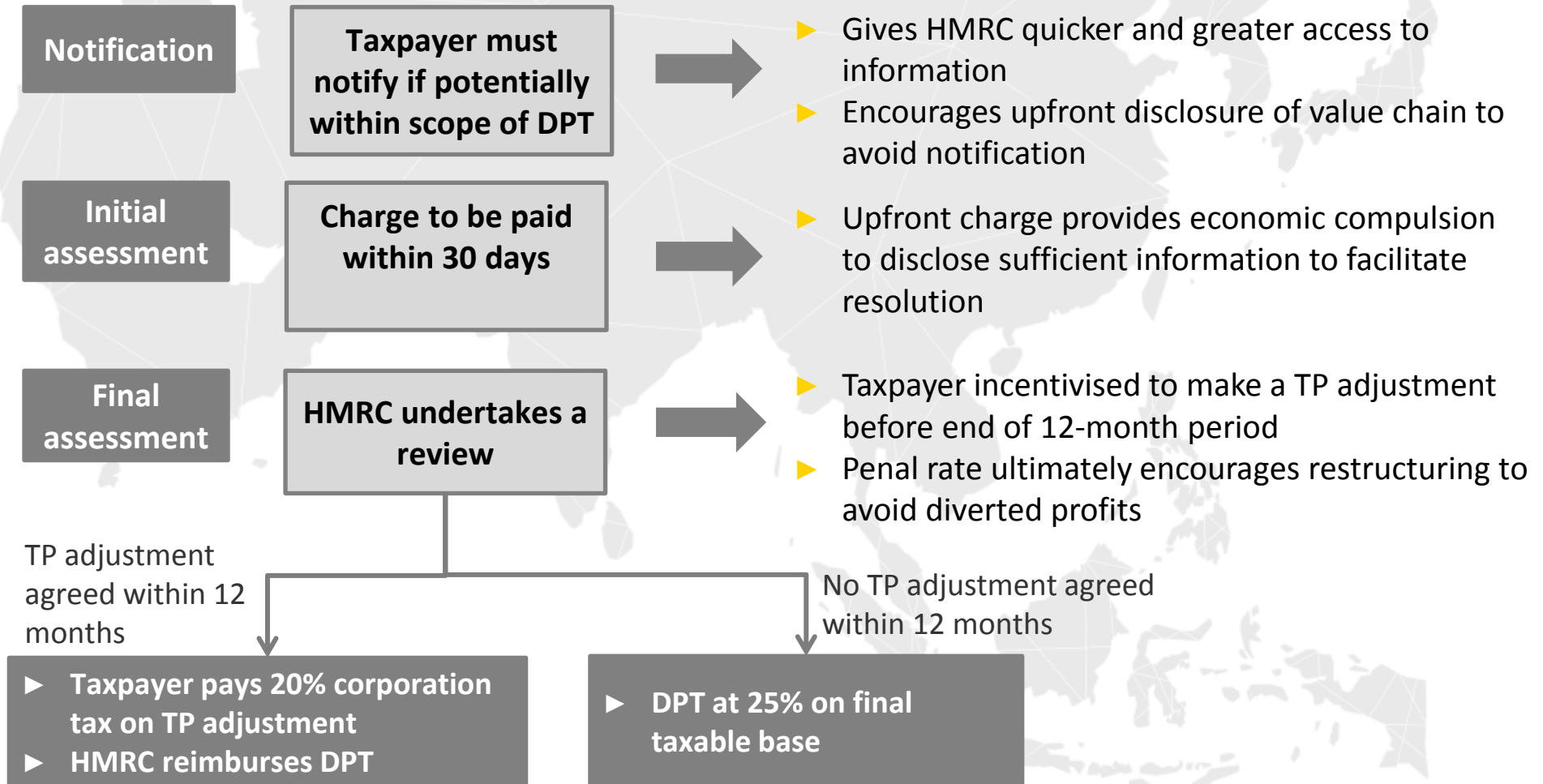


2. Avoidance of a UK PE?

Example:



DPT- a change in transparency and negotiation





Labuan IBFC

International Business
and Financial Centre, Malaysia

Thank You