

Global Tax Reset & BEPS

Implementation of BEPS action plan in the Kenyan context: The KRA Perspective

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Key Objective of BEPS

“Aligning Taxation with value creation”

RELEVANT BEPS ACTION POINTS

Action 4: Limit base erosion via interest deduction and other financial payments.

Action 6 : prevent treaty abuse

Action7 : prevent avoidance of PE status

Action13: transfer pricing documentation

Action 4: interest deduction

- Current Law
 - Benchmark and allow interest expense (sec.15)
 - withholding tax on interest paid out (sec. 35)
 - thin capitalisation rule - equity ratio : debt (1:3)
- Challenges- WHT system
 - Differential between withholding tax and corporate tax rate creates opportunities for BEPS
 - sometimes WT rate reduced significantly through bilateral agreements

Action 4: interest deduction

- Challenges- thin cap rule
 - still allows significant flexibility in the rate of interest that an entity may pay on that debt
 - Allows entities with higher levels of equity capital to deduct more interest expense, which makes it relatively easy for a group to manipulate the outcome of the test by increasing the level of equity in a particular entity



Action 4: interest deduction

- recommended approach
 - fixed ratio rule - limits an entity's net deductions for interest to a percentage of its EBITDA
 - recommended approach includes a corridor of possible ratios of between 10% and 30%.
 - Enact targeted rules to prevent its circumvention, e.g by artificially reducing the level of net interest expense.

Action 4: interest deduction

- legislative options
 - restrict and disallow excess interest
 - allow entities to carry forward excess capacity for future
 - exempt special case entities for instance those in oil exploration

Action 6: prevent treaty abuse

- treaty anti-abuse rules
 - treaty shopping – establishing a letter box entity
- Proposals:

Treaty Preamble:

- First, a clear statement that the States that enter into a tax treaty intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements- be included in tax treaties

Action 6: prevent treaty abuse

Specific anti-abuse rule:

Second, a specific anti-abuse rule, the limitation-on-benefits (“LOB”) rule, that limits the availability of treaty benefits to entities that meet certain conditions- will be included in the OECD Model Tax Convention.

General anti-abuse rule

Thirdly, a more general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test or “PPT” rule) will be included in the OECD Model Tax Convention.

Action 6: prevent treaty abuse

General anti-abuse rule

Under the general rule, if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.

Action 6: prevent treaty abuse

- Proposals:

- Minimum standards:

- Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the “minimum standard”).

Action 6: prevent treaty abuse

- Proposals:

- Minimum standards:

- That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Action 6: prevent treaty abuse

Minimum standards:

Countries will implement this common intention by including in their treaties:

- (i) the combined approach of an LOB and PPT rule described above,
- (ii) the PPT rule alone, or
- (iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

Action 6: prevent treaty abuse

- Proposals:

- Targeted rules:

New rules to be included in tax treaties in order to address other forms of treaty abuse . These targeted rules addresses:

- (1) certain dividend transfer transactions that are intended to lower artificially withholding taxes payable on dividends;
- (2) transactions that circumvent the application of the treaty rule that allows source taxation of shares of companies that derive their value primarily from immovable property;
- (3) situations where an entity is resident of two Contracting States, and

Action 6: prevent treaty abuse

- Proposals:

 - Targeted rules:

Targeted rules addresses:

(4) situations where the State of residence exempts the income of permanent establishments situated in third States and where shares, debt-claims, rights or property are transferred to permanent establishments set up in countries that do not tax such income or offer preferential treatment to that income.

Action 7: prevent avoidance of PE status

- ‘Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.
- Work on these issues will also address related profit attribution issues.’ .

Action 7: prevent avoidance of PE status

Article 5 (5)

Notwithstanding the provisions of paragraphs 1 and 2 **but subject to the provisions of paragraph 6, where a person** **other than an agent of an independent status to whom paragraph 6 applies** **is acting in a Contracting State on behalf of an enterprise and has, and habitually exercises, in a Contracting State, an authority to conclude contracts, 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,

that enterprise shall be deemed to have a permanent establishment in that State

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Action 7: prevent avoidance of PE status

Article 5 (4)

- Restrict the exemption of a PE to preparatory or auxiliary works (*delivery of goods activity now not exempted*)
- Creation of a service PE -

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Action 7: prevent avoidance of PE status

Preventing Fragmentation –Revision to Article 5

Add the following new paragraph 4.1 to Article 5:

4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.



Action 13: *transfer pricing documentation*

- To enhance transparency for tax administrations.
- The requirement that MNEs provide to governments information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.
- Based on cost- benefit analysis

Action 13: *transfer pricing documentation*

Three -tiered approach

1. Master file –containing information relevant to all group members
2. Local file –containing information relevant to the material transactions of the local taxpayer
3. Country-by-country report containing information on the global allocation of the MNE's income and taxes paid, and other information relevant to location of economic activity

Action 13: *transfer pricing documentation*

The Master file:

- Organizational structure
- Description of MNE's businesses
 - profit drivers
 - supply chain for major products
 - intra-group services arrangement plus capacities of the provider
 - geographic markets for groups products and services
 - FAR analysis for group members
 - Business restructuring transactions, acquisitions and divestitures during the year

Action 13: *transfer pricing documentation*

The Master file:

- MNE's Intangibles
 - overall strategy for the development, ownership and exploitation of intangibles
 - location of principal R&D facilities and location of R&D management.
 - list of intangibles of the MNE group and ownership
 - A list of important agreements related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements.

Action 13: *transfer pricing documentation*

The Master file:

- MNE's Intangibles
 - A general description of the group's transfer pricing policies related to R&D and intangibles
 - A general description of any important transfers of interests in intangibles among associated enterprises during the year, including the entities, countries, and compensation involved

Action 13: *transfer pricing Documentation*

The Master file:

- MNE's intercompany financial activities
 - A general description of how the group is financed, including important financing arrangements with unrelated lenders.
 - The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organized and the place of effective management of such entities.
 - A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises
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Action 13: *transfer pricing Documentation*

The Master file:

- MNE's financial and tax positions
 - Annual consolidated financial statement for the year concerned if prepared for financial reporting, regulatory, internal management, tax or other purposes.
 - MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

Action 13: *transfer pricing documentation*

The Local file:

- Local entity
 - management structure, local organization chart, individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices
 - key competitors

Action 13: *transfer pricing documentation*

The Local file:

- Local entity
 - controlled transactions & payments
 - FAR analysis
 - TP method
 - Tested party
 - Assumptions made
 - comparability adjustments
 - APA's not involving local tax jurisdiction

Action 13: *transfer pricing documentation*

Country by Country Reporting:

- Allocation of income, taxes and business activities by tax jurisdiction
 - Revenues (Related, Unrelated)
 - Profit before Income tax
 - Accrued Tax
 - income tax paid
 - Capital

Action 13: *transfer pricing documentation*

Country by Country Reporting:

- Allocation of income, taxes and business activities by tax jurisdiction
 - accumulated earnings
 - Number of employees
 - Tangible assets other than cash
- List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Action 13: *transfer pricing documentation*

2014 Report:

- Model Treaty Provisions
- Design of Domestic Rules

The End

