Impact of BEPS on Financing Structures

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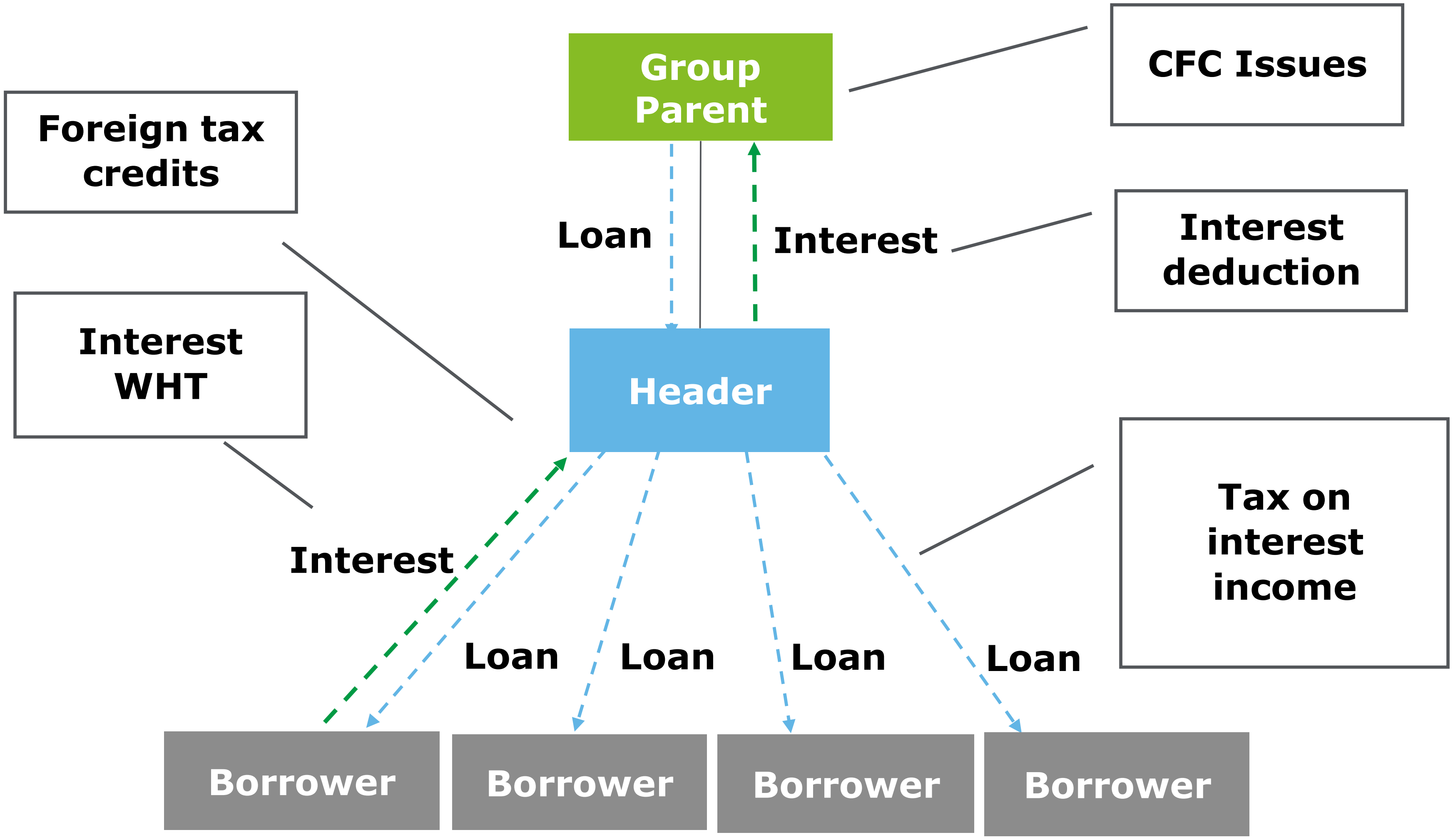
Typical financing structures

Intragroup financing structure



BEPS Actions

Action item	
1	Digital economy
2	**Hybrid mismatch arrangements**
3	Controlled foreign company rules
4	**Interest deductions**
5	Harmful tax practices
6	**Preventing tax treaty abuse**
7	Avoidance of permanent establishment status
8	**TP aspects of intangibles**
9	**TP aspects of risk and capital**
10	TP for high risk transactions
11	Methodologies and data analysis
12	Disclosure rules
13	**TP documentation**
14	Dispute resolution
15	Multilateral instruments

Recommendations for changes to domestic law, as well as double tax treaties, to address hybrid instrument mismatches. Will affect the after-tax cost of hybrid financing. Certain arrangements in US groups may be unintentionally impacted (e.g. if hybrid entities are involved)

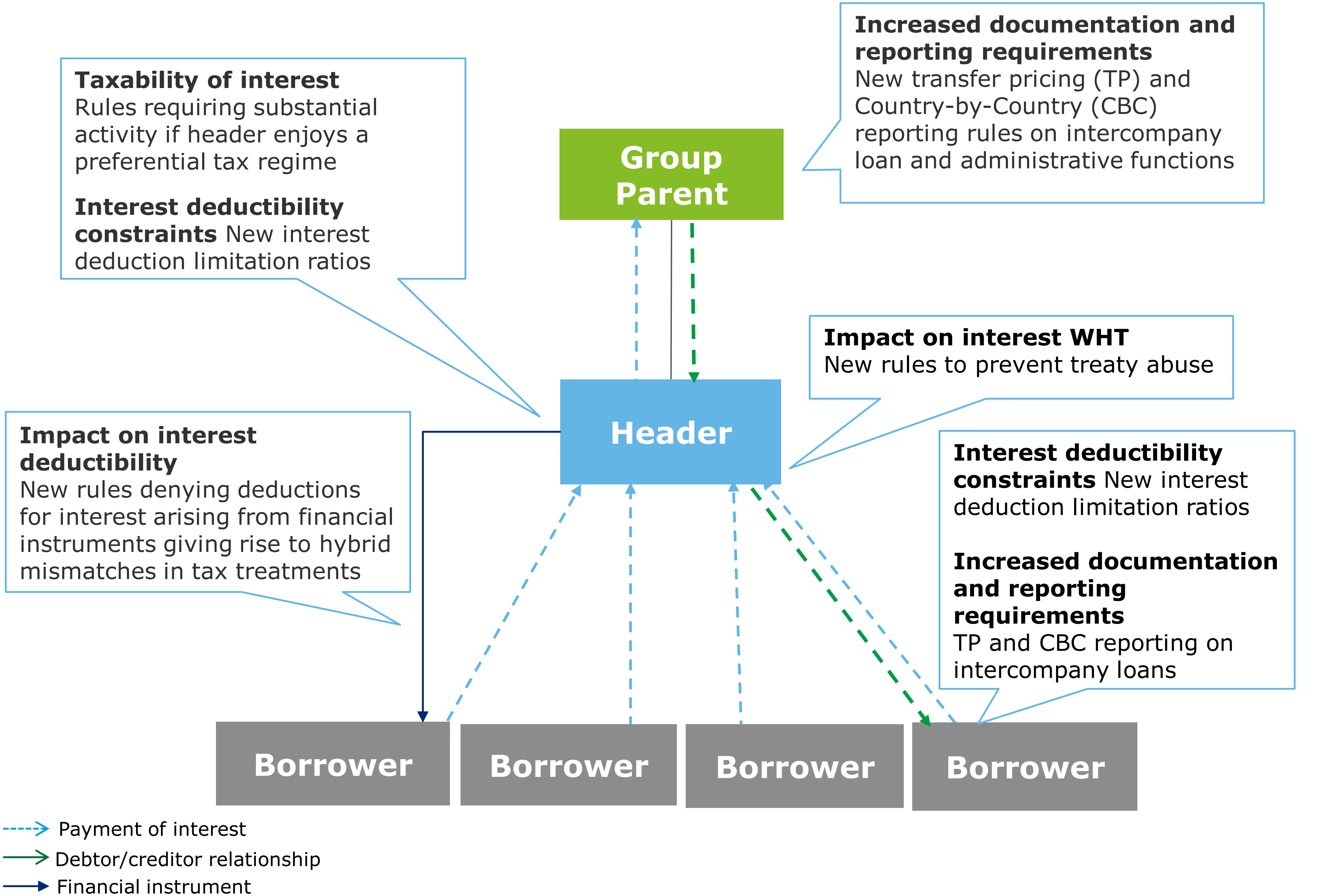
- Recommendations will limit interest deductions based on either group attributes, fixed economic ratios or both. Number of countries who will adopt these Action 4 recommendations is uncertain
- Many groups are reviewing internal financing structures and simplifying financing arrangements

- Key changes in BEPS recommendations:
  - Decreased importance of contractual allocations of risk; rather control of risk determines risk allocation. Focus is on managing and controlling risk
  - Emphasis on where functions are carried out and where people are located rather than legal location of risk
  - Transaction should be respected if it has the "fundamental economic attributes of an arrangement between unrelated parties and commercial rationality"
- One example concludes that when borrowing from an affiliate and a 3rd party and the 3rd party loan price reflects an implicit group credit support, the related party loan should be priced commensurate with the 3rd party loan, i.e. no group synergy should be factored into the i/c interest rate

Recommendations propose new **3-tier** approach to TP documentation:

- Country by country report - Key financial information on MNC affiliates on an aggregate country basis with an activity code for each affiliate
- Masterfile - Key information about the group`s global operations including a focus on 3rd party and intercompany funding arrangements
- Local file – Detailed local analysis of the transactions

Impact of BEPS on a typical financing structures



BEPS Impact in Asia Pacific Countries

China

- Interest deductions (Action 4) and transfer pricing– Updated rules on TP documentation covering thin capitalization
- Masterfile, Local file, and CbC reporting (Action 13) – Effective for years starting on or after 1 January 2016

Hong Kong

- CbC reporting (Action 13) – Effective for years starting on or after 1 January 2018

Singapore

- CbC reporting (Action 13) – Effective for years starting on or after 1 January 2017

South Korean

- Interest deductions (Action 4) – Thin capitalization rules were strengthened by changing debt to equity ratio requirements from 3 to 1 to 2 to1 effective from 1 January 2015
- CbC reporting (Action 13) – Effective for years starting on or after 1 January 2016

Japan

- Hybrid (Action 2) – Deductible dividends not exempt for tax purposes for years starting on or after 1 April 2015
- Masterfile, Local file, and CbC reporting (Action 13) – Effective for years starting on or after 1 April 2016

Indonesia

- Interest deductions (Action 4)– New thin capitalization rules based on debt to equity ratio effective from 1 January 2016

Australia

- Interest deductions (Action 4) – Thin capitalization rules based on debt to asset rations tightened in 2014
- Masterfile, Local file, and CbC reporting (Action 13) – Effective for years starting on or after 1 January 2016
- Transfer pricing (other) – ATO Taxpayer Alerts provide a summary of ATO concerns about arrangements involve funding of an overseas entity or operations by an Australian entity, where the funds are subsequently loaned back at interest to the Australian group in a manner which generates Australian tax deductions while not generating Australian assessable income. Typically, the income from the interest flows is not taxed offshore.

BEPS Impact in the US and the UK

UK

- Hybrid (Action 2) – Legislation enacted effective 1 January 2017 Hybrid mismatch arrangements are defined as cases where an amount is deductible in one jurisdiction but not taxed in any other jurisdiction, or where an amount is deductible more than once. Under hybrid mismatch rules, deductions may not be permitted for payments from the UK to non-UK recipients if the arrangement gives rise to a deduction/non-inclusion mismatch, including those that arise because the payee is a company that has one or more permanent establishments.
- Interest deductions (Action 4) – The UK proposals follow the recommended approach set out in the final report for limiting base erosion involving interest deductions and other financial payments that was issued by the OECD in October 2015 as part of the G20/OECD base erosion and profit shifting (BEPS) project (specifically action 4) , and have been subject to a previous consultation in the UK. The basic approach is to limit interest deductions to 30% of tax-based EBITDA.
- CbC reporting – Effective for years starting on or after 1 January 2016

U.S.

- Interest deductions (Action 4) - An existing fixed ratio (generally 50%) limit on deductibility of net interest expense applicable to foreign-owned corporates
- Interest deduction (other) - Imposes documentation requirements on certain related party debt instruments as a prerequisite to treatment of such instruments as debt and recast related party debt as stock in connection with certain distribution or acquisition transactions
- CbC reporting (Action 13) – Effective for years starting on or after 1 January 2017

Impact of BEPS on Financing Structures

Business Model Operations

- Location, administration and value of the treasury function
- Greater visibility of risk and function allocation
- Increased Substance
  - Qualified personnel
  - Technology supports decision making
  - Head office guidance/ coordination NOT execution
- Intra group services

Treasury Operations

- Liquidity model changes
  - Financing entities
  - Back-to-Back lending
  - Intercompany lending
  - Cash pooling
  - Factoring
- Working capital management
- Revised cash forecasting
- Timing and manner of repatriation of built up cash
- Increased local banking needs
- Treasury/Shared Service Centers (SSC)

Intercompany Leverage Structures

- Types of Instruments used
- Related party loan structures
- Routing of funds through intermediaries to obtain tax benefits
- Excessive debt push downs
- Level of interest deductibility
- Rate setting and review
- Documentation
- Tax rulings and requisite substance

Risk Management Structures

- Exposure Identification
- Payments/Receipts on behalf of
- Foreign exchange risk management and interest risk management
- Centralised interest rate hedging

OECD BEPS will require greater substance, coherence, transparency

Q&A