Dbriefs Bytes Transcript

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For comments on General Information, see **the highlighted text below**.

1. OECD / G20 : BEPS & other projects

1.1 G20 Finance Ministers meeting

Well, as expected, the G20 Finance Ministers (who met in Cairns last weekend) welcomed the seven BEPS 2014 deliverables which were released by the OECD last week.

But probably because most of the 2014 deliverables are still incomplete, the G20 failed to use either the "e" word (endorse) or the "a" word (accept) in their communique. This is what the communique said :

> "We are strongly committed to a global response to cross-border tax avoidance and evasion so that the tax system supports growth-enhancing fiscal strategies and economic resilience. Today, we welcome the significant progress achieved towards the completion of our two-year G20 / OECD Base Erosion and Profit Shifting (BEPS) Action Plan and commit to finalising all action items in 2015."

Also, a number of countries which have made statements supporting the 2014 deliverables have also used the “welcome the significant progress” formulation, rather than endorse – for example, Japan, the US, and the Netherlands. One exception is the UK, which issued a statement last week saying it formally commits to implementing the country-by-country reporting template. I will talk about China’s position later in this video.

The G20 meeting produced quite a number of documents on BEPS, as well as the other tax projects being undertaken by the G20, either on its own or together with the OECD.

Here's my selection of the best :

(a) The G20 communique which I just referred to.

(b) The OECD Secretary-General's progress report on the four tax projects on which the two organisations have collaborated : (1) the BEPS project; (2) the Common Reporting Standard for automatic exchange of information; (3) the specific challenges faced by low income countries in regard to tackling key international tax issues, including BEPS; and (4) the ongoing review of all global jurisdictions in regard to exchange of information on request.

(c) And Parts 1 and 2 of the OECD's detailed report on the impact of BEPS in low income countries. Part 1 was released a couple of months ago. Part 2 was released in the run-up to the Cairns meeting.

To access all of the documents from the G20 meeting, please follow the link in the summary slides at the end of this video.

In regard to the Common Reporting Standard for automatic exchange of information, the G20 communique stated that the finance ministers "endorsed" the Common Reporting Standard, and :

> "We will begin exchanging information automatically between each other and with other countries

by 2017 or end-2018, subject to the completion of necessary legislative procedures."

1.2 <u>Tension points</u>

As I mentioned last week, the 2014 deliverables contain a lot of gaps, a lot of areas of "unfinished business".

Of course, some of those gaps are appropriate because there truly does need to be a co-ordination with the 2015 deliverables.

However, it's clear that some of the gaps are simply because a consensus has not yet emerged on various issues.

For example :

- In regard to country-by-country reporting : the filing process is still in debate.
- In regard to Action 5 on harmful tax practices, there is conflict as to the use of the so-called "nexus approach" : those countries with patent boxes are seeking to drop the nexus approach, whilst other countries (like the US) are pushing for the nexus approach.
- On Action 8, the Bermudan cash box continues to be debated. There are two issues here : how do you limit the return to the cash box, and what do you do with the residual return?

The countries will need to resolve all of these gaps, plus complete all of the September 2015 deliverables, all in the next 12 months, to stay on track.

1.3 <u>Secondary BEPS agenda</u>

One of the interesting developments in the area of BEPS is the emergence of what's been called a "secondary BEPS agenda" in regard to developing countries. This phrase was used by Joel Cooper of the World Bank at a Asia Pacific transfer pricing conference this week in Singapore.

He is referring to a number of issues which have been identified as of particular interest to developing countries. Some of these issues are covered in the OECD's report on the impact of BEPS in low income countries.

The issues include the following :

- The question of tax incentives to encourage foreign investment : good policy or bad?
- Taxation of indirect transfers
- Outbound service fee payments
- In regard to transfer pricing : lack of information on comparables
- And should developing countries show more reluctance to enter into double tax treaties?

1.4 <u>Next steps</u>

In last week's OECD webcast on BEPS, Pascal Saint-Amans said that discussion drafts for several of the September 2015 deliverables will be released by the end of this year, with the objective of conducting a consultation process during January to March 2015.

He said that the full BEPS calendar for the period for the remainder of 2014 and into 2015 will be published by the OECD either today or next week. Look out for that on BEPS Central.

2. UN

2.1 **23 September conference : papers**

In regard to the issue of the impact of BEPS on low income countries, the United Nations held a timely conference in Paris this week called "Tax Base Protection for Developing Countries".

Many of the papers concern various BEPS Actions, including the 2015 deliverables - for example :

- There's a very interesting paper on "preventing the artificial avoidance of PE status", which of course is BEPS Action 7. It's 77 pages, and it's written by Professor Adolfo Martin Jimenez, from the University of Cadiz in Spain. View it as a primer to get ready for the upcoming discussion draft on Action 7.
- There's also a paper on "limiting interest deductions", which is BEPS Action 4. This is 30 pages in length, and was written by Peter Barnes from Duke University (and, of course, before that, GE).
- And there are other papers on :

  (a) treaty abuse (Action 6), by Graeme Cooper of the University of Sydney; and

  (b) taxation of capital gains, including indirect transfers, by Wei Cui from the University of British Columbia.

If you would like to obtain a copy of these papers, please follow the link in the summary slides at the end of this video.

2.2 Tax Experts Committee meeting : late October

And the UN has released the current draft of the agenda for the next meeting of its Committee of Tax Experts, which will be on 27 to 31 October.

The agenda is jam-packed, but I think the most interesting issue is the taxation of services.

If you would like to obtain a copy of the draft agenda, please follow the link in the summary slides at the end of this video.

4. China

4.1 China's view on BEPS

Now for China's views on BEPS.

The SAT organized a half-day conference yesterday in Beijing. The conference was led by Director Liao, who (of course) is heavily involved in the BEPS project.

Here are some of the key points made by the SAT :

- Tax and commercial substance alignment should be at the heart of the international tax regime and China's domestic tax regime.
- China will actively participate in bilateral negotiations, cautiously participate in multilateral negotiations and safeguard its sovereignty and independence. Furthermore, China will not take extreme measures. Also, it will not solely emphasize China's tax rights as a source country, considering the country's future economic growth and its expanding outbound investment sector.

- As a result of BEPS (which will make substantive changes to the tax regime), and the automatic exchange of information (which will make procedural changes to the tax regime), income and assets hidden overseas by wealthy Chinese individuals and Chinese resident enterprises will be detected by the tax authorities.

- The SAT believes that China has almost no harmful tax practices. [I wonder what the "almost" refers to.]

- The SAT's position on so-called "special tax adjustments", which refers to adjustments under GAAR, transfer pricing, CFC rules, thin capitalization and some other grounds, is under review. The SAT will release a draft for public comments before the end of this year, and the final rules will be issued, likely in early 2015.

- The Anti-tax Avoidance Division, which is the division in charge of transfer pricing adjustments, will defer all of its negotiations with other countries until 2015 (indeed, likely to be the end of 2015) so that the division can focus on reshaping China's current tax regime in this area in accordance with the BEPS project. It was not stated what the "negotiations" refer to, but this sounds to me like APA and MAP discussions – which would be bad news.

- In regard to transfer pricing related items:

    1. The Anti-tax Avoidance Division will focus on intangibles in future years. The SAT is pleased to see that the OECD's Action 8 deliverable has downplayed the importance of legal ownership and put more emphasis on value creation.

    2. The division is also happy to see the proposed Action 8 treatment of marketing intangibles. In the future, where there is a Chinese subsidiary of a multinational group and that subsidiary performs a marketing function, a cost-plus basis for rewarding the subsidiary would frequently be viewed as inadequate.

    3. Similarly, a China subsidiary that engages in contract R&D for a multinational corporation should generally not be paid on a cost-plus basis.

    4. Intra-group transactions, such as intra-group management services and intra-group lending (with the lender located in Bermuda for instance), are regarded as high risk transactions, which have been used by some as a means to shift profits out of China and may justify a formulary approach in some instances. This issue is not a focus of the BEPS project, but it is very much a focus for China.

    5. Multinationals that establish several single function subsidiaries in China, with each receiving a low return, will likely be challenged. Although the SAT did not state this, such a challenge could be under the GAAR rule.

- No clear position was taken as to which one of the three options in Action 6 would be adopted by China.

- China will not accept binding arbitration at the moment because China is not equipped or ready to do so. However, China does not exclude this as a potential option when China does become equipped and ready.

- In terms of the BEPS report on the digital economy, the SAT believes that data has value because collecting data incurs costs and data can be traded. Moreover, in regard to the question of where value is created, the SAT believes that both the supply and demand sides need to be considered – not just the supply side.

- And the SAT will soon post on its website a list of 15 unacceptable tax behaviors, such as a low return to a "high-tech" company. This list will likely be the focus of the SAT in the near future.

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