BEPS

WAKE UP!

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BEPS recommendations on Harmful tax practices, Treat Abuse, Permanent Establishment (Actions 5,6,7)

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Agenda

Action 1: Address the tax challenges of the digital economy			
"Gaps"	"Frictions"		"Transparency"
i. Establishing international coherence of corporate income taxation	ii. Restoring the full effects and benefits of international standards		iii. Ensuring transparency while promoting increased certainty and predictability
Action 2: Neutralise the effects of hybrid mismatch arrangements	Action 6: Prevent treaty abuse		Action 11: Establish methodologies to collect and analyze data on BEPS and the actions to address it
Action 3: Strengthen controlled foreign company (CFC) rules	Action 7: Prevent the artificial avoidance of PE status		Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
Action 4: Limit base erosion via interest deductions and other financial payments	Assure that transfer pricing outcomes are in line with value creation	Action 8: Intangibles	Action 13: Re-examine transfer pricing documentation
Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance		Action 9: Risk and capital	Action 14: Make dispute resolution mechanisms more effective
		Action 10: Other high-risk transactions	
Action 15: Develop a multilateral instrument			

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Action 5: Countering Harmful tax practices

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Action 5: Countering Harmful tax practices

Introduction

Goal

Countering harmful tax practices more effectively taking into account **transparency** and **substance**

Venues

- Substantial Activity Requirement
- Exchange of Rulings
- Review of preferential regimes
- Engage Non-OECD countries

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Countering Harmful tax practices

Substantial activity requirement for preferential regimes

Basic Principal

benefits should be granted only to qualifying taxpayers to the extent those taxpayers **undertake the core activities required to produce the type of preferred business income** covered by the preferential regime

Measurement Tool

Nexus Approach

- First Examined - IP Regimes
- Core activity - Performance of R&D

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Countering Harmful tax practices

Substantial activity requirement for preferential regimes

Nexus Approach = Proportionate Approach

the formula:

$$\frac{a+b}{a+b+c+d}$$

Where:

a - company's expenditure on R&D **performed by the company itself**

b - company's expenditure on R&D **performed by unrelated parties**

c - company's expenditure on the **acquisition of IP**

d - company's expenditure on R&D **performed by related parties**

30% uplift is available

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Countering Harmful tax practices

Substantial activity requirement for preferential regimes

Qualifying IP

- Patents
- Broadly defined Patents (petty, innovation, & short term patents)
- Copyrighted software
- Other IP assets that are non-obvious, useful, and novel (caped)

"marketing-related IP assets such as trademarks **can never** qualify for tax benefits under an IP regime"

Timing

- No new entries after 30 June 2016
- **Grandfathering** may be granted up to 30 June 2021
- "After that date, no more benefits stemming from the respective old regimes may be given to taxpayers"

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Countering Harmful tax practices

Review of Preferential Regimes

16 IP Regimes Reviewed Including Israel's

Non of Which Consistent with Nexus Approach

Amendment Period is expected to commence in 2015

43 non IP regimes are under review

Process continues

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Countering Harmful tax practices

Improving Transparency

Agreed Approach

Compulsory, Spontaneous
Ruling Exchange Framework

Covered Ruling

- Preferential regimes
- Unilateral APAs
- Unilateral downward adjustment of the taxpayer's taxable profits – e.g.: Excess profits rulings; Informal capital rulings
- Permanent establishment
- Related party conduit rulings
- Any other type of ruling which is identified in the future

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Countering Harmful tax practices

Improving Transparency

Compulsory, Spontaneous Ruling Exchange Framework

	Two Stage Process	Applicability	
I	Providing Country to send information to Selected Other Countries*	Past Rulings From 1/1/2010	By December 2016
		Future Rulings From 1/4/2016	Within three months
II	Selected Other Countries* may request a copy of the ruling		

Assuring Systems

* The residence countries of all related parties with which the taxpayer enters into a transaction for which the ruling was granted. In addition ultimate parent company and the immediate parent company.

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Countering Harmful tax practices

Next Step

	IP Regimes	Non - IP Regimes	Transparency
OECD + G20 Countries	Monitor legislative changes towards the Nexus Approach	Continue Review	Systems
Non OECD	Develop Strategy		

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Action 6: Prevent Treaty Abuse

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Action 6: Prevent Treaty Abuse

Introduction

Goal

Countering Treaty Abuse & Shopping

Venues

- Clear Statement
- LOB / PPT
- Other changes
- Policy Suggestions

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Action 6: Prevent Treaty Abuse

Still a way to go …

Finalised	Incomplete (further work required)
• Principal Purpose Test - PPT • Art. 10 : minimum shareholding period for “substantial shareholder” rate • Art. 13(4) : 365 day rule for determining land-rich status • Art. 4(3) : change to the corporate residence tie-breaker rule • Art. 1(3): “saving clause” • Title and preamble	• Limitation on benefits - LOB • Special tax regimes • Future changes in a country’s tax laws • Non-CIV funds • Pension funds • Transactions intended to avoid dividend characterisation • PE in third jurisdiction • Arts. 23A / 23 B : income derived through hybrid entities

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Action 6: Prevent Treaty Abuse

Agreed Minimum Standard

Clear Statement

Title & Preamble Change

+

PPT

or

LOB + PPT

or

LOB +
anti conduit

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Action 6: Prevent Treaty Abuse

Title & Preamble

Proposed title and preamble to double tax treaties:

Title:

Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital **and the prevention of tax evasion and avoidance**

Preamble:

(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital **without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping** arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

Have agreed as follows:

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Action 6: Prevent Treaty Abuse

Principal Purpose Test – Paragraph 7

"Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if **it is reasonable to conclude**, having regard to all relevant facts and circumstances, that **obtaining that benefit was one of the principal purposes of any arrangement or transaction** that resulted **directly or indirectly** in that benefit, **unless it is established** that granting that benefit in these circumstances would be in accordance with the **object and purpose** of the relevant provisions of the Convention." [bolding added]

No Burden of proof

Broad

Taxpayers Burden

Subjective

Optional Paragraph 8 - Local Country Discretion

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Action 6: Prevent Treaty Abuse

LOB

LOB

Under Construction

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Action 6: Prevent Treaty Abuse

Other Changes

Art 10 (2) Substantial Shareholder Minimum Standard	25 % for 365 → 5% WHT
Art 10 **Optional**	Denial of Substantial Shareholder to specific CIV
Art 13(4)	365 day rule for determining land-rich status
Art. 4(3)	corporate tie-breaker rule

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Action 6: Prevent Treaty Abuse

Timing & Next Step

Timing	2017 Via Action 15
Consider	Current Structure

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Action 7: PE status

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Action 7: PE status

Introduction

Goal

Prevent the artificial avoidance of PE status

Venues

- Commissioner& similar principals arrangements
- Specific activity exemptions
- **Splitting up of contracts**

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Action 7: PE Status

Overview

Issue	Article	Options Sep 2014	Recommendation May 2015	Final Oct 2015
Commissionaire and similar Principal arrangements	Arts 5(5) & 5(6)	A, B, C, D	B	Amended B
Specific activity exemptions: preparatory & auxiliary	Art 5(4)	E, F, G, H	E	
Specific activity exemptions: fragmentation of activities	Art 5(4)	I & J	J	
Splitting up of contracts	Art 5(3)	K & L	L	
Insurance	Arts 5(5) & 5(6)	M & N	N	

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Action 6: PE Status

Art 5(5) Dependent Agent PE

Existing	New
"…. where a person…. is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State, an authority to conclude contracts in the name of the enterprise,…."	"…. where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts or **habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise**, and these contracts are a) in the **name of the enterprise**, or b) for the **transfer of the ownership** of, or for the **granting of the right to use**, property owned by that enterprise or that the enterprise has the right to use, or c) for the **provision of services by that enterprise**, …. "
	Replaced: or **negotiates the material elements of contracts**

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Action 7: PE Status

Art 5(5) Targeted Arrangements

Commissioner	Art 5(5) b +c
Marketing Subsidiaries	Art 5(5)a + new language
Distribution Subsidiaries	Do not Act on Behalf (new commentary)

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Action 7: PE Status

Art 5(5) Commentary

- **"habitually concludes contracts"** → **may include "Standard terms"**

- **"or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise"**

  ↓

  - conclusion of contract "directly results" from the agent's actions
  - agent acts as the "sales force" of the enterprise
  - agent "convinced" the third party to enter into contract with enterprise
  - can apply to "standard terms" contracts

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Action 7: PE Status

Art 5(4) Specific Activity Exemption

Specific activities currently can include:

- Storage
- Display
- Collecting information
- Purchasing
- Delivery
- Activities of a preparatory character
- Activities of an auxiliary character

Under Proposed Article 5(4):

Art 5(4) may only apply where **the activity (or activities) is of a 'preparatory or auxiliary character'** in relation to the **business** as a whole

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Action 7: PE Status

Art 5(4) Specific Activity Exemption

Proposed Commentary:

‘Preparatory’

- ‘an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole’

‘Auxiliary’

- an activity that has an auxiliary character… generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole’

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Action 7: PE Status

Anti-fragmentation & contract splitting

Art 5(4) Specific Activity Anti Fragmentation	Combined Activity
Art 5(3) Construction PE Contract Splitting	Combined Contract (group's view)

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Action 7: PE Status

PE Attribution of profits

"…follow-up work on attribution of profits issues related to Action 7 will be carried on after September 2015 with a view to providing the necessary guidance **before the end of 2016**, which is the deadline for the negotiation of the multilateral instrument that will implement the results of the work on treaty issues mandated by the BEPS Action Plan." [bolding added]

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Action 7: PE Status

Timing & Next Step

Timing	2017 Via Action 15
Consider	Current Structure

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