Changing international tax landscape

What is the local impact of Base Erosion and Profit Shifting (BEPS) anti-tax avoidance initiatives?

Background

The Organisation for Economic Corporation and Development (OECD) on 16 September 2014 published the first set of reports and recommendations on its BEPS action plans.

The BEPS action plan was endorsed by the G20 in July 2013 and it identifies 15 key areas to be addressed by 2015 in order to address loopholes and gaps in the current domestic and international tax system. These loopholes and gaps are seen as creating opportunities for taxpayers who are involved in cross-border activities to aggressively structure their activities to mitigate potential tax exposure or achieve no tax liability.

OECD's BEPS Project aims to provide governments/ tax administrators with clear international solutions for fighting aggressive corporate tax planning strategies that artificially shift profits to locations where they are subjected to more favourable tax treatment.

The concept of *'fair taxes'* is at the heart of the BEPS discussions. It considers if taxpayers are paying adequate amount of tax in jurisdictions where the income-generating activities are performed, or whether the income is being artificially moved away to other jurisdictions resulting in the taxpayers paying little or no taxes on the income.

In this newsletter, we present an overview of the various BEPS actions plans, as well as synopsis of the recommendations contained in the reports of the 7 Action Plans that were released on 16 September 2014. We also highlight anticipated impact of the 7 Actions Plans on the Nigerian tax landscape.

The BEPS Action Plans

The action plans which address various BEPS issues under various broad areas are as follows:

Tax issues associated with the digital economy	
Action 1	Address the tax challenges of the digital economy
Establishing international coherence between domestic corporate income taxation rules and tax policies	
Action 2	Neutralize the effects of hybrid mismatch arrangements
Action 3	Strengthen Controlled Foreign Corporation (CFC) rules
Action 4	Limit base erosion via interest deductions and other financial payments
Action 5	Counter harmful tax practices more effectively, taking into account transparency and substance
Restoring full effects and benefits of international standards	
Action 6	Prevent treaty abuse
Action 7	Prevent the artificial avoidance of permanent establishment (PE) status
Actions 8 – 10	Assure that transfer pricing outcomes are in line with value creation: Action 8 - Intangibles Action 9 - Risks and capital Action 9 - Risks and capital
Ensuring transparency while promoting increased certainty and predictability	
Action 11	Establish methodologies to collect and analyze data on BEPS and the actions to address it
Action 12	Require taxpayers to disclose their aggressive tax planning arrangements
Action 13	Re-examine transfer pricing documentation
Action 14	Make dispute resolution mechanisms more effective
From agreed policies to tax rules; the need for a swift implementation of the BEPS measures	
Action 15	Develop a multilateral instrument

The first set of 2014 seven (7) deliverables

OECD released the first set of 7 deliverables on 16 September, 2014, and presented the reports to the meeting of the G20 Finance Ministers and Central Bank Governors which held in Cairns from 20 – 21 September, 2014.

The 2014 deliverables had been adopted by the forty-four (44) countries that make up the OECD committee on fiscal affairs, which is made up of the 34 OECD members, G20 member countries and accession countries.

The 7 2014 deliverables consist of:

Final reports	
Action 1	Addressing the tax challenges of the digital economy
Action 15	Developing a multilateral instrument
Interim report	
Action 5	Countering harmful tax practices more effectively, taking into account transparency and substance
Draft recommendations	
Action 2	Neutralizing the effects of hybrid mismatch arrangements
Action 6	Preventing treaty abuse
Action 8	Assuring that transfer pricing outcomes are in line with value creation - Intangibles
Action 13	Re-examining transfer pricing documentation

Highlights of the Seven 2014 deliverables

The 2014 deliverables; which are still in draft format, will be consolidated and finalized with the rest of the reports on the remaining actions points to be delivered in 2015.

In its current form, the 2014 deliverables present clear indication of likely global tax policy changes expected to be pursued unanimously by domestic tax authorities for implementation in their local tax legislations and bilateral tax treaty provisions.

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i. Action 1 deliverable: Addressing the tax challenges of the digital economy

The report acknowledged the difficulty of isolating and addressing the tax challenges posed by the digital economy, considering that the digital economy has become widely prevalent in recent years and intertwined with every other sector of the economy.

The particular BEPS concerns associated with the digital economy relate to arrangements that artificially eliminate or reduce taxable income in the jurisdictions where income is generated.
This is usually achieved through avoiding the creation of taxable presence by means of remote digital supply of services and intangible goods, artificial contractual reallocation of functions, risks and assets in situations where physical presence is inevitable, avoidance of withholding tax (WHT) through treaty shopping, etc.

BEPS concerns are also triggered where value added tax (VAT) is avoided or reduced in both the service provider's and recipient's countries as a result of remote digital non-VATable supplies made to businesses engaged in VAT-exempt activities, who are not required to self-assess VAT on foreign supplies of services and intangible goods.

The report concludes that BEPS issues associated with the digital economy will be adequately addressed by the various BEPS action points relating to restoration of taxation on 'Stateless income', market and/or ultimate parent's jurisdiction.

ii. Action 2 deliverable: Neutralizing the effects of hybrid mismatches (HMM) arrangements

HMM arrangements are artificial cross-border business structures or arrangements that intentionally seek to exploit differences in the treatment of an entity or instrument under the laws of two or more countries.

These arrangements lead to a mismatch and double non-taxation on both sides when all or part of a payment which has been allowed as deductible in one jurisdiction is either not included in the reported taxable income in the other jurisdiction or also treated as deductible.

In order to neutralize the effects of such arrangements, the report recommends the jurisdiction of the payer applying the primary response of denying the payer a deduction for payments made under hybrid arrangements.

In the possible event that the payer is located in a jurisdiction that did not apply the primary response, the reports also recommends the payee's jurisdiction applying a defensive rule by including the deduction in the ordinary income of the payee.

iii. Action 5 deliverable: Countering the effects of harmful tax practices more effectively, taking into account transparency and substance

The report on Action 5 deliverable; which is aimed at developing solutions to counter the effects of harmful tax regimes, is an extension of the work of OECD's Forum on Harmful Tax Practices (FHTP).

The tax regimes that are covered in the work relate to preferential treatment of income; for business tax purposes, in relation to geographically mobile activities like financial services and intangibles.

It seeks to create a more level playing ground for free and fair tax competition among different countries through the elimination of harmful country practices. Country practices are deemed harmful if the meet the following 3 tests:

i. Results in activities being shifted from one country to the country providing the preferential tax regime
ii. Results in an amount of investment or income that is not commensurate with the presence and level of activities in the regime
iii. If the preferential regime is the main motivation for the location of the activities

The report on Article 5 provides various options for setting the 'substantial activity' criteria to be used in assessing if a regime qualifies as harmful preferential regime by virtue of being set up to encourage purely tax driven operations or arrangements, and for realigning taxation rights with jurisdictions where substantial activities occur.

The report also sets a basic framework for encouraging spontaneous exchange of information among countries on rulings reached by member countries in relation to harmful preferential regimes. This will enable other countries more effectively counter the effect of lack of information and secrecy associated with such regimes and enable the countries take better and more effective defensive measures against such regimes.

Work on the report on Action 5 deliverable is still ongoing and the FHTP is expected to use the final frameworks in reviewing and assessing the tax regimes of the OECD member and associated countries.

iv. Action 6 deliverable: preventing the granting of treaty benefits in inappropriate circumstances

The BEPS concerns that are considered in Action 6 relate to situations in which taxable persons are able to inappropriately obtain the benefits of other countries' bilateral tax treaties in circumstances that circumvent limitations imposed by the treaties, and arrangements that circumvent the provisions of domestic tax laws using treaty benefits.

The report recommends a number of changes to the current OECD model tax convention. The recommendations aim at preventing these arrangements that amount to treaty abuse and generate double non-taxation or low taxation.

Some of the recommended changes include introduction of *Limitation of Benefits (LOB) rule* and *Principal Purpose of Transactions (PPT) rules* in tax treaties to specifically target treaty shopping arrangements whereby persons who are not resident in Contracting States try to obtain treaty benefits only available to residents of those states.

LOB rules restrict the application of treaty benefits only to residents who are qualified persons by reason of strict qualifying criteria of legal nature, ownership and activities in the Contracting States.

iv. **Action 8 deliverable: Guidance on transfer pricing aspects of intangibles**

The report on Action 8 contains proposed revisions to Chapters I and II of the OECD transfer pricing guidelines, providing clarification on definitions of intangibles and identification of transactions involving intangibles. The revisions also provide additional guidance on performance of transfer pricing analysis for transactions involving cost savings arising from location advantages, assembled workforce and group synergies.

The report also proposes a completion deletion and revision of Chapter VI of the OECD guidelines. It introduces a new approach towards identifying and valuing intangible property rights for transfer pricing purposes.

'Intangibles' have been accorded a broader descriptive definition as anything "…*which is not physical or financial asset capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances..."*

The above description deviates from the usual classification of intangible property rights as commercial, trade, or marketing tangibles, or as hard, soft, routine or no-routine intangibles.

v. **Action 13 deliverable: Guidance on transfer pricing documentation and Country-by-Country reporting**

The report on Action 13 provides for revision of chapter V of the current OECD TP guidelines in order to enhance transparency for tax administrators, by providing them with adequate information to conduct transfer pricing risk assessments and examinations.

It provides for a country-by-country reporting requirement for multinational enterprises (MNEs), which will include detailed business, income and tax disclosures for each of the group entities located in different tax jurisdictions.

It also provides for standardized group-level master-file and local TP documentation reporting templates.

vi. **Action 15 deliverable: Developing a multilateral instrument to modify bilateral tax treaties.**

The BEPS project acknowledges that the outcome of the project will, of a necessity, require an overhaul of countries' existing bilateral tax treaties.

Action 15 examines the mechanics and issues involved in countries negotiating a multilateral tax treaty to amend existing bilateral tax treaties and implement the final outputs of the BEPS projects. It recommends convening an international conference in 2015 to develop the multilateral instrument.

Anticipated impact on Nigeria's tax landscape

The outputs of the BEPS projects are expected to have the following short term and long term impacts in Nigeria:

a. *Introduction of more stringent and transparent transfer pricing compliance requirements:*

Regulation 11(b) of Nigeria's Income Tax (Transfer Pricing) Regulations, No1, 2012, automatically incorporates the OECD Transfers Pricing Guidelines into Nigeria's local TP jurisprudence; including any future supplements or amendments that may be made to the Guidelines.

Consequently, the recommendations contained in the reports on BEPS Action 8 (Guidance on transfer pricing aspects of intangibles) and Action 13 (Guidance on transfer pricing documentation and Country-

Given the significant connection Nigeria's treaty countries have with OECD, it would be expected that adoption of the proposed multilateral tax treaty instrument by OECD will trigger a wave of review and modification of Nigeria's current and pending DTAs

by-Country reporting) involving revisions to Chapters I, II and V of the OCED Guidelines will become immediately applicable in Nigeria once the recommendations are approved.

The report on Action 8 (Guidance on transfer pricing aspects of intangibles) will only be finalized after incorporating the results of the work on the remaining Action points; with the latest deadline being December 2015. On the other hand, the recommendations on Action 13 – guidance on TP Documentation is expected to be approved within a shorter period of time.

b. *Modification of Nigeria's Bilateral Tax Treaties to incorporate outputs of the BEPS project and swiftly address BEPS concerns*

Nigeria currently has bilateral Double Tax Agreements (DTAs) in force with eleven (11) countries and has also negotiated DTAs with eight (8) additional countries that are awaiting ratification by the National Assembly.

7 out of the 11 treaty countries are full members of OECD, while 2 are accession/ partner countries. Also, of the 8 countries that have DTAs with Nigeria awaiting ratification, 3 are OECD full members and 1 is an accession/ partner country.

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The status of the relationship between Nigeria's treaty countries and the OECD is shown in the table below:

Nigeria's effective DTAs	Full OECD membership status	OECD Accession/ partnership status
France	√	
Canada	√	
United Kingdom	√	
Romania	-	-
Belgium	√	
Czech Republic	√	
People's Republic of China	-	√
South Africa	-	√
Netherlands	√	
Pakistan	-	-
Italy	√	
Nigeria's DTAs awaiting ratification	**Full OECD membership status**	**OECD Accession/ partnership status**
Philippines	-	-
Poland	√	
Spain	√	
Sweden	√	
South Korea	-	-
Russia	-	√
Mauritius	-	-
Algeria	-	-

We anticipate that the outcome of the BEPS project will have quite significant consequential impact on the current transfer pricing policies and documentation of Nigerian taxpayers, in relation to transactions that will be affected by those modifications.

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