

Tax Analysis

For more information, please contact:

International Tax Services
National leader/Eastern China
Shanghai
Vicky Wang
Partner
Tel: +86 21 6141 1035
Email: vicwang@deloitte.com.cn

Northern China
Beijing
Jennifer Zhang
Partner
Tel: +86 10 8520 7638
Email: jenzhang@deloitte.com.cn

Southern China
Hong Kong
Sharon Lam
Partner
Tel: +852 2852 6536
Email: shalam@deloitte.com.hk

BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

Introduction

The OECD released a discussion draft on 14 March 2014 as part of its work on Base Erosion and Profit Shifting (BEPS). The discussion draft includes proposals for Action 6 (Prevent Treaty Abuse) of the BEPS Action Plan. The Action Plan identifies treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concern.

The draft proposals set out in the document do not represent the consensus views of either the Committee of Fiscal Affairs or its subsidiary bodies, but are intended to provide stakeholders with substantive proposals for comment.

Proposals

(A) Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

Limitation on benefits clause: A specific anti-abuse rule is proposed based on the limitation on benefits provision already included in many US treaties. The rule is designed to limit treaty benefits to companies (and individuals, not for profits, pension funds and government bodies) with sufficient presence in the relevant country. The rule operates based on the legal nature, ownership in, and general activities of, residents of a treaty country. One of the matters discussed is whether the rule should include a "derivative benefits" clause to allow a treaty country to look through to the shareholders where they would also be entitled to benefits under a treaty.

Purpose rule: In addition to the limitation on benefits clause, the Discussion Draft proposes a broadly drafted general purpose rule aimed at removing treaty benefits from income where one of the main purposes of the arrangements or transaction was to obtain treaty benefits.

Determining treaty residence: The Discussion Draft proposes removing the place of effective management tie-breaker clause for determining treaty residence (where different domestic rules would treat an entity as resident in two countries). This will be replaced by a requirement that the competent authorities of the two countries endeavour to determine residence, by reference to place of effective management, place of incorporation/constitution and any other relevant factors.

Minimum shareholding period re dividends: It is proposed that the reduced rates of withholding tax applicable to non-portfolio dividends are restricted to shareholdings that are owned throughout a period of months that includes the dividend payment. Comments are sought on what the number of months should be.

Withholding taxes on payments to permanent establishments (PE): A new clause is proposed to restrict relief from withholding taxes on payments to a third country PE, to apply where the combined rate of tax paid by the recipient in the PE and residence countries is less than 60% of the tax rate of the residence country.

(B) Clarification that tax treaties are not intended to be used to generate double non-taxation

The title and preamble to the OECD Model Tax Convention will be amended to clarify that the prevention of tax evasion and avoidance, specifically including but not limited to treaty shopping, is a purpose of tax treaties; countries that enter into a treaty intend to eliminate double taxation without creating opportunities for tax avoidance and evasion. This title and preamble will be relevant to the treaty's interpretation.

(C) Tax policy considerations that countries should consider before deciding to enter into a tax treaty with another country

It is proposed that the model tax treaty include key points for countries to consider in relation to the conclusion, modification (or termination) of a tax treaty. The avoidance of double taxation remains a main objective of tax treaties in order to reduce tax obstacles to cross-border services, trade and investment. However, other considerations include the ability to eliminate double taxation domestically, increased risk of non-taxation, excessive taxation from high withholding tax rates, increased certainty and cross-border dispute resolution for taxpayers and the ability of prospective treaty partners to provide assistance in the collection of taxes and exchange of information.

Timetable and Next Steps

Comments are requested by 9 April 2014 given the extremely tight timetable for the BEPS project. A public consultation event was held in Paris on 14/15 April 2014 before the proposals are finalised in September 2014. Adoption of the final proposals will need to await the multilateral convention (Action 15 – due December 2015), as individual negotiation will be time-consuming.

Deloitte Comments

One of the concerns with the proposals, which are wide-ranging, is the degree of uncertainty that will exist in applying a purpose test. It will also likely be difficult to apply, such a test, on a consistent basis. This uncertainty will create practical issues for businesses seeking to understand whether the benefits of a treaty will apply to their transactions.

Note: Contents discussed in this Tax Analysis pertain to Deloitte International Tax Services

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Beijing

Kevin Ng
Partner
Tel: +86 10 8520 7501
Fax: +86 10 8518 7501
Email: kevnng@deloitte.com.cn

Hong Kong

Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Shenzhen

Constant Tse
Partner
Tel: +86 755 3353 8777
Fax: +86 755 8246 3222
Email: contse@deloitte.com.cn

Chongqing

Kevin Ng
Partner
Tel: +86 23 6310 6206
Fax: +86 23 6310 6170
Email: kevnng@deloitte.com.cn

Jinan

Eunice Kuo
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: eunicekuo@deloitte.com.cn

Suzhou

Frank Xu / Maria Liang
Partner
Tel: +86 512 6289 1318 / 1328
Fax: +86 512 6762 3338
Email: frakxu@deloitte.com.cn
mliang@deloitte.com.cn

Dalian

Frank Tang
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: ftang@deloitte.com.cn

Macau

Quin Va
Partner
Tel: +853 8898 8833
Fax: +853 2871 3033
Email: quiva@deloitte.com.hk

Tianjin

Jason Wu
Partner
Tel: +86 22 2320 6680
Fax: +86 22 2320 6699
Email: jassu@deloitte.com.cn

Guangzhou

Constant Tse
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: contse@deloitte.com.cn

Nanjing

Frank Xu
Partner
Tel: +86 25 5791 5208
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn

Wuhan

Justin Zhu
Partner
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032
Email: juszhu@deloitte.com.cn

Hangzhou

Qiang Lu
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn

Shanghai

Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Xiamen

Lynch Jiang
Partner
Tel: +86 592 2107 298
Fax: +86 592 2107 259
Email: ljiang@deloitte.com.cn

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National Tax Technical Centre

Email: ntc@deloitte.com.cn

National Leader

Leonard Khaw
Partner
Tel: +86 21 6141 1498
Fax: +86 21 6335 0003
Email: lkhaw@deloitte.com.cn

Northern China

Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Southern China (Hong Kong)

Davy Yun
Partner
Tel: +852 2852 6538
Fax: +852 2520 6205
Email: dyun@deloitte.com.hk

Southern China (Mainland/Macau)

German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Eastern China

Kevin Zhu
Director
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.

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