Dbriefs Bytes Transcript

22 November 2013

For comments on Action 10, see **the highlighted text below**.

BEPS

- **The OECD's public consultation on transfer pricing, which was held in Paris on 12 and 13 November, was still the world's number 1 BEPS story this week.**
- **As a quick recap, the consultation meeting covered four topics :**
- **(i) country-by-country reporting;**
  (ii) the two-file approach for standardized transfer pricing documentation;
  (iii) intangibles; and
  (iv) the relationship between transfer pricing and the BEPS Project.
- **In last week's Dbriefs Bytes, I spent some time on the first two of these topics.**
- **Let me now say a few words about the last two: intangibles and the relationship with the BEPS Project.**
- **In regard to intangibles, the first point to note is that, according to the OECD, the consultation on 12 and 13 November was the last public consultation on the topic of intangibles. The OECD noted that a lot of work has been done on the transfer pricing aspects of intangibles: the OECD has published and received comments on two discussion drafts, and it has held two public consultation meetings (the first in November 2012 and the second earlier this month). They also said that, although the intangibles project started before BEPS, it has now been subsumed into BEPS (it's BEPS Action number 8) and the deadline for that action is September 2014.**
- **There was some debate in the meeting in regard to the definition of "intangibles", and in particular the question of whether goodwill should or should not be regarded as an intangible; if it were not regarded as an intangible, the alternative would be to treat it as a comparability factor in regard to pricing the transfer of other assets.**
- **But the most important issue which was discussed concerns the allocation of the returns from the intangible between the legal owner and other related parties. The legal owner is the correct legal recipient of the returns from intangible property. But the OECD wants to avoid a situation where the returns go to the legal owner, but the significant functions (involving the development, enhancement, maintenance and protection of the property) are performed by other related parties (who are remunerated on a cost plus basis). How do you ensure that the significant functions performed by the other related parties are properly rewarded, reflecting the "added value" which those functions bring?**
- **And that question was keenly debated in the consultation. A key view from the business community is that the discussion draft gives too little attention to the search for comparables for those significant functions performed by related parties. It too readily indicates that comparables would be unlikely to be found and that, as a consequence, a profit split approach would be necessary.**
- **Which I guess brings us to the question of the so-called "special measures". The OECD's BEPS Action Plan, released in July, indicated that, in some situations, the arm's length**

principle does not lead to the proper allocation of profits between related parties, and consequently so-called "special measures" are necessary to achieve that objective. The need for these "special measures" is referred to in BEPS Actions 8, 9 and 10.

- **A number of business representatives accepted the need for special measures, but indicated that this should be done in a transparent manner, and not by pretending that it is an application of the arm's length principle. For example, Will Morris, the chair of BIAC's tax committee (BIAC, of course, is the official private sector channel into the OECD), said this in his closing comments:**

"On intangibles, we have had several detailed discussions...What I did take away, however, especially when it comes to valuing and / or allocating the residual attributable to an intangible, is that we have a problem. And it's a problem that we're currently trying to cover up with language - but I'm not sure that works. I believe that in many areas the Arm's Length Standard continues to work, and I also believe that there are good reasons for it being used as the default, or the starting point, in all areas. However, and there is a however, where it doesn't work, we shouldn't try to cover that up by saying that it does and then coming up with yet another ad hoc 'improvement' to the Arm's Length Standard. There may, in some cases, be very good reasons for diverging from the Arm's Length Standard...

"...But if we're going to do that, then we should do it very clearly, and with full agreement from a broad range of countries that this is a different taxing principle. We do ourselves no favours by classifying it as just another Arm's Length Standard method that may or may not work in a hierarchy of methods that businesses and different countries may choose, or not, to adopt. That only leads to more and more double taxation as countries go their different ways. We shouldn't necessarily be scared of 'special methods'. The Arm's Length Standard is the default, and the case needs to be made for deviating from it. But if that case can be made, then let's do it transparently, and with a clear articulation of the taxing principle, so that the desired outcome is clear to all parties"

Japan

A BEPS-related development from Japan

- Japan's Ministry of Finance issued a report last week on the consumption tax treatment on in-bound supplies of services and intangibles.
- As you know, consumption tax is the Japanese term for VAT.
- And consumption tax has been in the news this year because of the proposed increases in tax rates in 2014 and 2015. But that's not the focus of this report.
- Instead, the report focuses on the consumption tax treatment when a foreign supplier supplies services or intangibles (in particular, digital content such as music, movies, games and software) to Japanese buyers.
- Under the current law, such supplies are treated as occurring at the foreign location of the foreign supplier. This means that the supplies fall outside the consumption tax system.
- The report separately considers the "B to C" situation and the "B to B" situation.
- In the "B to C" situation (in other words, where the Japanese buyer is a consumer), the report says that foreign suppliers have a competitive advantage over domestic suppliers. The price charged by domestic suppliers will include consumption tax, whereas the price charged by foreign suppliers will not.
- In the "B to B" situation (in other words, where the Japanese buyer is registered for consumption tax), there will ordinarily be no net difference between domestic suppliers and foreign suppliers, assuming

the Japanese buyer can obtain a full input tax credit for the consumption tax charged by the domestic supplier.

- The report proposes that the law be changed such that the place of supply shall be determined by the place of consumption - in other words, the destination principle. This would mean that consumption tax would be levied in regard to such in-bound supplies. Although this would not lead to a net difference in the "B to B" situation (assuming the Japanese buyer can obtain a full input tax credit), it would lead to a change in the "B to C" situation (which would remove the current pricing advantage enjoyed by foreign suppliers).

- Of course, compliance would be a big issue: how to enforce the imposition of the consumption tax on the foreign supplier?

- The report considers a number of alternatives:

(i) Requiring foreign suppliers to register for consumption tax and file consumption tax returns. The report acknowledges that co-operation with foreign tax authorities, in terms of information exchange and collection of taxes, would be necessary. This will require amendment to Japan's treaties, in order for them to cover consumption tax.

(ii) A reverse charge system. However, this would work only for "B to B" supplies.

- It should be noted that the report is a government thought paper, rather than an announcement of a law change.

- I might also add that there have been recent press reports that the tax authorities in Thailand are considering the same sort of issue.