



Global Tax Reset: The changing world of tax

A detailed overview of the BEPS action points

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Action 1: Digital Economy

Action 1 addresses the tax challenges of the digital economy and aims to identify and address the main challenges that the digital economy poses for the existing international tax rules.

A discussion draft was released by the OECD in Spring 2014. Following comments from interested parties and a public consultation meeting in April 2014, the OECD paper on Action 1 was published in September 2014. It should be noted that the G20 and OECD intend that final recommendations will form a comprehensive and cohesive approach. As a result, while some of the proposed solutions have been agreed, they are not yet finalised and may be affected by other Actions or decisions and future work on BEPS in 2015/2016.

An additional discussion draft was released by the OECD in December 2014 and comments on the discussion draft were published in February 2015.

A final report on Action 1 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

The Davis Committee (DC) has already commented on its recommendations for South Africa in respect of this. In its report the DC recognised the challenges faced by the digital economy and approaches already adopted in other countries, notably Canada, the UK, Australia, New Zealand, France and India. Referring to the Katz Commission, the DC acknowledged the recommendations of that Commission that South Africa should not seek to pioneer a new tax system to address the digital economy. It further referred to the Green Paper on E-Commerce issued in 2000 which pointed out that the legal framework in South Africa was insufficient to deal with e-commerce issues.

The DC considered the BEPS report from both the direct tax and indirect tax perspective. In terms of direct tax it concluded that the effect of the Controlled Foreign Company (CFC) and transfer pricing rules in place make it difficult for South African's to shift profits without shifting significant substance, often impractical in e-commerce businesses. Therefore other than some adjustments to the foreign tax credit rules and the CFC rules relating to e-commerce transactions, the DC felt that there was no adequate basis for expanding the South African fiscal jurisdiction to allow for the taxation of income as a result of e-commerce transactions. The decision was thus to await outcomes of the OECD's work on Permanent Establishment thresholds in respect of the digital economy. One area which was identified as needing attention was the need to create clear source rules to enable a tax on non-resident suppliers of goods and services to South Africans. In our view, this is one of the most important considerations for South Africa in that a clear definition of source pertaining to all nature of activities should be brought into the legislation.

From an indirect tax perspective, again referring to a number of foreign examples, it made a number of recommendations including reviewing the administration burdens on foreign suppliers of electronic services with no other presence in South Africa.

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Action 2: Hybrids

Action 2 aims to neutralise the effects of hybrid mismatch arrangements. The OECD intends to do this by making changes to the model tax convention and providing recommendations on the design of domestic rules to prevent hybrids from being a source of 'double non-taxation'. Discussion drafts on Action 2 were released by the OECD in Spring 2014. Following comments from interested parties, the OECD paper on Action 2 was published in September 2014. Part 1 of the paper contains recommendations for the design of domestic rules and Part 2 of the paper contains the OECD's recommendation on treaty issues. A final report on Action 2 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

Concerns raised by the DC are with respect to the legislation relating to hybrid entities and hybrid instruments. The DC are of the view that the legislation relating to hybrid entities is still behind the G20, while the legislation (s 8E – 8FA) relating to the hybrid instruments is keeping pace with the G20, however the sections are complex and unclear. The DC therefore recommends that the hybrid instruments legislation be simplified to deal with legal principles rather than specific transactions or instruments. The rules should also be in line with international best practices otherwise they would result in double taxation or double non-taxation of income.

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Action 3: Controlled Foreign Companies (CFC's)

Action 3 aims to develop recommendations regarding the design and strengthening of controlled foreign company rules, to address concerns over the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate to reduce or avoid taxation. A discussion draft was released by the OECD in April 2015. Public comments were released by the OECD in May 2015, following which a public consultation took place. A final report on Action 3 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

The CFC rules contained in s9D of the South African Income Tax Act (ITA) are complex and unclear. The application of the recommendations contained in the report on Action 3 may be welcome in helping to overhaul SA's CFC legislation. The report sets out the following six building blocks for the design of effective CFC rules: (1) definition of a CFC, (2) CFC exemptions and threshold requirements, (3) definition of income, (4) computation of income, (5) attribution of income, and (6) prevention and elimination of double taxation. The recommendations are not minimum standards so SA may choose not to implement them, if they are deemed unfit for the policy objectives of SA's overall tax system.

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Action 4: Interest deductions

Action 4 aims to limit base erosion via interest deductions and other financial payments. Recommendations are expected to be published for domestic law limitations on tax deductions for both related and unrelated party interest expense and economically equivalent payments. The work stream will also develop guidance for the transfer pricing of debt. A discussion draft was published by the OECD in December 2014. Interested parties were invited to submit comments by 6 February 2015 and a public consultation was held in February 2015.

A final report on Action 4 was released by the OECD on 5 October 2015 as part of its final package of measures.

The G20/OECD will undertake further work in 2016 on Action 4, specifically in relation to finalising the design of the group carve-out ratio and special rules for banking and insurance.

South African Perspective:

In line with international concerns the South African tax base could potentially be at risk of allowing interest deductions in excess of what is actually incurred overall by a group. This is mitigated to a large extent through the following existing measures in place in South Africa:

- **Exchange control:** The interest rate payable on loan financing obtained from a non-resident is capped and subject to pre-approval by the South African Reserve Bank ("SARB"). The SARB places a cap on the interest rate payable on these loans.
- **Transfer pricing:** Section 31 and the SARS Draft Interpretation Note on Thin Cap requires taxpayers to not only price the interest rate at arm's length, but also to determine whether it is thinly capitalised on an arm's length basis.
- **Income tax:** Sections 8F, 8FA, 23N and 23M restrict interest deductions.
- **WHT on interest:** With effect 1 March 2015, a 15% WHT is imposed on South African sourced interest paid to non-resident persons, subject to DTA reductions.

All of the above measures should prevent excessive interest deductions provided taxpayers comply with these rules and measures in place.

It is therefore unlikely that South Africa is significantly at risk of BEPS through excessive interest deductions.

However, the current legislative environment is complex and unclear. Having several differing sections all serving to limit interest deductions is cumbersome and needs addressing. The lack of clarity on the application is also a concern with no final guidance having been provided on the thin capitalization measures since the incorporation of these into the broader transfer pricing rules in 2012. Taxpayers need certainty and simplification to be compliant.

From a broader regulatory point of view, it is also preferable that tax and exchange control rules applicable to inbound debts be aligned as far as possible.

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Action 5: Harmful tax practices

Action 5 aims to identify and counter harmful tax practices, taking into account transparency and substance. The Action Plan will look at developing recommendations on the definition of harmful tax practices, and developing a strategy to expand to non-OECD members.

An interim report was issued by the OECD in September 2014, setting out the progress made to date on Action 5. Its main focus was on intangible regimes such as patent boxes. Following the report, the UK and Germany put forward proposals endorsing the 'modified nexus' approach, which is predicated on a link between the expenditure incurred to develop patents and the income that those patents generate. On 6 February 2015, the OECD announced that the proposals have now been agreed by all OECD and G20 countries, and therefore present a consensus position.

A final report on Action 5 was released by the OECD on 5 October 2015 as part of its final package of measures.

The G20/OECD will undertake further work in 2016 on Action 5, specifically in relation to revision of criteria and expanding the participation of non-OECD countries.

South African Perspective:

There is concern as to whether SA's headquarter company regime constitutes a harmful tax practice. Currently, SA's headquarter regime is actually a holding company regime which enables multinationals to use SA as a conduit for passive income flows. The DC recommends that SA give consideration to creating a full headquarter regime which incorporates minimum levels of substance as required by the OECD so that it is not considered a harmful tax practice.

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Action 6: Prevent treaty abuse

Action 6 aims to prevent treaty abuse, through developing model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

A discussion draft was released by the OECD in March 2014. Following comments from interested parties, the OECD paper on Action 6 was published in September 2014. The report contains model provisions and related Commentary, but these should be considered as drafts that are subject to refinement. Final versions are expected to be released in September 2015. A discussion draft on follow-up work was released in November 2014. Comments received from interested parties in response to this draft were published in January 2015, following which a public consultation took place at the end of January 2015.

A further discussion draft was released by the OECD in May 2015, including proposals on how to deal with the follow-up work on Action 6. Interested parties were invited to submit comments by 17 June 2015 and the OECD confirmed that they do not intend to hold a public consultation on the revised discussion draft.

A final report on Action 6 was released by the OECD on 5 October 2015 as part of its final package of measures.

The G20/OECD will undertake further work in 2016 on Action 6, specifically in relation to the treaty entitlement of certain funds.

South African Perspective:

To prevent treaty override disputes, the OECD recommends that the onus is on countries to preserve the application of domestic anti-avoidance rules in their treaties. The DC recommends that SA should ensure it categorically preserves the use of the application of domestic anti-avoidance provisions in its tax treaties. The “main purpose” requirement in the GAAR is akin to the Principle Purpose Test (PPT) that the OECD recommends. SA should apply its GAAR prevent tax abuse that circumvents domestic provisions.

The DC also recommends that SA should take steps to renegotiate its older treaties or sign protocols amending the titles and preambles of older treaties to the effect that they are not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

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Action 7: Permanent establishment status

Action 7 aims to prevent the artificial avoidance of Permanent Establishment (“PE”) status, by redefining the threshold for creating a PE to prevent base erosion and profit shifting. The work includes a focus on the use of commissionaires and keeps some specific activity exemptions, including for warehousing.

A discussion draft was released by the OECD in October 2014. Comments received from interested parties in response to this draft were published in January 2015, following which a public consultation took place at the end of January 2015.

A further discussion draft was released by the OECD in May 2015. Interested parties were invited to submit comments by 12 June 2015 and the OECD confirmed that they do not intend to hold a public consultation on the revised discussion draft.

A final report on Action 7 was released by the OECD on 5 October 2015 as part of its final package of measures.

The G20/OECD will undertake further work in 2016 on Action 7, specifically in relation to profit attribution rules.

South African Perspective:

The report on Action 7 includes changes to the definition of permanent establishment in the OECD Model Tax Convention that will address strategies used to avoid having a taxable presence in a country under tax treaties. It will be to SA's benefit to incorporate these changes into all its DTAs.

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Action 8: Transfer pricing – Intangibles

Please refer to comments above in relation to Actions 8, 9 and 10 collectively. Action 8 looks specifically at intangibles and will develop rules to prevent base erosion and profit shifting where intangibles are owned by, used by, contributed to or moved among group members. A discussion draft was released by the OECD in July 2013 following on from earlier work to modernise this area before the start of the BEPS project. Comments received from interested parties in response to this draft were published in October 2013 and a public consultation took place in November 2013. The OECD released their paper on Action 8 in September 2014.

A discussion draft on cost contribution arrangements was released by the OECD in April 2015. Interested parties were invited to submit comments by 29 May 2015 and a public consultation was held at the beginning of July 2015.

A discussion draft on hard-to-value intangibles was released by the OECD at the beginning of June 2015. Interested parties were invited to submit comments by 18 June 2015 and a public consultation was held at the beginning of July 2015.

Final reports on Actions 8-10 were released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective: In Africa exchange control regulations may impact upon the practicalities of entities charging for the provision of intra-group intangibles.

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Action 9: Transfer pricing- Risk and Capital

Please refer to comments above in relation to Actions 8, 9 and 10 collectively. Action 9 looks specifically at risks and will develop rules to prevent base erosion and profit shifting by transferring risks among, or allocating excessive capital to, group members.

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Action 10: Transfer pricing – high risk transactions

Please refer to comments above in relation to Actions 8, 9 and 10 collectively. Action 10 looks specifically at other high-risk transactions and will develop rules to prevent base erosion and profit shifting by engaging in transactions which would not, or would only very rarely, occur between third parties.

Various discussion drafts have been released by the OECD in relation to Action 10:

- A discussion draft on low value-adding intra-group services was released in November 2014. Comments submitted by interested parties were published by the OECD in January 2015.
- A discussion draft on cross-border commodity transactions was released in December 2014. Interested parties were invited to submit comments by 6 February 2015.
- A discussion draft on the use of profit splits in the context of global value chains was released in December 2014. Interested parties were invited to submit comments by 6 February 2015.

Final reports on Actions 8-10 were released by the OECD on 5 October 2015 as part of its final package of measures.

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Action 11: BEPS data collection

Action 11 aims to establish methodologies to collect and analyse data on BEPS and the actions to address it. The OECD intends to do this by developing recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

In August 2014, interested parties were invited to comment on Action 11 and the comments received were published in October 2014. A discussion draft was subsequently published in April 2015. Public comments were released by the OECD in May 2015, following which a public consultation took place.

A final report on Action 11 was released by the OECD on 5 October 2015 as part of its final package of measures.

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Action 12: Disclosure of aggressive tax planning

Action 12 aims to require taxpayers to disclose their aggressive tax planning arrangements. This will be addressed through the development of recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on the experiences of the increasing number of countries that already have such rules. A discussion draft was released by the OECD in March 2015. Public comments were released by the OECD in May 2015, following which a public consultation took place. A final report on Action 12 was released by the OECD on 5 October 2015 as part of its final package of measures.

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Action 13: Transfer pricing documentation

Action 13 aims to re-examine transfer pricing documentation and will develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.

A white paper on transfer pricing documentation was released by the OECD in July 2013, with a discussion draft in January 2014 followed by a public consultation. A report was published in September 2014 containing guidance on transfer pricing documentation and country-by-country reporting. This report proposed a new three tier global standard for transfer pricing documentation, including a common template for country-by-country information to be reported to tax authorities and in transfer pricing master and local files.

In February 2015, the G20 and OECD released further guidance on the implementation of transfer pricing documentation and country-by-country reporting. The guidance covers implementation of country-by-country reporting including the timing of introduction, application to 'large' businesses and filing mechanisms.

The OECD released an Implementation Package for country-by-country reporting on 8 June 2015. The package consists of model legislation requiring the ultimate parent entity of a multinational group to file the country-by-country report in its jurisdiction of residence, including backup filing requirements when that jurisdiction does not require filing. The package also

contains three Model Competent Authority Agreements to facilitate the exchange of country-by-country reports among tax administrations.

A final report on Action 13 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

South Africa has specifically been mentioned as one of the few countries that will require more detail on the CbC reporting. It is considered very likely that the CbC thresholds will be lowered for South African MNEs.

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Action 14: Dispute Resolution

Action 14 aims to make dispute resolution mechanisms more effective, through developing solutions to address issues that prevent countries from resolving treaty-related disputes under mutual agreement procedures.

A discussion draft was released in December 2014. Comments from interested parties were published in January 2015, followed by a public consultation.

A final report on Action 14 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

The measures developed under Action 14 of the BEPS Project and contained in the report, aim to minimize the risks of uncertainty and unintended double taxation. They do so by ensuring the consistent and proper implementation of tax treaties, including the effective and timely resolution of disputes regarding their interpretation or application through the mutual agreement procedure.

A group of countries have also committed to provide for mandatory binding arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified timeframe. These countries are Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, UK and USA. As SA has DTAs with all of those countries, except for Slovenia, there is a possibility that the DTAs would need to be amended to include a specified timeframe for the resolution of disputes.

The South Africa Revenue Service (SARS) have recently published guidance relating to MAP procedures in South Africa, including an explanation of what MAP entails and how to submit a request for MAP.

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Action 15: Multilateral instrument

Action 15 aims to develop a multilateral instrument to enable jurisdictions to implement measures developed in the course of the work on BEPS and to amend bilateral tax treaties. A report was released by the OECD in September 2014, identifying the issues arising from the development of a multilateral instrument that modifies bilateral tax treaties. The report concluded that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly.

Work on the development of the Multilateral Instrument began on 27 May 2015, with over 80 countries participating in the ad hoc Group that will complete the work under Action 15. A number of procedural issues have been agreed, with the substantive work expected to begin at an Inaugural Meeting in November 2015.

A final report on Action 15 was released by the OECD on 5 October 2015 as part of its final package of measures.

South African Perspective:

The DC recommends that existing multilateral agreements should be updated in accordance with BEPS proposals, once finalised. South African entities should consider waiting for OECD BEPS proposals before signing further multilateral agreements. The proposed OECD multilateral instrument to amend numerous bilateral treaties via a single instrument should be supported as a general principle, subject to such amendments being appropriate in the context of SA's treaties. Considering the range of issues handed, the use of a single multilateral treaty to adapt existing bilateral treaties could potentially be managed by a range of agreements.

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