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Dbriefs Bytes Transcript

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For comments on Action 3, see **the highlighted text below**.

BEPS

1. BEPS : CFC rules, special measures, and Action 11

Well, I have quite a few BEPS-related developments for you.

Let's start with Danielle Rolfes, from the US Treasury.

At a recent conference, she elaborated on the point that was made last week by her colleague (Bob Stack) that the answer to the Bermudan cash box question is not to dramatically change the transfer pricing rules, but to make sure that all parent company jurisdictions have workable CFC rules.

According to Rolfes, the US will push for a requirement, under BEPS Action 3, that all participating countries should have CFC rules which meet a minimum standard. So the argument goes, this will have the effect of reducing BEPS-like activities, and thus will reduce the erosion of source country tax bases - without undermining the credibility of the arm's length principle.

Well, on the other side of this debate, some opposing arguments are made - such as these:

- Firstly, the idea of having a minimum standard for CFC rules is probably going to be very difficult to achieve in the EU. In the 2006 decision of the European Court of Justice in the Cadbury Schweppes case, the court held that the EU "freedom of establishment" rule would prevent the UK from implementing its CFC regime unless the regime "relates only to wholly artificial arrangements intended to escape the national tax normally payable". It will be difficult to craft a minimum standard for CFC rules which satisfies both the US and the Cadbury Schweppes case.
- Secondly, although the US government officials talk about strengthening CFC rules, they never seem to mention the US "check the box" rules, which have the effect of substantially weakening the US's own CFC rules in Subpart F. That apparent omission is sure to be noted by the Europeans.
- And finally, remember the comments of Pascal Saint-Amans in regard to the arm's length principle. He has described himself as agnostic, not wedded to the religion of the arm's length principle. If a new rule is required to get the job done, then let's use the new rule - and don't worry about whether it fits neatly into the arm's length principle.

So, I can foresee that this whole question (of where do the residual returns from the Bermudan cash box go?) will be a **major tension point** between the US on one side (which says "stronger CFC rules"), and many of the participating countries on the other (which will be saying : "transfer pricing special measures").

Action 11 is probably one of the least exciting items in the BEPS Action Plan, at least in my view.

Its title is this : "Establish methodologies to collect and analyse data on BEPS and the actions to address it".

You might remember that the OECD recently called for public comments on Action 11.

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Well, this week the OECD has published all of the comments, which extend to 121 pages.

The folks who made the public comments consist of the usual suspects, but I did note that the Chinese government was one of only two governments to make submissions - the other being Costa Rica.

If you would like to obtain a copy of the 121 pages of comments, please go to BEPS Central.

And not to be outdone, the Australian Senate (which is the upper house of Parliament) has decided this week to undertake a review of : "tax avoidance and multinational corporations operating in Australia".

This is presumably in reaction to the press coverage of the report, which I mentioned in last week's Dbriefs Bytes, concerning the effective tax rates of the top 200 companies which are listed on the Australian Stock Exchange.

The review is not government-sponsored - it's an initiative of the Opposition and Green parties. But, just like in the UK, it will give a platform (with Parliamentary privilege) to any Margaret Hodge-wannabes Down Under.

2. BEPS : Action 5

Well, if there is going to be tension on transfer pricing "special measures", the fur will really be flying in 2015 on Action 5, harmful tax practices.

There are a lot of vested interests at stake.

A good example was shown last week by David Gauke, who is the UK's Financial Secretary to the Treasury. In a speech at the Securities Industry Conference, he applauded the BEPS project, but at the same time strongly defended the UK's patent box tax incentive.

He said this :

> "I reject any suggestion that the UK's Patent Box facilitates profit shifting. Let me be clear here : categorically, it does not create an opportunity for businesses to reduce their taxes without increasing their value to the UK economy.
>
> "To gain the advantages of the Patent Box, a company must either have developed the IP itself, or actively manage the commercial exploitation of the IP. This is a substantial amount of activity for a business to undertake.
>
> "If all a business wanted to achieve was to shift their profits in order to receive a lower tax rate, then this simply would not be worth the hassle."

He then went on to criticise the so-called nexus approach, which is the approach currently favoured by the OECD to determine whether a tax incentive is based on substance.

If you would like to obtain a copy of David Gauke's speech, please go to BEPS Central.

In last week's Dbriefs Bytes, I referred to the supporting documentation which had been recently released by the EU in regard to their official enquiry into the legality of tax incentives given to Apple (by Ireland) and to Fiat (by Luxembourg). The assertion is that there has been a breach of EU law in regard to selective state subsidies.

Well, this week, Amazon's tax incentive in Luxembourg has been added to the enquiries.

There was also news this week in regard to Gibraltar. According to the press reports, the EU is investigating 165 tax rulings given by the Gibraltar tax authorities between 2011 and August 2013.

You could say that the Gibraltar tax authorities are between a rock and a hard place.

And finally in regard to Action 5 and harmful tax practices, there was an interesting theory put forward this week by Mindy Herzfeld of Tax Analysts, in an article titled : "Where BEPS may hit first".

Under Action 5, a tax incentive will need to pass two conditions in order to be considered not to be harmful.

The first condition concerns "substance". There has been a lot of focus and debate on how substance should be determined. As I mentioned already, according to David Gauke, the UK Financial Secretary, it should not be determined under the so-called nexus test.

But all of that focus and debate on the substance condition, has drawn attention away from the second condition - which concerns compulsory, spontaneous exchange of tax rulings.

Even tax incentives which satisfy the substance condition, will be required to satisfy the compulsory, spontaneous exchange condition - or else be labelled as "harmful".

According to Mindy Herzfeld :

> "The compulsory ruling exchange is one of a few [anti-BEPS] measures that may go into effect immediately."

And I wonder what aggressive tax authorities would do with that information?

3. BEPS : Unilateral Actions

Well, we continue to see examples of unilateral actions in regard to BEPS measures - both within the OECD and G20, as well as outside these two groups.

Firstly, the UK is not waiting for the OECD and G20 to finalise the proposed rules in regard to BEPS Action 2 on "hybrid mismatch arrangements" - it has announced that it will take steps against these arrangements.

Its first step will be to publish, on 3 December as part of the government's Autumn Statement, a consultation on the implementation of rules to prevent hybrid mismatches.

If you would like a copy of the government's announcement, please go to BEPS Central.

Another OECD member, Poland, has recently tightened its interest deductibility rules, well before the OECD has released anything on BEPS Action 4. Notably, the thin cap rules have been changed, to replace the current 3 to 1 debt to equity ratio, with a 1 to 1 ratio.

And a third recent example, this time from the world of developing country is Kenya.

Kenya's recently enacted Finance Act 2014 has two very interesting measures, from a BEPS perspective.

Firstly, an LOB provision has been inserted into the domestic law, and it has the potential to significantly limit treaty benefits for non-residents.

This "do it yourself" LOB provision is now contained in subsections (5) and (6) of section 41 of the Income Tax Act :

Subsection (5) says :

> "Subject to subsection (6), where a [double tax treaty]......provides that income derived from Kenya is exempt or excluded from tax, or the application of the [treaty] results in a reduction in the rate of Kenyan tax, the benefit of that exemption, exclusion, or reduction shall not be available to a person who, for the purposes of the [treaty], is a resident of the other contracting state if fifty per cent or more of the underlying ownership of that person is held by an individual or individuals who are not residents of that other contracting state for the purposes of the [treaty]."

And subsection (6) says :

> "Subsection (5) shall not apply if the resident of the other contracting state is a company listed in a stock exchange in that other contracting state."

Taken together, these two subsections represent a much more powerful LOB provision than is currently contemplated under BEPS Action 6 - and it's all done through a domestic law override of the treaty. That will displease the purists.

The **second** interesting measure is an indirect share transfer provision, which seems to have been

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loosely modelled on India's amended section 9(1)(i).

You will remember that I reported two weeks ago in Dbriefs Bytes that a so-called “secondary BEPS agenda” for developing countries, has been identified by commentators such as Joel Cooper of the World Bank. One of the items on that “secondary BEPS agenda” is the taxation of indirect share transfers.

The new Kenyan rule on indirect share transfers is contained in section 3(2)(g) and section 15(5A) of the Income Tax Act.

Two key points should be noted :

- Firstly, it relates to indirect transfers of “**immovable property**” in Kenya only - unlike the Indian provision, which relates to indirect transfers of all types of property in India.

- And secondly, the minimum threshold ownership interest, for the provision to apply, is 20 per cent. You will remember that in the recent Copal case, the Delhi High Court stated that the minimum threshold ownership interest in India is 50 per cent.

If you would like to obtain a copy of the Finance Act 2014 (it’s 36 pages long), please follow the link in the summary slides at the end of this video.

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