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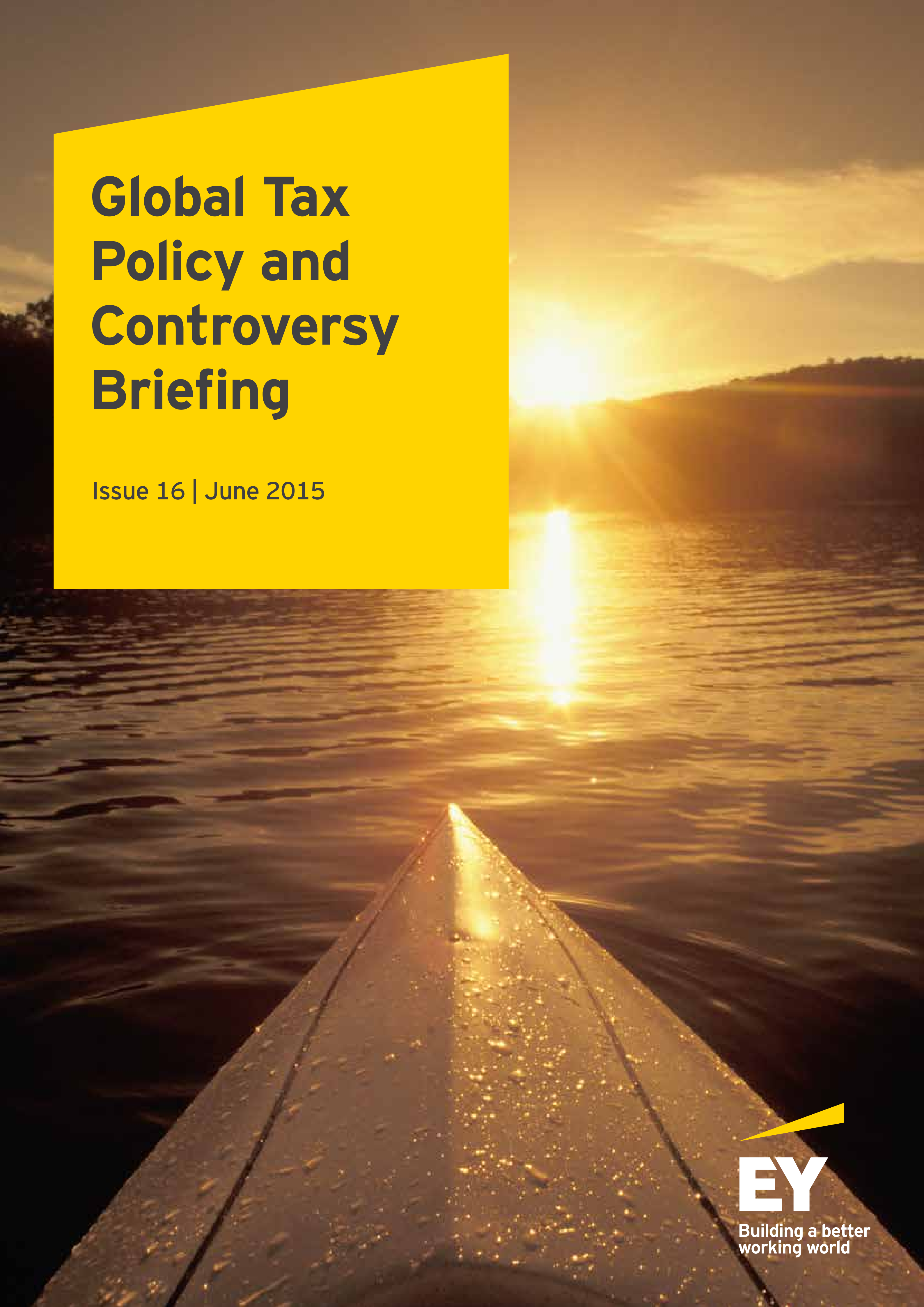
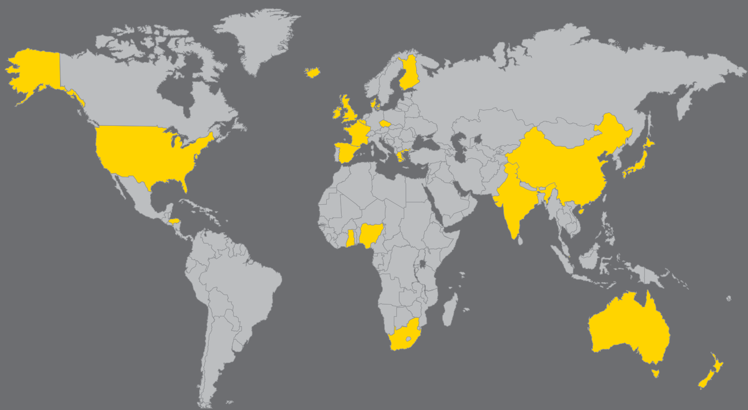


Building a better working world

"There's a strong commitment to putting more energy behind the MAP forum. It's a challenge, that's for sure, but there was a strong understanding at the plenary that we have to get behind this."

– Interview with Josephine Feehily, outgoing chairman of the Forum on Tax Administration



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Contributing Editor
Rob Thomas
T: +1 202 327 6053
E: rob.thomas@ey.com

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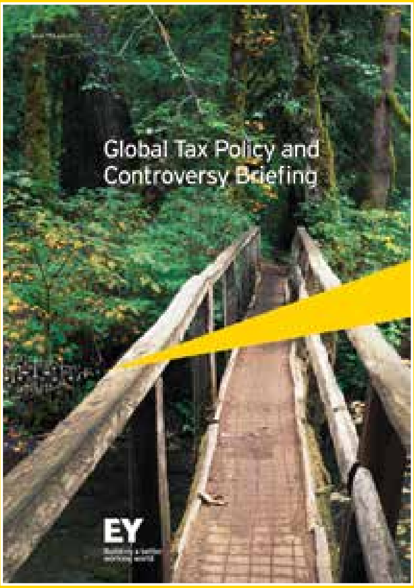

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Welcome

We can all be forgiven for thinking at the time that the September 2014 BEPS recommendations might have represented a high water mark in relation to output from the OECD's BEPS project. In fact (and accepting that September saw both discussion drafts and final recommendations – though certainly not as many as the OECD had hoped for), the September output was surpassed by both the OECD's pre-Christmas output and, more recently, a veritable flurry of new and revised discussion drafts, public comments, and consultation sessions on virtually every aspect of the BEPS Action Plan. Our BEPS timeline on page 16 summarizes the developments of the last few months, while all Actions are covered in individual articles.

Racing to the finish line: new drafts, revised drafts, public consultations

Many of pre-Christmas drafts were the catalyst for a series of January and February 2015 public consultations. Certain highlights (or perhaps, more accurately, lowlights) do stand out. In particular, Action 14 on dispute resolution, the only real "pressure valve" for the BEPS project, was a disappointment to the business community who hoped that the earlier discussion draft might have included agreement on mandatory, binding arbitration, which is viewed by many as a mechanism for resolving disputes. This is particularly concerning in light of the expectation that recommendations under other BEPS Actions will increase disputes and the associated risk of double taxation. Business will certainly be hoping for more from a revised Action 14 discussion draft in the coming months.

While Action 4 (deductibility of interest and other financial payments) may not have drawn such widespread disappointment, it did draw significant concern from business, with the OECD's Business and Industry Advisory Committee (BIAC) representative noting concerns about the group-wide approach contained in the discussion draft, including practical challenges and the potential creation of perverse incentives to increase third-party leverage.

The representative, Will Morris, expressed the preference of BIAC for a fixed ratio approach, noting that such an approach is relatively simple and stable, but further noting concern about the discussion draft's suggestion that the benchmark ratio should be lower than the ratios currently used in some countries. Again, a revised discussion draft is expected in coming months, further illustrating the very real issues the OECD is facing in trying to develop consensus around highly complex and sensitive issues in a very limited Similarly, business has raised significant concerns on other discussion drafts, including on Action 3 (Controlled Foreign Companies,) where BIAC also expressed concern that the lack of consensus reflected in the discussion draft represents a missed opportunity; here, it was noted that while the objective of CFC rules is to complement transfer pricing rules to discourage BEPS and to reduce harmful tax competition, the discussion draft failed to clearly articulate such goals.

Chris Sanger

Global Director,
Tax Policy Services
T: +44 20 7951 0150
E: csanger@uk.ey.com

Rob Hanson

Global Director,
Tax Controversy Services
T: +1 202 327 6053
E: rob.hanson@ey.com

Action 12 meanwhile (on mandatory disclosure regimes) may not have yet attracted much attention but has the potential to interact with many OECD and non-OECD developments of the few months, not least the European Commission's 27 January adoption of a binding general anti-abuse rule (GAAR) in the Parent-Subsidiary Directive (PSD).

In slightly more positive news, the OECD in early February released three additional papers: An agreed approach on intangible property regimes under BEPS Action 5 (i.e., the UK/Germany proposal on patent boxes), implementation guidelines for country-by-country reporting under BEPS Action 13 (Article included) and the mandate for negotiation of multilateral instruments under BEPS Action 15. Action 5 and 13 developments are covered on pages 28 and 30, respectively.

European Commission developments

The adoption of the PSD GAAR is but one new The adoption of the PSD GAAR is but one new development from the European Commission in the area of tax evasion and avoidance. 17 December 2014 saw the Commission extend its tax rulings practice inquiry to all Member States as well as announcing the intention for a new Action Plan to combat tax fraud and evasion, while 3 February 2015 saw the opening of yet another state aid investigation, this time into Belgium's "excess profit ruling" system. The Commission's stated intention was to introduce a new action plan that focuses on a "fairer and more transparent taxation approach within the European Union." The first part of this action plan was delivered on 18 March 2015, when the Commission presented a package of tax transparency measures. A key element of the transparency Package is a proposal to introduce quarterly, automatic exchange of information between Member States regarding their cross-border tax rulings, including Advance Pricing Arrangements (APAs), while a second element also calls for a one-off exchange of tax rulings made within the last 10 years, where such rulings remain active at the point the revised Directive is adopted. As noted by the Commission itself:

"Member State Y would find out about the artificially high prices that the subsidiary is charging to the parent company, in order to shift profits to Member State X. As a result, it may be able to apply the anti-abuse element of the Parent-Subsidiary Directive, and deny the company the usual tax exemption for dividends."

The second package from the Commission (whose June 17 launch date comes after the launch date of this publication) will focus on a new action plan on tax avoidance and will have a proposal for a Common Consolidated Corporate Tax Base - with the consolidation element postponed – at its heart, as well as containing a number of short term measures which are designed to integrate the results of the BEPS project at EU Member State level.

So, all things considered, the announcement of a Tax Transparency Package, the publication of a second package of measures focusing on the CCCTB and the many ongoing State Aid investigations all illustrate a rapid expansion of the existing tax work of the Commission in the anti-avoidance area.

Forum on Tax Administration

Our feature interview in this edition is with Josephine Feehily, outgoing Chair of the OECD's Forum on Tax Administration (FTA). We interviewed Ms. Feehily shortly after the important Dublin FTA meeting, which included information on the strengthening of the JITSIC network, but also on the work that tax administrators feel is necessary to improve dispute resolution. Of course, aspirations for improvement are not always consistent with political objectives, and whether mandatory, binding arbitration can ever become a well-supported, global reality remains to be seen.

Multilateral developments, while critical to the future of the cross-border tax architecture, are of course not the only game in town. In this edition we provide coverage of our 2015 Tax policy outlook, which illustrates that the broad-based, low tax rate trend continues to play out globally. The growth of the taxation of consumption has been another tax "megatrend" of recent years, with companies being the unpaid tax collectors of government. In that regard, we hope that the executive summary of EY's "Indirect tax in 2015" publication will be an interesting read for all. At the country level, developments continue to play out at a high pace; highlights include the passing into law of the UK's Diverted Profits Tax, a similarly-focused multinational companies' anti-avoidance measure from Australia and a new Model Tax Treaty from the US.

While it will naturally be declared a success at November's G-20 meeting in Turkey, a common refrain today is that the BEPS project will by no means be over at that point. As a final thought, this is both the most challenging and perhaps exciting time to be involved in Tax. By working together we can achieve successful outcomes that will work both for business and regulators and deliver the certainty and assurance that we all seek. We hope you find this bumper edition of our publication a useful tool and please, do let either of us know if there are specific issues we should cover in the coming months.

Interview

An interview with Josephine Feehily, outgoing chairman of the OECD's Forum on Tax Administration

Josephine Feehily was the chairman of the Irish Revenue Commissioners until the end of January 2015 and was the chairman of the OECD's Forum on Tax Administration (FTA), hosting the Ninth Meeting of this forum in Dublin in October 2014. She has been succeeded in her FTA role by Edward Troup, Tax Assurance Commissioner and second Permanent Secretary at the UK's tax administration, Her Majesty's Revenue and Customs.

Ms. Feehily also recently completed her third term as chairperson of the Council of the World Customs Organization (WCO). She took up the position as chairperson for Ireland's new Policing Authority in February 2015.

Chris Sanger

Global Director, Tax Policy Services
T: +44 20 7951 0150
E: csanger@uk.ey.com

Rob Thomas

Director – Tax Policy & Controversy
Ernst & Young LLP
T: +1 202 327 6053
E: rob.thomas@ey.com

Rob Thomas: Could you start by telling us about the Forum on Tax Administration and its work? We're all very focused on BEPS and the OECD at the moment, but our readers may not know much about the FTA, its vision, mission and composition.

Josephine Feehily: The origins of the FTA come from a desire by Commissioners to get together, share best practices and collaborate across borders. It was set up about ten years ago by a number of commissioners and Jeffrey Owens (the former head of OECD's Centre for Tax Policy and Administration). There was a concern in the international tax area that only the policymakers were getting together and I remember talking with my predecessor, Frank Daly, about where to go to develop best practices around tax administration.

It seemed that everybody was making their own bilateral contacts and building up loose networks to discuss better ways of doing things. Out of that, the FTA grew to enable commissioners to come together periodically to talk about two things. First, to share best practices and learn from each other, raising the bar of the tax administrations' performance generally. Second, to deepen collaboration and cooperation across tax administrations and to make sure that administrations were part of the wider policy discussion. Policymakers are good at making policy, but we (tax administrators) have to actually deliver the money and the policy implementation at the end of the day. Policymaking is not an end in itself.

Over the years, the FTA has grown and now there are 46 member countries. It's made up of the OECD members plus a number of others. We have recently developed a new criterion for membership for countries who want to become members: they now have to sign up for automatic exchange of information under the various standards.

Rob Thomas: The FTA's current work program that was mandated at the 2013 FTA meeting in Moscow covers working smarter, tax debt management and measures of tax compliance outcomes. Are those still ongoing or have they been somewhat overtaken by recent events? What are the key focus areas right now?

Josephine Feehily: The work on each of those issues led to reports which we endorsed in Dublin.[1] The measures of tax compliance and the practical guide that came out of that is a really difficult piece of work, which certainly is by no means complete. But a document was produced to help countries understand how to focus on outcomes, not just outputs. We produced a report on debt management on small and medium-sized enterprise (SME) compliance by adopting a systems approach. And we had a fourth report on increasing self-service channels and electronic services.

We didn't produce a new work plan for 2014-15 in Dublin. The FTA has a new chair, at least one new vice-chair and new members. So what we took away is a list of things that we will talk about further before nailing down a work plan for the year ahead. Among the topics, one that is on the work program, and will certainly move ahead, is the establishment and build-out of the new Joint International Tax Shelter Information Centre (JITSIC) Network. There's also further work to be done on the Mutual Agreement Procedure (MAP). And some of the members would like to see more work done on debt management, electronic services and electronic data capture to deepen everybody's understanding of the value coming from capturing third-party information in real time, rather than having taxpayers send a return a year and a half later. E-commerce risks are also on the list. Overarching all of this, there will be a revisiting of the architecture of the FTA: we have working groups, networks and priority projects, and it's all getting a bit crowded. So we gathered up ideas and

[1] Forum on Tax Administration meeting in Dublin, 24 October 2014.

"Previously, JITSIC had a small number of members. This new network will be open to everybody."

left them with the new bureau to work out the priorities that they would adopt in the coming year.

One thing that is a bit different in the last couple of the years is the balance between domestic best practice and international tax cooperation. I think it has shifted lately. It's not absolutely dominated by base erosion and profit shifting (BEPS), but the implementation of the pieces of BEPS as they come along will assume a bigger prominence in the agenda going forward.

For example, the practical implementation of the automatic exchange of information will be a very significant piece of the FTA's work because we don't want 45 countries trying to devise their own solution. There was a very definite view in Dublin that we should try and work out how to do that together. Some countries are well advanced on it, but some are only just starting to think about it.

Rob Thomas: Is there a sponsor of that particular initiative to move it forward?

Josephine Feehily: Not until the bureau sits down and allocates jobs.

Chris Sanger: When might that be?

Josephine Feehily: I'd be surprised if they don't do it informally, if not formally, in January because we've tended to have a bureau meeting every January. The FTA has committed to meeting about every year and a half, and the next one will be in China. So there is a deadline that will drive when the work has to be started and whether it's going to be delivered for the next forum plenary in Beijing in the first half of 2016.

Enhanced cooperation between tax administrations

Rob Thomas: Coming back to the FTA communiqué, there was language on agreement of a strategy for systematic and enhanced cooperation between tax administrations. Can you tell us what that means in practical terms?

Josephine Feehily: This particular piece of work is being sculpted by Australia. One of the immediate priorities which will be led by (ATO) Commissioner Jordan is to put flesh on that strategy. This means taking the existing physical JITSIC structure with physical offices and morphing it into a virtual network instead. Previously, JITSIC had a small number of members. This new network will be open to everybody. In the context of the network, members will be asked to appoint a single contact person, who will be kind of a competent authority and liaison officer all blended in one. Periodically, the members will form themselves into groups to carry out compliance activities, interventions, audits, risk assessments and simultaneous examinations, under a framework that the strategy will specify in considerably more detail now that Chris (Jordan) has received the plenary's endorsement to draw it up.

Chris Sanger: How are you making sure those different groups are consistent? Is that effectively the role of the framework?

Josephine Feehily: I think the groups may not necessarily be consistent because they might decide to do different interventions. One thing for certain, of course, is that nobody in the group can do anything that there isn't a legal basis for. It all has to operate within existing legal frameworks, existing treaties and competent authority models until there's a new model. It's about providing structure and guidance when the groups come together so that they will know how to navigate that whole competent authority space safely and proactively.

Chris Sanger: When do you expect to see that come to fruition?

Josephine Feehily: Drafts will be developed in the course of the next year. In the meantime, there may be live pilots as well. The smaller JITSIC structure is already there, and I think you'll find that other countries will join them in doing pilots.

Mutual agreement procedure

Chris Sanger: One of the other things that the communiqué noted was the practical operation of the mutual agreement procedure. Can you tell us how that fits with the strategic plan or whether this is being led by one of the other countries?

Josephine Feehily: That's being led by the United States. We were conscious that the MAP process had fallen behind a little bit and did not have the same energy around it. But it has to work and there has to be a way of concluding transfer pricing issues. The strategic document (on MAP) was presented for endorsement. The members have committed to working together actively to promote MAP, to ensure that the principle as embedded in the network of tax treaties and conventions is properly applied and to put resources into the process to make sure that everything moves along quickly. It's a vision for all MAP forum participants to ensure that the effectiveness of the procedures is collectively improved to meet the needs of both government and taxpayers.

The forum members were invited to sign up, collaborate and work more actively, closely and quickly to resolve cases. That forum will continue to be led by the US. It's a very important piece of the jigsaw because, whether it's in BEPS-land or in tax administration, we're talking about double taxation and double non-taxation, so there must be mechanisms that work in order to enable those things to be addressed at the level of individual cases. There's a strong commitment to putting more energy behind the MAP forum. It's a challenge, that's for sure, but there was a strong understanding at the plenary that we have to get behind this.

> "The better we become at gathering, grinding and analyzing the information, and the more effective we are at managing data and mitigating risks using data, there is a possibility that people will ask for more in the future."

Chris Sanger: How does that fit with mandatory arbitration and India saying that they would not support mandatory and binding arbitration?

Josephine Feehily: This is just a personal view – but if MAP works, it can avoid the mandatory arbitration question. There would have been a sense when MAP was first established that it is much better to have a mutual agreement process that everybody participates in rather than going down the mandatory (arbitration) route alone because there are complicated global issues around the mandatory option.

Putting on my previous WCO hat, mandatory arbitration doesn't always work very fast for either the government or for business. So if we can make MAP work, I think it should avoid mandatory arbitration becoming necessary in the vast majority of cases.

Tax control frameworks

Rob Thomas: Staying with the (FTA) communiqué, there was a reference to cooperative compliance, specifically tax control frameworks (TCFs). Can you talk a little bit about how TCFs fit into cooperative compliance, and the methodology behind them?

Josephine Feehily: I see this very much as an evolution, and in some cases it might be old wine in new bottles. It's a tool that will enable cooperative compliance concepts to be more widely available at the SME level in particular. At the end of the day, as tax administrators we all have more taxpayers than we can police, so having control frameworks and models in place that leverage the business' own controls seems to be sensible. So at one level, it's an evolution of the language, both broader and also "downwards" to the SME sector. Some countries, such as the Netherlands, are far advanced on this, while other countries, including Ireland, are still revisiting and refreshing their cooperative compliance framework. So they haven't yet begun to move it into an SME space. I imagine a lot of countries that are not as active in this space as the Netherlands are very keen to learn from this work to see how they can leverage business' own controls in particular.

When your clients are asking about (tax control) frameworks, if they have a framework that does a tax risk assessment for them that can be shared with the administration, I see it as a win-win for everybody. We don't have enough resources to do everything we need, and neither do any of the other tax administrations. Part of it is about managing resources, while the other part is about leaving compliant businesses alone, freeing us up to focus on the risky ones.

Rob Thomas: Can you foresee the FTA or the OECD generally putting some tighter definitions around what they would expect to see in a TCF, or is it really up to the company to decide?

Josephine Feehily: As this work goes forward, best practice guides will likely emerge. There are similar road maps for tax administration, but clearly these guides will need to be available publicly. So I'd be surprised if the FTA didn't produce best practice guidance on what a TCF might look like and what it might contain. However, the level of granularity will depend on how interested members are in continuing to take the work on cooperative compliance forward. But certainly in the short term, I could see the various networks producing public documents that would define what a control framework might contain in an ideal situation.

Rob Thomas: Moving on to enforcement issues. We ran a survey a few months ago with about 900 clients, of whom 74% said they felt that some, but certainly not all, tax administrators have started BEPS-based reviews or BEPS-based audits, even before the September recommendations had been made or the discussion drafts were released. Is there any danger of the BEPS brand being misused?

Josephine Feehily: Administrations can't begin to apply provisions that aren't in their law. So I imagine what's happening is that the global discussion about base erosion, effective corporate tax rates and tax avoidance is probably causing administrations to put multinational corporation (MNC) tax compliance a bit higher up on their risk radar. Maybe what they're seeing is more activity, but that's just because consciousness is rising, driven by the global discussion about the taxation of multinationals rather than being exclusively BEPS-driven. When corporate taxation is moving from the business pages to the front pages, it becomes common currency. So it's simply that administrations are saying maybe they should be looking a bit more closely at some of the practices of some MNCs. I expect that people are actually using the word BEPS as shorthand for the focus on multinational compliance.

Rob Thomas: I know it's not scheduled to be reviewed until 2020, but do you foresee countries pushing for more information, either broader or deeper information at the entity level, to be reported to them under country-by-county (CbC) reporting?

Josephine Feehily: I imagine that some countries might. From an administration point of view, we need to manage the information that we get. For my own administration, for example, getting from where we are to CbC reporting will be a significant first step. Whether what is currently envisaged under CbC will whet administrations' appetite for more information will depend on what transpires from the analysis of the data

"Consumer activism may be a bigger driver for granularity than necessarily everything that's happening in the BEPS field."

that is received in the first offering and their ability to leverage the data. But I think you are right to ask the question, and I think that question will be asked when the time for review comes around.

In some ways, the better we become at gathering, grinding and analyzing the information, and the more effective we are at managing data and mitigating risks using data, there is a greater possibility that people will ask for more in the future.

Tax in the boardroom

Chris Sanger: We've seen many tax administrators wanting to put tax into the boardroom as much as they can and we've seen that actually be embedded into law in Spain. Where do you see this trend going? Is this something you're discussing at the FTA as a best practice?

Josephine Feehily: I think it was more active when the United Kingdom and South Africa produced their codes in relation to the taxation of banking. Right now, it's a topic that people talk about rather than being actively part of a work program. We would have found the idea of directors' compliance statement very useful to us (in Ireland), but it was dropped from company law some time ago. I certainly talk about the whole concept at various boardroom events in Ireland, but I think the extent to which administrations will take it forward in a legal context will vary.

We do have a mechanism (in Ireland) to influence state bodies, and we use that to embed tax in the code of practice for governance of state bodies. I think in many countries, reasonably similarly to what we're doing, getting tax into the boardroom is about engaging with the various representative bodies and using persuasion, then getting access to boardrooms and to CEOs and CFOs under the banner of cooperative compliance rather than putting it in law.

There wasn't any active discussion in Dublin about putting tax in the boardroom onto a legal footing. If it is being discussed in the FTA architecture, it would be in the large businesses network, but it hasn't reached my desk.

Let me go back for a second to the CbC reporting, to color in something that's been playing around in my head for a while. Consumer activism may be a bigger driver for granularity than necessarily everything that's happening in the BEPS field. We've seen consumer activism and the impact it has in relation to the Public Accounts Committee in the UK, for example. Certainly with High Street brands and retailers, I'm hearing consumer demand for information on how much of their profits is earned in any country. Customers are looking across the world without leaving their computer or table, transparently seeing what prices are being charged, and they're wondering whether they're being ripped off in the tax area.

Chris Sanger: We've seen the development of this in the UK with the "Fair Tax Mark," which originally focused on those companies that have a large consumer base. It's more of a transparency mark than it is "fair tax" mark.

Josephine Feehily: If anyone can define "fair" in a tax context, I'll buy them a drink! I have a background in industrial relations and we had a concept of "felt fairness." It probably applies more in tax than any technical definition of fairness. If it doesn't feel fair, it doesn't matter how legally sound it is. Finding that point in both tax policy and tax administration where citizens feel that something is fair is a big challenge.

Confidence in the tax system

Chris Sanger: One of the challenges I think we have in some places is that all the focus on corporate tax has led to an unfair loss of confidence in tax administrations actually doing their job. That can become a loss of confidence in the tax system generally. Is there something that the FTA can and should be doing in that space to try and bolster things on a wider basis?

Josephine Feehily: First of all, having the forum and the mechanisms to share our experience is very helpful for individual commissioners. In terms of the public perception that tax systems are not being administered fairly, I'm not sure that there's much the FTA can do about that. It probably has to be tackled at the national level in order to have kind of an authentic local feel to it. In Ireland, for example, in the last few years, Pascal (Saint-Amans) has appeared a number of times in the local (Irish) media, and that's been helpful, but only for the group that actually engages with what's going on. Those are the people who know there is a difference between the global tax rules and the interplay of those rules. I think the people who would be interested in an FTA- or OECD-led discussion already understand the differences and the challenges. So I think we have to handle the public confidence piece largely on a case-by-case basis, nationally, depending on our cultures.

Rob Thomas: Aside from how you managed to find the time for the FTA role and the World Customs Organization, what kind of intersection was there between the tax and the WCO role? What benefits did you gain from having exposure to both?

Josephine Feehily: Well to be honest, I wouldn't have chosen to have both at the same time if it hadn't happened the way it happened, with Doug Shulman stepping down (from the FTA). I couldn't have done it without a lot of support from my own organization. But we (in Ireland) are an integrated organization, and increasingly you're seeing that revenue agency model in developing countries and also in some European countries where mergers (of tax and customs agencies) are actively happening. So from either the customs experience or the tax experience, I didn't find that difficult. Stepping from one to the other wasn't particularly difficult because we do it at home every day. I actually find it strange that some tax administrators aren't learning more from their customs peers.

"There's also enormous scope for learning from how global customs and global trade works in terms of data exchange and how customs can learn from the tax world how to build a trust environment for exchanging information."

But I was surprised at the institutional level that there was very limited engagement and there were a couple of things that I think are likely to deepen in the coming years. First of all, inevitably, the organizations will end up discussing transfer pricing and customs valuation. No matter how many times people say it's different and it has a different purpose, information is being shared globally and mismatches will become evident. So I can see a need for the two organizations to develop frameworks and structures to align those two pieces, to align valuation for transfer pricing purposes and for customs purposes, to avoid misunderstanding and to enable administrations and business and practitioners to know how things will be interpreted in the two different fora.

The other piece that struck me very much at the WCO in 2014 was an active discussion led by Brazil and some of the other BRICS about exchange of information. Customs is nowhere near as advanced as the OECD (tax administrations) on this. There is a WCO convention called the Johannesburg Convention, which was about exchange of information, which was put on the books of the WCO about 10 years ago and had very few signatories. So we had a very active discussion at the latest WCO meeting about the fact that the tax world was overtaking the customs world at an increasing pace in terms of exchange of information.

When I went to Berlin recently (for the meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes), I met a WCO official who had been sent to sit in at the global forum to learn about the exchange of information. So I think that's an area of common interest as well. Finally, the WCO has the Harmonized System, has been a standards-setting organization for years and has been defining data elements for just as long. It has put in place very good structures for defining data elements and for standards settings in 179 countries. That's going to be increasingly important for tax.

Obviously we have defined the data elements for the exchange of information, but if we move into other data elements, learning how 179 countries cope with it, I think, is something that the OECD could learn from the WCO.

There's also enormous scope for learning from how global customs and global trade works in terms of data exchange and how customs can learn from the tax world how to build a trust environment for exchanging information, because low trust has damned customs from deepening the exchange of information.

Chris Sanger: So a piece of advice for your new chair of the FTA, for Edward Troup, would be to keep close to the WCO?

Josephine Feehily: At least to be aware that it's there and to be aware that that relationship should deepen, even if only driven by transfer pricing valuation questions.

Chris Sanger: What other advice would you give to Edward as the new chair of the FTA?

Josephine Feehily: One piece of advice I already gave to Edward is that it's time to revisit the architecture (of the FTA) and make sure that groups don't keep doing things for the sake of doing things when those things are not necessarily focused on the priorities. He had already come to that view himself, by the way.

A second piece was that it wouldn't be wise to rush to settle priorities. Rather, gather up the ideas and then reflect with the vice chairs before settling on priorities. I personally found the vice chairs very helpful. Also, getting to know the secretariat at a deep level is very important.

Chris Sanger: Where next for you personally?

Josephine Feehily: I have a new job!

Chris Sanger: So we heard! Rather than policing taxpayers, you're going to be policing for real!

Josephine Feehily: In the last week, I've been nominated by the government to be the first chair of a new independent policing authority, a body which Ireland currently doesn't have. We have a single national police force that reports to a minister. So a political decision was made a number of months ago to put in place a policing authority between the police commissioner and the political system.

It's a feature of the police service, for example in Northern Ireland, in other parts of the UK and in some other countries. The legislation hasn't passed yet, but my immediate plans are to take a little bit of time out, and then to chair the authority, which will be the oversight body for our national police force.

Chris Sanger: It sounds like you've got a full set of new challenges.

Josephine Feehily: When I thought about it, some of the concepts were not dissimilar, and that's what attracted me to it. The police service here has suffered a bit of public confidence bashing, which is something we worry about all the time in tax. In a self-assessment environment, we use language like "taxing by consent." Policing by consent is one of the key policing principles. That balance between service and enforcement, between being responsive to the needs of the community and at the same time upholding the law.

At some level, the concepts are not alien. Its things like how to have the kind of structure where you have visibility across the economy, which we do in tax, in policing across society. And at the same time, focusing your resources on the most risky cases, just like we do in tax. So the authority is very much around oversight of the commissioner's strategic plan, governance, ethics, integrity and public accountability. So at one level, I'm not saying that the elements won't be different—of course they'll be vastly different—but the concepts are not entirely alien. So that'll keep me off the streets for a while!

BEPS-related developments

UK

UK's Diverted Profits Tax passed into law.

Iceland

Iceland issues final regulation on transfer pricing documentation.

Ireland

Irish Department of Finance launches Knowledge Development Box consultation.

Spain

Spain announces new country-by-country reporting obligations.

United States

United States releases Model Tax Treaty including new clauses designed to counter US tax base erosion.

Ghana

Ghana commences transfer pricing audits – Ghana Revenue Authority reveals that over 250 transfer pricing audits have been initiated.

Honduras

Honduran Tax Authorities create an International Taxation and Transfer Pricing Department.

Nigeria

Nigeria begins first audit cycle under new transfer pricing regulations.

France

A think tank affiliated with the French Government issues a report entitled "Taxation and the digital economy: A survey of theoretical models.".

Belgium

European Commission opens state aid investigation into the Belgian excess profit ruling system.

Luxembourg

Luxembourg introduces legal framework for tax rulings and updates transfer pricing rules.

Denmark

Denmark introduces international GAAR.

Czech Republic

Czech Republic announces closer scrutiny of transfer pricing.

Finland

Finland proposes changes to transfer pricing legislation.

Japan

Japan's coalition leading parties release an outline of the 2015 Tax Reform, including a proposal for an anti-hybrid measure.

China

China issues administrative guidance on general anti-avoidance rules, issues new Notice 7 on indirect transfers of assets.

Singapore

Singapore Tax Authority releases updated transfer pricing guidelines.

India

India announces a two-year delay to GAAR implementation.

Australia

Australia's Federal Budget includes a new Multinational Companies Anti-Avoidance Rule and GST on inbound digital services.

Greece

New Bill of the Greek Government includes stricter substance requirements on cross-border and related party transactions

South Africa

South Africa's Davis Tax Review Committee issues report on BEPS.

South Africa's tax administration increase scrutiny of retroactive transfer pricing adjustments.

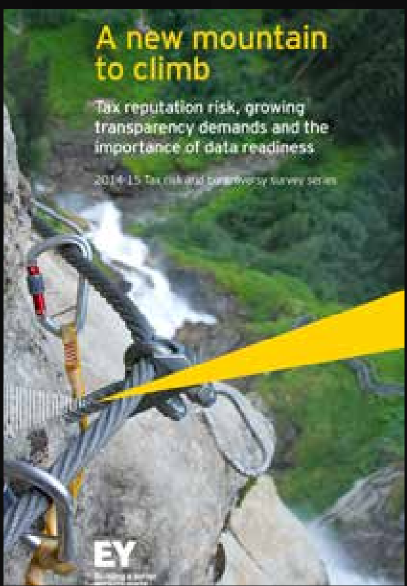
New Zealand

New Zealand's Minister of Revenue releases two official reports regarding BEPS.

New Zealand government releases 2015-16 Tax policy work program, including major focus on BEPS.

A new mountain to climb

Tax reputation risk, growing transparency demands and the importance of data readiness



Companies face more reputation-related tax risks than ever, according to our report, A new mountain to climb. Public opinion is driving political action and requiring a higher threshold than complying with the letter of the law.

Constant scrutiny from stakeholders, especially news and social media, has businesses concerned about protecting their brand. If a company doesn't proactively manage the increased reputational risk posed by the ongoing "fair share of tax" debate, its image can be quickly tarnished.

In our survey of 962 tax and finance executives in 27 countries, we found:

89% of those who worked for the largest global companies said they were somewhat or significantly concerned about news media coverage, how much companies pay in tax or their seemingly low effective tax rates. In 2011, fewer than half of companies said they were similarly concerned.

94% of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years.

83% said they regularly brief the CEO or CFO on tax risks or tax controversy.

43% said they regularly brief the audit committee.

65% of those who worked for the largest global companies said they were somewhat or significantly concerned about news media coverage, how much companies pay in tax or their seemingly low effective tax rates. In 2011, fewer than half of companies said they were similarly concerned.

Greater transparency on the horizon

As stakeholders become more concerned about where tax revenue is coming from, more tax transparency obligations are being put in place. At the same time, governments have opened their lines of communication and are now exchanging more information related to individual and corporate taxation.

From forthcoming country-by-country reporting rules proposed by the OECD under Action 13 of its Base Erosion and Profit Shifting project to a new package of tax transparency proposals from the European Commission, what a business tells one government about its taxes, it will soon be telling all.

Preparation, communication and flexibility are instrumental for businesses facing this new transparency environment.

Companies need:

- Robust processes and oversight
- Watertight documentation and audit trails
- Leading operational systems
- World-class data management systems

With these elements in place, new reporting obligations can be met with less disruption to business activities. Furthermore, the appropriate communication tools can be developed to help mitigate future reputational risks. Such readiness will also help companies to communicate more effectively internally as well as externally.

Six tactics to help you prepare

1 **Actively monitor the changing landscape.** Track media coverage and social media channels. This may require closer collaboration with communications and PR functions within the enterprise.

2 **Assess your readiness to respond to reputational risk threats.** Understand whether you have complete visibility of tax structures and taxes paid wherever you operate. Know whether taxes paid are in line with your business results. And know whether the board has an agreed-upon strategy and plan of action for responding to a negative story.

3 **Enhance communication with internal and external stakeholders.** Communicating effectively about your company's total tax picture, tax policies and overall tax profile is critical to successfully managing tax reputation risks. Be sure your company is prepared if a crisis were to come about.

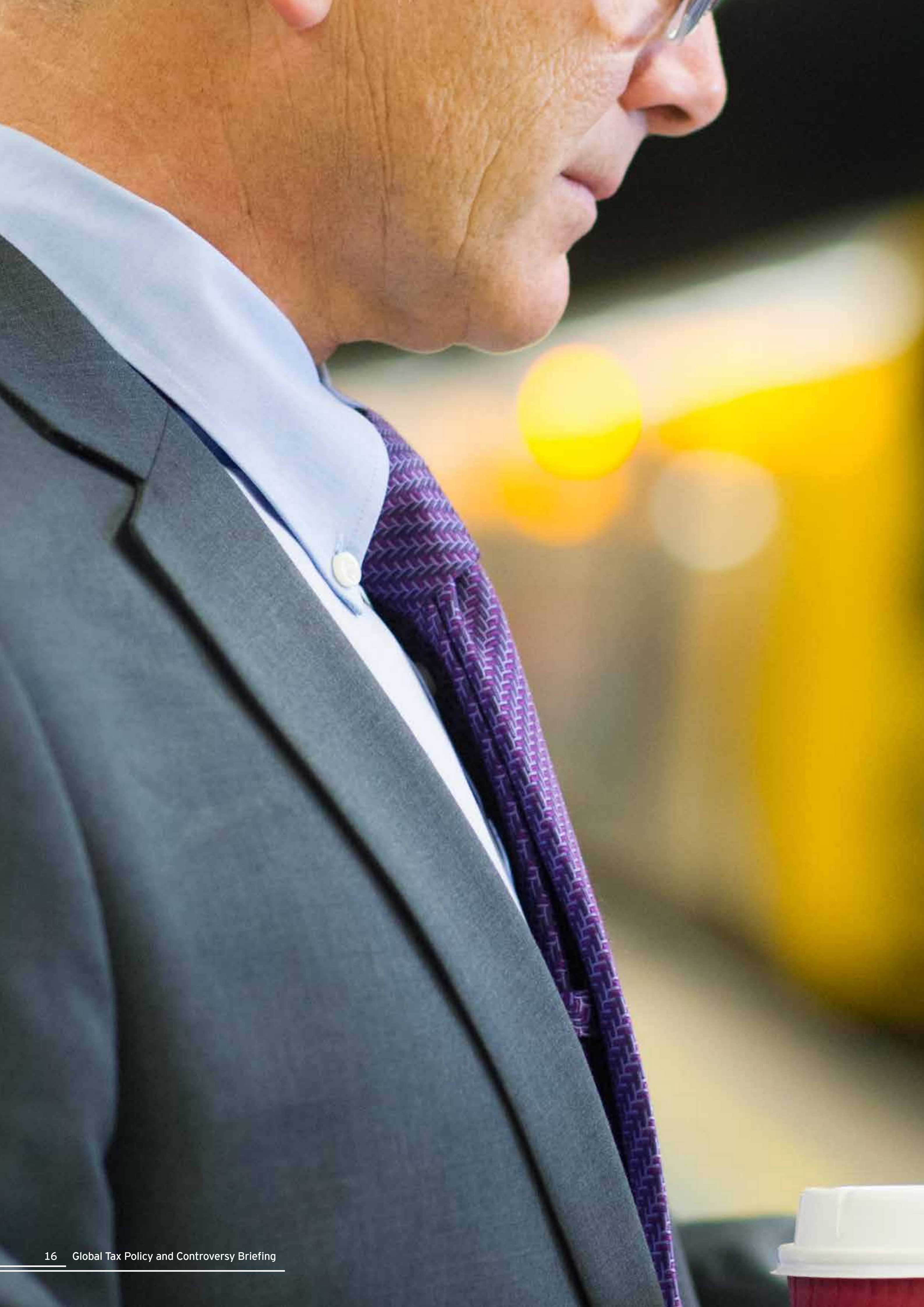
4 **If appropriate, prepare a total tax picture.** The development and sustenance of an accurate total tax picture often sits at the heart of a tax reputation risk strategy. It incorporates much more than listing of taxes paid around the world, instead presenting deeper insights on why a company operates where it does, why it is structured in the way it is and how it manages its tax department.

5 **Decide with whom your company wishes to communicate about tax.** Beyond governments, investors may want to know how the OECD and other reforms will affect your company. You may wish to assure employees your tax policies are sound. You may also decide to adopt a media strategy.

6 **Embed reputation risk thinking into your business and decision-making processes.** In the current environment, tax issues can emerge from almost anywhere. Be sure to factor reputation risk into your business operations and focus on case-scenario strategies.

Don't leave your company's reputation to chance. To thrive in the current reputation risk environment, it can be useful to define yourself before others define you.

Access the full report at
www.ey.com/taxriskseries



Staying up to date with Base Erosion and Profit Shifting developments

While one may have expected the OECD's September 2014 recommendations to represent a peak of activity within the ambitious BEPS project, recent months have seen a steady flow of new developments, from both the OECD and the European Commission. With some days and weeks seeing a real spike of new activity, this timeline provides summaries of the key developments from both the OECD and European Commission since our last edition.

To read full EY analysis and commentary on each development below, please visit

www.ey.com/taxalerts

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13. Re-examine Transfer Pricing Documentation
14. Make Dispute Resolution Mechanisms More Effective
15. Develop a Multilateral Instrument

6 OECD releases public discussion draft on follow-up work on treaty abuse under BEPS Action 6

On **21 November 2014**, the OECD released a discussion draft in connection with follow up work on Action 6 on preventing treaty abuse. The discussion draft identifies particular areas with respect to the recommendations released in September 2014 where the OECD intends to do additional work. It also includes specific questions on which comments or suggestions are invited. Much of the planned work relates to the operation of the proposed limitation on benefits provision, but the proposed principal purpose test for treaty benefits will also be the subject of some additional work. As indicated in the September 2014 deliverable, the OECD is particularly focused on addressing treaty qualification issues that arise with respect to collective investment vehicles and other types of investment funds including pension funds, private equity funds, and sovereign wealth funds.

OECD holds a BEPS workshop with several developing countries

On **10-11 December 2014**, the OECD held a workshop with officials from several developing countries to discuss their increased involvement in the BEPS project. The participating countries were Albania, Azerbaijan, Bangladesh, Croatia, Georgia, Jamaica, Kenya, Morocco, Nigeria, Peru, Philippines, Senegal, South Africa, Tunisia, and Vietnam. Representatives of the African Tax Administration Forum also participated. Matters discussed included the need for support in implementing BEPS measures and the need for balance between attracting foreign direct investment and collecting corporate income tax.

15

OECD hosts webcast update on the BEPS project

On **15 December 2014**, the OECD hosted a webcast on the BEPS project. Pascal Saint-Amans and other senior members of the OECD Secretariat provided an update on recent activity, focusing on the follow-up work on the BEPS Actions for which output was delivered on 16 September 2014; the recently released discussion drafts on Action 6 (follow up work on addressing treaty abuse), Action 7 (permanent establishment), and Action 10 (transfer pricing for low value-adding intra-group services); and the upcoming discussion drafts on other BEPS Actions.

16

10 OECD releases discussion draft on cross-border commodity transactions under BEPS Action 10

On **16 December 2014**, the OECD released a discussion draft under Action 10 on transfer pricing for commodity transactions. The draft proposes additions to the OECD Transfer Pricing Guidelines that address use of the comparable uncontrolled price method and use of publicly available commodity prices in transfer pricing for commodity transactions between associated enterprises. Comments are requested by 6 February 2015 and the OECD held a public consultation on the transfer pricing related Actions on 19-20 March 2015.

10 OECD releases discussion draft on use of profit split method in global value chains under BEPS Action 10

On **16 December 2014**, the OECD released a discussion draft under Action 10 on use of the profit split method for transfer pricing in the context of global value chains. The draft addresses a series of scenarios where in the OECD's view it may be more difficult to apply one-sided transfer pricing methods to determine transfer pricing outcomes that are appropriately aligned with value creation and it may be appropriate to apply a transactional profit split method. The draft requests responses to specific questions regarding these scenarios, which will be taken into account in developing revisions to the OECD Transfer Pricing Guidelines provisions on the profit split method. Comments were requested by 6 February 2015 and the OECD held a public consultation on the transfer pricing related Actions on 19-20 March 2015.

17

European Commission extends tax rulings practice inquiry to all Member States and announces intention for new Action Plan to combat tax fraud and evasion

On **17 December 2014**, the European Commission (EC) announced that it has expanded its inquiries into the tax ruling practices under EU state aid rules, asking all EU Member States to provide full information on rulings made to all companies during the period 2010 to 2013. Under the expanded inquiry, the EC asks all EU Member States to provide information regarding their tax ruling practices, in particular to confirm whether they provide tax rulings, and, if they do, to submit a list of all companies that have received a tax ruling during the period 2010 to 2013. The press release announcing these developments, however, does not note whether the specific technical detail of each individual ruling must be supplied by the country concerned as well as the name of the company receiving such ruling. As noted in the EC press release announcing the expansion, the new requests are *fully in line with the recent calls for more transparency of tax rulings, in particular the initiative announced by President Juncker on the upcoming legal proposal regarding the automatic exchange of information on tax rulings, on which work is being led by Commissioner Moscovici*.

18

4 OECD releases discussion draft on interest deductions under BEPS Action 4

On **18 December 2014**, the OECD released a discussion draft on limitations on interest deductions under Action 4. The draft reviews existing approaches to address BEPS concerns through limitations on the deductibility of interest and other financial payments. The draft then sets forth options for approaches that may be included in a best practice recommendation, including group-wide tests, fixed-ratio tests, and approaches that combine both types of tests. It also addresses a range of technical, policy and industry sector issues. Comments were requested by 6 February 2015 and the OECD held a public consultation on 17 February 2015.

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OECD releases public discussion draft on international VAT-GST guidelines

On **18 December 2014**, the OECD released a discussion draft on value-added tax (VAT) guidelines on services and intangibles, which is integrally related to the work on Action 1 (digital economy). The draft sets forth a series of principles for determining the place of taxation for business-to-consumer supplies of services and intangibles. It also includes a recommended approach for collection of VAT on such supplies. Comments are requested by 20 February 2015 and the OECD held a public consultation on 25 February 2015.

December 18

14 OECD releases discussion draft on more effective dispute resolution mechanisms under BEPS Action 14

On **18 December 2014**, the OECD released a discussion draft on improving dispute resolution mechanisms under Action 14. The draft anticipates that treaty-based disputes will increase as a result of the BEPS work and focuses on ways to improve the effectiveness of the Mutual Agreement Procedure (MAP) under treaties. The Draft identifies obstacles that are preventing countries from resolving treaty-related disputes through the MAP and proposes options for addressing those obstacles. The Draft discusses mandatory binding arbitration as a tool for increasing the effectiveness of the MAP, but makes clear that there is no consensus on the appropriateness of such arbitration mechanisms. Comments were requested by 16 January 2015 and the OECD held a public consultation on 23 January 2015.

8-10 OECD releases discussion draft under BEPS Actions 8-10 on risk, recharacterization and special measures

On **19 December 2014**, the OECD released a discussion draft under Actions 8-10 on transfer pricing for risk, recharacterization and special measures. The draft includes proposed revisions to the OECD Transfer Pricing Guidelines that focus on delineation of transactions, relevance and allocation of risk, determination of the economically relevant characteristics of transactions, and recharacterization or non-recognition of transactions. The draft also includes options for some "special measures" relating to the transfer pricing for intangible assets, risk, and over-capitalization. Comments were requested by 6 February 2015 and the OECD held a public consultation on the transfer pricing related Actions on 19-20 March 2015.

14 OECD publishes public comments on discussion draft for BEPS Action 14 – Make dispute resolution more effective

On **19 January 2015**, the OECD posted on its website more than 400 pages of comments received from stakeholders on the discussion draft on BEPS Action 14 – Make dispute resolution more effective, including the global comment letter submitted by EY.

19 January 19

11 21

7 OECD publishes public comments on discussion draft for BEPS Action 7 on Preventing the artificial avoidance of PE status

On **11 January 2015**, the OECD posted on its website more than 750 pages of comments received from stakeholders on the discussion draft on BEPS Action 7 on Preventing the artificial avoidance of PE status including the global comment letter submitted by EY.

7 OECD holds public consultation on BEPS Action 7 on permanent establishment

On **21 January 2015**, the OECD held a public consultation on the discussion draft on permanent establishment (Action 7). Participating in the consultation were representatives of the business community (including EY representatives) and NGOs, country representatives, and the OECD Secretariat. Business commentators expressed concern that the options in the discussion draft for lowering the permanent establishment standard would create uncertainty, increase compliance and administrative burdens, exacerbate disputes and controversy, and result in increased risk of double taxation. The OECD intends to issue a revised discussion draft on Action 7 in Spring 2015, which will provide an opportunity for additional comments.

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15 Develop a Multilateral Instrument

6 OECD holds public consultation on follow-up work on BEPS Action 6 on preventing treaty abuse

On **22 January 2015**, the OECD held a public consultation on the follow up work on treaty abuse (Action 6). Participating in the consultation were representatives of the business community (including EY representatives) and NGOs, country representatives, and the OECD secretariat. The discussion focused largely on issues related to treaty qualification of collective investment vehicles and other investment funds and on the technical details of the proposed limitation on benefits provision. Business commentators stressed the need to ensure that the proposed anti-abuse rules do not place undue burden on businesses seeking to access treaty benefits. The OECD intends to issue a revised discussion draft on Action 6 in the spring, which will provide an opportunity for additional comments.

14 OECD holds public consultation on BEPS Action 14 on improving dispute resolution

On **23 January 2015**, the OECD held a public consultation on the discussion draft on dispute resolution (Action 14). Participating in the consultation were representatives of the business community (including EY representatives) and NGOs, country representatives, and the OECD Secretariat. The bulk of the comments focused on the urgent need for agreement on mandatory binding arbitration as part of the mutual agreement procedure under treaties. Business commentators described real progress on improvements in dispute resolution as an essential part of the BEPS project. The OECD intends to issue a revised discussion draft on Action 14 in the spring, which will provide an opportunity for additional comments.

27

European Council formally adopts binding general anti-abuse rule in Parent-Subsidiary Directive

On **27 January 2015**, the European Council formally adopted a binding general anti-abuse rule to be included in the Parent-Subsidiary Directive (PSD). This new rule aims at preventing Member States from granting the benefits of the PSD to arrangements that are not "genuine," i.e., that have been put into place to obtain a tax advantage without reflecting economic reality. The clause is formulated as a "de minimis" rule, meaning that Member States can apply stricter national rules, so long as they meet the minimum EU requirements. Member states will have until 31 December 2015 to implement the general anti-avoidance rule into national law.

February

03

European Commission opens state aid investigation into the Belgian excess profit ruling system

On **3 February 2015**, the EU Commission announced that it has opened an in-depth state aid investigation into Belgium's so-called "excess profit" ruling system. According to the EU Commission, the system allows group companies to substantially reduce their corporation tax liability in Belgium on the basis of so-called "excess profit" tax rulings. Under this system, multinational entities in Belgium may reduce their corporate tax liability by those "excess profits" that the Belgian Government believes result from the advantages of being part of a multinational group. At this stage, the EU Commission has doubts as to whether the tax provision complies with EU state aid rules.

06

5 OECD explains agreed approach on intangible property regimes under BEPS Action 5

On **6 February 2015**, the OECD released Action 5: Agreement on Modified Nexus Approach for IP Regimes, which describes the consensus on the approach for a substantial activity requirement for intangible property regimes such as patent boxes in connection with BEPS Action 5 (harmful tax practices). The agreed approach builds on the "modified nexus approach" that was developed jointly by the German and UK governments. The Action 5 document describes conceptual issues with respect to the modified nexus approach and additional work that will be done in order to allow agreement on the detailed rules to be reached in 2015.

13 OECD issues implementation guidelines for country-by-country reporting under BEPS Action 13

On **6 February 2015**, the OECD released Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting, which provides much-anticipated guidance on implementation of the country-by-country (CbC) report that is part of the three-tier transfer pricing documentation approach developed under BEPS Action 13. The guidance provides for the first CbC reports to be filed covering 2016 fiscal years. The guidance further provides for CbC reports generally to be filed in the home country of a multinational corporation (MNC) group's parent company and shared with other relevant countries under government information exchange mechanisms. The guidance also addresses other implementation matters related to the CbC report.

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15 OECD issues mandate for negotiation of multilateral instrument under BEPS Action 15

On **6 February 2015**, the OECD released Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS, which sets forth the mandate, agreed by the OECD and G20 countries, with respect to the process for developing the multilateral instrument contemplated under Action 15. The mandate authorizes the establishment of an ad hoc group to conduct work on a multilateral instrument that would implement solely the BEPS measures that take the form of recommended tax treaty provisions. The group is to have its first meeting no later than July 2015 and is to aim to have the multilateral instrument ready to open for signature by year-end 2016.

February 06

10

8-9 OECD publishes public comments on discussion draft for BEPS Action 8-9 on transfer pricing and risk

On **10 February 2015**, the OECD posted on its website more than 800 pages of comments received from stakeholders on the discussion draft on BEPS Action 8-9 on transfer pricing and risk, recharacterization, and special measures, including the global comment letter submitted by EY. On the same day, the OECD also posted 500 pages of comments on the discussion draft on BEPS Action 10 on the use of profit splits in the context of global value chains and more than 200 pages of comments on the discussion draft on BEPS Action 10 on transfer pricing aspects of cross-border commodity transactions, including the global comment letters submitted by EY on those two documents.

4 OECD holds public consultation on BEPS Action 4 on interest and other financial payments

On **17 February 2015**, the Organisation for Economic Co-operation and Development (OECD) held a public consultation in connection with the Base Erosion and Profit Shifting (BEPS) project that was focused on Action 4 on the deductibility of interest deductions and other financial payments. During the consultation, business participants expressed a variety of concerns about the proposed group-wide approaches. It was noted that borrowing needs differ across entities within a group. The difficulties in using consolidated financial statement data to determine allocations to group members were discussed, including the fact that group-level adjustments would mean that the sum of the member numbers typically would not equal the group numbers such that the resulting allocation would not be based on 100% of the group's external interest expense.

4 OECD publishes public comments on discussion draft for BEPS Action 4 on interest deductions and other financial payments

On **11 February 2015**, the OECD posted on its website more than 1,000 pages of comments received from stakeholders on the discussion draft on BEPS Action 4 on interest deductions and other financial payments, including the global comment letter submitted by EY.

On **17 March 2015**, the European Commission's expert group on automatic information exchange published its first report. The report sets out a number of key recommendations designed to ensure that EU legislation on the automatic exchange of information in direct taxation is effectively aligned and fully compatible with the OECD Global Standard on automatic exchange of financial account information (also known as the Common Reporting Standard or CRS).

11 12 17 18 March 17 19-20

OECD hosts sixth webcast update on BEPS project

On **12 February 2015**, the OECD hosted a webcast to provide an update on the BEPS project. The webcast included an overview of the OECD's recent activities with respect to the BEPS Action Plan and a brief report on BEPS related matters addressed during the G20 Finance Ministers and Central Bank Governors meeting on 9-10 February 2015. The webcast focused in particular on the work on transfer pricing issues related to risk, recharacterization and special measures (Actions 8-10), guidelines on VAT with respect to business to customer (B2C) transactions involving services and intangibles, and improving the effectiveness of treaty dispute resolution mechanisms.

European Commission initiates work to create a "fairer and more transparent taxation approach within the European Union"

In December 2014, the European Commission (the Commission) in its 2015 Work Programme1 stated that it will clamp down on tax evasion and tax avoidance and ensure that taxes are paid in the country where the profits are generated. On **18 February 2015**, the College of Commissioners (the grouping of 28 Commissioners) commenced this work with a first orientation debate, where possible action points were discussed. The Commissioners agreed that the main focus should be to ensure that companies pay their fair share of taxes in the country where the economic activity generating the profit is based, by encouraging greater tax transparency.

8-10 OECD held a public consultation event on transfer pricing matters

On **19-20 March 2015** the OECD held a public consultation event on transfer pricing matters at the OECD Conference Centre in Paris, France. The event concentrated on matters covered by four recently published discussion drafts on which written comments had been invited and which deal with work in relation to Actions 8, 9 and 10 of the Action Plan on Base Erosion and Profit Shifting (BEPS).

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12 OECD issues discussion draft on mandatory disclosure rules under BEPS Action 12

On **3 March 2015**, the OECD issued a discussion draft on mandatory disclosure rules under Action 12 (Disclosure of aggressive tax planning arrangements) of the base erosion and profit shifting (BEPS) project. The discussion draft makes a series of recommendations about the design of mandatory disclosure regimes intended to allow maximum consistency between countries while also being sensitive to local needs and to compliance costs. The discussion draft focuses in particular on international tax schemes, which are viewed as an area of special concern and the primary focus of the BEPS project. It notes that disclosure schemes that are intended to address domestic avoidance might not be sufficient to capture cross-border arrangements and provides recommendations for an alternative approach.

3 OECD releases discussion draft on mandatory disclosure rules under BEPS Action 12

On **3 April 2015**, the OECD released a discussion draft in connection with Action 3 on strengthening controlled foreign company (CFC) rules under its Action Plan on Base Erosion and Profit Shifting (BEPS). The document titled, BEPS Action 3: Strengthening CFC Rules (the Discussion Draft or the Draft) addresses how to use CFC rules to address base erosion and profit shifting. The Draft discusses in detail each of the following core elements or "building blocks" of CFC rules including definition of a CFC; threshold requirements; definition of control; definition of CFC income; rules for computing income; rules for attributing income and rules to prevent or eliminate double taxation. The Draft includes recommended approaches for each of these core elements, except the definition of CFC income, for which several options are included.

11 OECD issues discussion draft on economic analysis of base erosion and profit shifting under BEPS Action 11

16 April 2015

12 OECD holds public consultation on BEPS Action 12 on mandatory disclosure rules

11 May 2015

7 OECD releases revised discussion draft on preventing artificial avoidance of PE status under BEPS Action 7

15 May 2015

16 May 11 15

29 12 22

8 OECD releases discussion draft on cost contribution arrangements under BEPS Action 8

29 April 2015

3 OECD holds public consultation on BEPS Action 3 on CFC rules

12 May 2015

6 OECD releases revised discussion draft on follow up work on treaty abuse under BEPS Action 6

On **22 May 2015**, the OECD released a revised discussion draft in connection with the follow up work on Action 6 on the prevention of treaty abuse under the Base Erosion and Profit Shifting (BEPS) Action Plan. The document titled, BEPS Action 6: Preventing Treaty Abuse (the Revised Discussion Draft or the Revised Draft) describes proposals developed by the OECD after the issuance of a discussion draft on 21 November 2014. The Revised Discussion Draft describes the current status of the discussions of OECD Working Party 1, the working group responsible for treaty matters (the Working Party), on each of the 20 issues. In some instances, new proposals that have been agreed by the Working Party are presented in the Revised Draft. In other instances, the Revised Draft includes proposed approaches that are to be further considered at the Working Party meeting scheduled for 22-26 June 2015.

OECD releases discussion draft on CFC rules under BEPS Action 3

Gerrit Groen

International Tax Services
T: +1 212 773 8627
E: gerrit.groen@ey.com

On 3 April 2015, the Organisation for Economic Co-operation and Development (OECD) released a discussion draft in connection with Action 3 on strengthening controlled foreign company (CFC) rules under its Action Plan on Base Erosion and Profit Shifting (BEPS). The document titled BEPS Action 3: Strengthening CFC Rules addresses how to use CFC rules to address base erosion and profit shifting.

The draft discusses in detail each of the following core elements or "building blocks" of CFC rules:

- Definition of a CFC
- Threshold requirements
- Definition of control
- Definition of CFC income
- Rules for computing income
- Rules for attributing income
- Rules to prevent or eliminate double taxation

The draft includes recommended approaches for each of these core elements, except the definition of CFC income, for which several options are included.

Detailed discussion

The 3 April 2015 discussion draft under Action 3 identifies seven core elements or building blocks of CFC rules and provides recommendations or options for the design of such elements. The draft includes a statement that it does not represent the consensus views of the OECD's Committee on Fiscal Affairs or its working groups. Rather, the draft is intended to give stakeholders an opportunity to provide input before the OECD issues its final recommendations under Action 3 by September 2015. Comments are to be submitted by 1 May 2015. A public consultation is scheduled for 12 May 2015.

The discussion draft notes that, in addition to CFC rules, some countries have proposed that further rules could be applied to income earned by CFCs that does not give rise to sufficient taxation in the parent jurisdiction through the rules. These secondary rules would introduce a tax in another jurisdiction (for example, in the source country of the income earned by the CFC). The draft also notes that the OECD is considering options for special measures with respect to transfer pricing under Actions 8-10,[1] which could be implemented as secondary rules. Similarly, possible future work on options to address the tax challenges of the digital economy could be adapted to apply as secondary rules. The draft indicates that no decision has been made yet regarding this high level proposal.

The discussion draft is divided into the eight chapters, which are summarized below.

Policy considerations

The discussion draft identifies a series of policy considerations in connection with the design of CFC rules: (i) what is the purpose of CFC rules; (ii) how to strike a balance between taxing foreign income and maintaining competitiveness; (iii) how to limit administrative and compliance burdens while not creating opportunities for avoidance; (iv) what is the role of CFC rules as preventative measures; (v) what is the scope of base stripping prevented by CFC rules; (vi) how to ensure that CFC rules do not lead to double taxation; and (vii) the interaction between CFC rules and transfer pricing rules.

Definition of a CFC

Chapter 2 of the discussion draft sets out two recommendations for defining a CFC: (i) adopt a broad definition so that CFC rules would apply to both corporate and non-corporate entities (such as partnerships, trusts, and permanent establishments [PEs]) when those entities are either owned by CFCs or treated in the parent jurisdiction as taxable entities separate from their owners; and (ii) include a modified hybrid mismatch rule that would prevent entities from circumventing CFC rules through different treatment in different jurisdictions.

The discussion draft recommends that CFC rules apply to transparent entities in two cases: (i) entities that are not taxable in one jurisdiction but are subject to taxation in the parent jurisdiction; and (ii) entities that would not otherwise be taxable and that are owned by another CFC. The draft also recommends that PEs be treated as CFCs where the company of which the PE is a part is resident in a jurisdiction with a territorial or exemption system that applies to PE income.

[1] See EY Global Tax Alert, OECD holds public consultation on BEPS Actions 8-10 on transfer pricing, dated 27 March 2015.

The discussion draft sets forth two alternative approaches for addressing the application of CFC rules in the case of hybrid instruments or entities. Under the narrow option, an intragroup payment would be taken into account in calculating the parent company's CFC income if (i) the payment is base eroding (e.g., deductible in one jurisdiction and subject to a zero or low rate of taxation in the jurisdiction of receipt); (ii) the payment is not included in CFC income; and (iii) the payment would have been included in CFC income if the parent jurisdiction had classified the entities and arrangements in the same way as the payer or payee jurisdiction. Under the broad option, in contrast, an intragroup payment would be taken into account if (i) the payment is not included in CFC income; and (ii) the payment would have been included in CFC income if the parent jurisdiction had classified the entities and arrangements in the same way as the payer or payee jurisdiction.

Threshold requirements

Chapter 3 of the discussion draft addresses threshold requirements with respect to the scope of CFC rules. The draft recommends inclusion of a low-tax threshold that is based on the effective tax rate (ETR) and that uses a tax rate that is meaningfully lower than the tax rate in the country applying the CFC rules.

With respect to the application of a low-tax threshold, a benchmark would compare the tax rate in the CFC jurisdiction either to a particular fixed rate or to a percentage of the parent jurisdiction's rate. The draft recommends that the benchmark be set at 75% of the parent jurisdiction's statutory corporate tax rate or lower, which the draft indicates is the level used by most existing CFC rules.

The discussion draft also recommends the use of the CFC's ETR in applying the benchmark. It states that using the ETR would be a more accurate comparison than using the statutory tax rate. For calculating the ETR, the draft recommends that the income measure should be either the tax base in the parent jurisdiction had the CFC income been earned there or the tax base computed according to an international accounting standard such as IFRS with adjustments made to reflect the tax base reductions that result in low taxation of the CFC income. The draft also notes that the ETR could be computed broadly or narrowly. A broad approach would calculate the ETR on an entity-by-entity basis or on a country-by-country basis by aggregating income within a country. A narrow approach would calculate the ETR on an item of income basis.

Definition of control

Chapter 4 of the discussion draft addresses the definition of control, which includes two elements: (i) the type of control that is required; and (ii) the level of that control. The draft's recommendation for control is that CFC rules should at least apply both a legal control test and an economic control test so that satisfaction of either test results in control for purposes of the rules. Countries may also include a de facto control test. The draft's recommendation for the level of control is that a CFC should be treated as controlled where residents hold, at a minimum, more than 50% control. However, the draft notes that countries may set their control threshold at a lower level. The specified level of control could be established through the aggregated interest of related parties or unrelated resident parties or from aggregating the interests of any taxpayers that are found to be acting in concert. Additionally, the draft states that CFC rules should apply where there is either direct or indirect control.

The discussion draft states that after determining what constitutes control, the next step is to determine how much control must be present in order for CFC rules to apply. The draft observes that most existing CFC rules require a "more than 50%" level of control. It states that this test is straightforward and easy to apply when control is held by a single person. However, in the event that minority shareholders are acting together to exert influence, their interests should be aggregated to determine control.

The draft recommends use of one of three approaches to determine if minority shareholders are acting together: an "acting-in-concert" test, an examination of the relationship of the parties, or a concentrated ownership test. The discussion draft states that including the interests of nonresident taxpayers under any of these approaches could add to the complexity of the control provisions. As such, the recommendation, as a minimum threshold, does not take into account nonresidents for purposes of determining control.

Definition of CFC income

Chapter 5 of the discussion draft outlines several approaches to defining income but does not yet include recommendations. The draft indicates that the approaches to defining CFC income do not reflect consensus as countries have different views on this issue.

The discussion draft first states that existing CFC rules apply either a full or partial system of inclusion in defining CFC income. The draft notes that because the full inclusion system includes all CFC income, there is no need to separately define the income subject to CFC rules. Hence, the discussion in the draft focuses on the definition of income issues under partial inclusion systems.

The discussion draft states that CFC rules should be able to accurately define income in the context of CFCs that are holding companies, that provide financial and banking services or that engage in sales invoicing, as well as income from IP assets, digital goods and services or captive insurance and re-insurance. The draft states that CFC rules must be capable of dealing with at least the following types of income: (i) dividends; (ii) interest and other financing income; (iii) insurance income; (iv) sales and services income; and (v) royalties and other IP income. At a minimum, CFC rules should capture income that raises BEPS issues within each category and should not capture income that arises from value-creating activity in the CFC jurisdiction.

The discussion draft states that the general principle is that highly mobile and/or passive income should be covered by CFC rules because it likely has been diverted away from the parent or a third jurisdiction to the CFC jurisdiction. This type of income typically includes, at the minimum, interest, royalties, dividends, and income earned other than in the course of an active trade or business. One approach, according to the draft, is a form-based analysis that categorizes an item of income based on a formal classification. Under this method, sales, services, and other income that is by its nature more associated with the carrying on of a trade or business would be excluded from CFC income. The draft states that a pure form-based approach is administratively convenient but it is also easily manipulated and does not address all income that could arise from base erosion and profit shifting.

Because of the drawbacks of a pure form-based approach, the discussion draft observes that CFC rules typically apply some degree of substance analysis. The draft outlines three types of substance analysis: (i) substantial contribution analysis; (ii) viable independent entity analysis; and (iii) employees and establishment analysis.

The substantial contribution analysis would focus on the relevant facts and circumstances to determine whether the employees of the CFC have made a substantial contribution to the income earned by the CFC. Once the CFC has shown a given level of activities, all income earned by that CFC would then be excluded from the definition. The draft comments that this analysis might be appropriate for several types of income but probably not for IP income. Also it states that it would be possible for companies to aim for the minimal level of contribution, knowing that they could then shield a residual amount of income.

The viable independent entity analysis would aim to assess all of the significant functions performed by entities within the group to determine if the CFC could be a viable independent entity. To the extent that the CFC does not own the assets or undertake the risks, the associated income would be subject to the CFC rules.

The employees and establishment analysis would use a measurement of employees and business premises as a more mechanical way of determining whether the activities required to earn the income are located in the CFC jurisdiction. The main differences between the employees and establishment analysis and the viable independent entity analysis are that (i) the CFC itself must have the employees and establishment necessary for earning the actual income, rather than just the employees and establishment necessary for managing or overseeing the value-creating activities; and (ii) the employees and establishment analysis does not require an analysis of risks or asset ownership.

The discussion draft further notes that existing CFC rules also examine whether income is highly mobile by looking at from whom it was earned (i.e., from related parties or from others) and where it was earned. Income earned from a related party is generally treated as CFC income because such income is presumed to have been shifted. Income earned outside of the CFC jurisdiction also is considered to raise profit shifting concerns.

The discussion draft observes that existing CFC rules generally use a combination of these approaches. Nevertheless, the draft states that these rules struggle to accurately determine the income that should be subject to the CFC rules. The draft therefore considers the need to develop rules to address various types of income that give rise to particular difficulties for existing CFC rules.

The draft suggests that dividend income could be treated as passive income, but excluded from CFC income if it is paid out of active income (or by related parties out of active income) or if the CFC is in the active trade or business of dealing in securities.

The draft similarly suggests that interest and other financing income could be treated as passive, but excluded from CFC income if the CFC is in the active trade or business of financing and is not overcapitalized.

The draft suggests that CFC rules could address insurance income by focusing on one or more of the following factors: (i) whether the income is derived (directly or indirectly) from a related party (and, for a narrower rule, whether the related party is able to deduct insurance premiums paid to the CFC); (ii) whether the parties to the insurance contract or the risks insured are located outside the CFC jurisdiction; (iii) whether the CFC has sufficient substance to assume and manage the risks on its own accord; and (iv) whether the CFC is overcapitalized.

The draft suggests that CFC rules could treat sales and services income as active income unless it is earned from a related party or the CFC lacks the substance to earn the income itself.

The draft states that income from royalties and IP has become the most challenging type of income to categorize in the digital economy. The draft suggests that to effectively address IP income, CFC rules could consider both whether the income is earned from a related party (including whether it was earned for IP developed with a related party) and whether the CFC carried out the required activities to develop the IP underlying the asset. This, however, would require distinguishing between IP income and other income, and the draft suggests that CFC rules may therefore be more effective if they apply just one rule to sales and services income and IP income that would treat all sales, services, royalty, and other IP income as passive unless the CFC has engaged in the substantial activities required to earn the income.

The discussion draft outlines two main approaches to defining what constitutes income subject to CFC rules: the categorical approach and the excess profits approach.

The categorical approach involves separate rules for different types of income. This allows jurisdictions to tailor their rules regarding treatment of each type of income. However, the draft notes that all types of income would have to be categorized and a substance analysis might have to be applied. The draft notes that this categorical approach is not dissimilar to a traditional CFC rule that combines a form-based analysis with a substance analysis, and states that jurisdictions could achieve similar outcomes to the categorical approach by applying it as a two-step approach. The first step would require jurisdictions to divide income into formal categories and the second step would be a substance analysis. The draft summarizes the result of the two-step process as:

- Passive income would be included in CFC income unless the CFC can meet the requirements of a substance analysis.
- Active income would be excluded from CFC income unless the CFC cannot meet the requirements of a substance analysis.

The other approach described by the discussion draft is a formulary excess profits approach. Under this approach, a "normal return" would be calculated for equity investment in the CFC. Any profit in excess of normal return would be treated as CFC income. The draft notes that some countries apply a substance based exclusion as a final step in such an approach.

The draft defines the "normal return" as the "rate of return" multiplied by the "eligible equity." The rate of return is an economic concept that begins by estimating the risk free rate of return and then increases it by a risk premium. The draft notes that economic studies often estimate the risk-inclusive rate as being approximately 8% to 10%, although this varies by industry, leverage, and jurisdiction. The draft suggests four options for determining risk-inclusive rate of return: (i) a set percentage such as 10%; (ii) a 10-year government bond yield increased by a fixed equity premium; (iii) the corporate group's cost of capital; or (iv) a combined approach that uses the first or second option but allows groups to opt instead to use their cost of capital.

The draft defines "eligible equity" as equity associated with the assets used in the active conduct of the trade or business in the low-tax jurisdiction. The draft suggests using either book value or tax value from the perspective of the parent jurisdiction to calculate equity, reduced by apportioned liabilities.

Finally, the draft discusses whether the definition of what constitutes income subject to CFC rules should be applied on an entity or transactional basis. The entity approach is an all or nothing approach, depending on whether at least a specified percentage of the income falls within the definition of CFC income. Under the transactional approach, in contrast, the character of each stream of income is assessed to determine whether that stream of income is within the definition of CFC income. The discussion draft considers it to be best practice generally to use the transactional approach rather than the entity approach.

Rules for computing income

Chapter 6 of the discussion draft addresses the computation of income of the CFC, providing recommendations on (i) which jurisdiction's rules should apply; and (ii) whether any specific rules for computing CFC income are necessary. The draft recommends that the rules of the parent jurisdiction be used to compute a CFC's income. The draft describes this approach as consistent with the goals of the BEPS Action Plan and as reducing administrative costs.

The discussion draft also recommends that jurisdictions should have a specific rule limiting the offset of CFC losses so that they can be used only against profits of the same CFC or other CFCs in the same jurisdiction. Such a rule could be applied together with a rule that limits offset of losses to similar types of profits.

Rules for attributing income

Chapter 7 of the discussion draft addresses how to attribute income to shareholders. The draft breaks this down into a five-step process: (i) determining which taxpayers should have income attributed to them; (ii) determining how much income should be attributed; (iii) determining when the income should be included in the returns of the taxpayers; (iv) determining how the income should be treated; and (v) determining what tax rate should apply to the income.

The discussion draft recommends that the threshold for attribution be tied to the minimum control threshold. However, the draft notes that countries can choose different attribution and control thresholds depending on the policy considerations underlying their CFC rules.

The discussion draft recommends that the amount of income to be attributed to each shareholder be calculated by reference to the shareholder's proportion of ownership in the CFC and the period of such ownership.

The discussion draft recommends that jurisdictions can determine when income should be included and how it should be treated so that their CFC rules operate in a manner that is coherent with their domestic law.

The discussion draft recommends that the tax rate of the parent jurisdiction be applied. The draft also notes that countries could consider a "top-up tax" instead of tax at the full rate.

Rules to prevent or eliminate double taxation

Chapter 8 of the draft sets out recommendations for preventing or eliminating double taxation.

The draft focuses on three situations where double taxation may arise: (i) situations where the attributed CFC income is also subject to foreign corporate taxes; (ii) situations where CFC rules in more than one jurisdiction apply to the same CFC income; and (iii) situations where a CFC actually distributes dividends out of income that has already been attributed to its resident shareholders under the CFC rules or a resident shareholder disposes of the shares in the CFC.

With respect to the first two situations, the discussion draft recommends that countries allow a credit for foreign taxes actually paid, including CFC tax on intermediate companies. With respect to the third situation, the draft recommends exempting dividends and gains on disposition of CFC shares if the income of the CFC has previously been subject to CFC taxation. However, the precise treatment of dividends and gains can be left to jurisdictions to determine so that such treatment is coherent with their domestic law.

Implications

The discussion draft is the first draft of the output to be produced under Action 3 of the OECD BEPS Project. While the draft makes recommendations with respect to several aspects of CFC rules, it does not make recommendations on the definition of CFC income; in that area, the draft includes options as there is not yet consensus among countries on a recommended approach. The recommendations and options in the discussion draft, if adopted by countries, could have significant implications for the taxation of global businesses. Companies should evaluate how the recommendations and options may affect them, stay informed about developments in the OECD and in the countries where they operate or invest, and consider participating in the dialogue regarding the BEPS project and the underlying international tax policy issues.

OECD holds public consultation on BEPS Action 3 on CFC rules

On 12 May 2015, the OECD held a public consultation in connection with the BEPS project that was focused on Action 3 on controlled foreign company (CFC) rules. The meeting was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the work on this Action.

On 3 April 2015, the OECD issued a discussion draft on Action 3 on strengthening CFC rules (the Discussion Draft or Draft).1 The Discussion Draft focuses on how to use CFC rules to respond to BEPS and addresses what it describes as the core elements or "building blocks" of CFC rules. The Draft includes recommended approaches or options for each of the core elements. The OECD received over 570 pages of comments on the Discussion Draft, which are posted on its website.

The public consultation on 12 May 2015 was a dialogue among stakeholders, country tax officials, and the OECD Secretariat on key issues and concerns raised in the comments. The consultation was hosted by OECD Working Party 11, which has responsibility for the OECD's work on Action 3. This working group also has responsibility for other BEPS Actions, including the work on Action 2 (hybrid mismatch arrangements), Action 4 (interest deductions and other financial payments) and Action 12 (mandatory disclosure).

Tax officials from 26 countries participated in the consultation. Also participating were representatives of multinational businesses and industry bodies; tax advisors, including EY representatives; and representatives of non-governmental organizations (NGOs). The consultation was live-streamed by the OECD and a recording is available on the OECD website.

In opening comments, a representative of the Business and Industry Advisory Committee (BIAC) to the OECD expressed concern that the lack of consensus reflected in the Discussion Draft represents a missed opportunity. It was noted that the objective of CFC rules is to complement transfer pricing rules to discourage BEPS and to reduce harmful tax competition but that the Draft fails to clearly articulate such goals. Further concern was expressed that the Draft departs from the common active/passive income structure for CFC rules by including new ideas such as the excess return approach. Moreover, some recommendations in the Draft could inappropriately shift taxing rights to residence jurisdictions from source jurisdictions, which could harm cross-border investment.

Read more of EY's analysis at bit.ly/1c2fe1a

OECD's public consultation on BEPS Action 4 on interest deductions and other financial payments

Barbara Angus
International Tax Services
T: +1 202 327 5824
E: barbara.angus@ey.com

On 17 February 2015, the Organisation for Economic Co-operation and Development (OECD) held a public consultation in connection with the Base Erosion and Profit Shifting (BEPS) Action 4 that is focused on the deductibility of interest deductions and other financial payments, where the OECD is proposing broad limitations on interest deductibility. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the work on this Action.

As background, the OECD issued a discussion draft on Action 4 on interest deductions and other financial payments on 18 December 2014. You can find full coverage of the discussion draft contents in EY Global tax alert 2014-2329 at **www.ey.com/taxalerts**. In addition, you can read EY's comment letter in response to the OECD at **www.ey.com/BEPS**. In our comment letter, we set forth a number of significant concerns in relation to the discussion draft.

Alternative approaches to limiting deductions for interest expense

The discussion draft set forth alternative approaches to limiting deductions for interest expense, including:

(1) Group-wide rules, which would limit the net interest deductions of a member of a multinational corporation (MNC) group to a proportion of the group's actual net third-party interest expense

(2) Fixed ratio rules, which would limit a company's interest deductions to an amount determined by applying a benchmark ratio to an entity's earnings, assets or equity

(3) Combinations of these two approaches

The discussion draft also describes a range of technical, policy and industry sector issues relevant to the consideration of these approaches. The OECD received over 1,000 pages of comments on the discussion draft, which are posted on its website.

The 17 February 2015 consultation was a dialogue among stakeholders, country tax officials and the OECD Secretariat on key issues and concerns raised in the comments. The consultation was hosted by OECD Working Party 11, which has responsibility for the OECD's work on Action 4. This working group also has responsibility for other BEPS Actions, including the work on Action 2 (hybrid mismatch arrangements), Action 3 (CFC rules) and Action 12 (disclosure of aggressive tax planning arrangements).

Delegates from 30 countries participated in the consultation. Also participating were business representatives from around the world, including EY representatives and representatives of non-governmental organizations (NGOs). The session was live-streamed by the OECD and recordings of the morning and afternoon sessions are available on the OECD website:

10:00–13:00: http://video.oecd.org/?action=video&id=1482

14:30–18:00: http://video.oecd.org/?action=video&id=1483

Opening remarks

The consultation began with opening remarks from the UK delegate who is a co-chair of the focus group on Action 4. He indicated that interest deductibility is a major concern for the countries involved in the BEPS project. Those concerns focus on when the total interest expense of group members exceeds the group's third-party interest expense and also when interest expense of a group does not align with the economic activity in the group. For this reason, the focus group is looking at options that would move the "gearing" of entities in the group closer to the "gearing" of the overall group.

The co-chair also:

(1) Noted the suggestion that best practice in this area should be based on the arm's-length principle

(2) Expressed the view that few countries apply arm's-length rules to interest and those that do use those rules do not use them to address BEPS activity

(3) Stated that the focus group decided not to use the arm's-length principle in the proposed measures under Action 4

Finally, the co-chair commented that the solution for interest deductions and other financial payments will require interaction across countries.

The representative of the Business Industry and Advisory Committee (BIAC) of the OECD opened by commenting on the importance of debt funding to many businesses and expressing the view that rules limiting deductibility should be narrowly crafted. He indicated that the arm's-length principle should have a role to play because it provides information about what third parties would do. The BIAC representative further noted concerns about the group-wide approach contained in the discussion draft, including practical challenges and the potential creation of perverse incentives to increase third-party leverage. He expressed the preference of BIAC for the fixed ratio approach, noting that such an approach is relatively simple and stable, but further noting concern about the discussion draft's suggestion that the benchmark ratio should be lower than the ratios currently used in countries. He concluded with BIAC's view that a combined approach would be the most appropriate of the options contained in the discussion draft, subject to concern about the ratio being made excessively low.

Data regarding debt levels in MNC groups

The discussion draft includes data on the global top 100 companies by market capitalization for 2009 and 2013, which purports to show that about half of those companies had net interest expense to EBITDA ratios of less than 5%. The discussion draft concludes from this data that the benchmark ratio for a fixed-ratio approach should be significantly lower than the 30% levels used in several countries. This analysis was roundly criticized in the comments submitted, on grounds that these companies are not representative of typical company leverage profiles, the use of data from consolidated financial statements was not appropriate and the current interest rate environment reflects all-time lows.

During the consultation, a member of the OECD Secretariat presented additional data based on 250 companies showing similar results. He also presented data that showed higher interest amounts in higher tax rate countries.

BIAC made an extensive presentation of data involving 20,000 companies for the five years from 2009 to 2013. Based on this data, 42-47% of the companies had net interest expense to EBIDTA ratios of greater than 10%. Looking at companies defined as small cap by Standard & Poor's Global Vantage Database, 52-62% had net interest expense to EBIDTA ratios of greater than 10%.

In response to the BIAC presentation, the member of the OECD Secretariat noted that it would be useful to look at affiliate data as well as group data. A US delegate noted that perhaps a fixed-ratio approach that differentiates between small cap and large cap companies would make sense and also suggested that it would useful to see data for a different period.

Group-wide approaches

Business participants expressed a variety of concerns about the proposed group-wide approaches. It was noted that borrowing needs differ across entities within a group. The difficulties in using consolidated financial statement data to determine allocations to group members were discussed, including the fact that group-level adjustments would mean that the sum of the member numbers typically would not equal the group numbers, such that the resulting allocation would not be based on 100% of the group's external interest expense. Comments were made about the drawbacks of both earnings and assets measures as the allocation key, and some participants suggested that flexibility regarding the choice of measure would be needed because of industry differences.

Many participants stressed the inability to engage in self-help under a group approach because of the restrictions on pushing debt down to group members that exist in many countries, noting that the result therefore would be external interest expense that is deductible nowhere in the world. In response to an OECD question about whether these problems could be addressed by applying a group-wide approach to a number that exceeds 100% of a group's net external interest expense (say 105-110%), business participants indicated that such an adjustment would be arbitrary and that the results still would not be fair in particular cases because the structural problems with the group-wide approach would remain.

Fixed-ratio approaches

Some business participants favored a fixed-ratio approach as involving less complexity and providing flexibility for each country to set its own benchmark level. It was stressed, however, that the benchmark ratio would have to be high enough to allow appropriate amounts of interest expense; in this regard, it was noted that different industries have very different amounts of leverage. It also was noted that interest above the amount allowed under a fixed-ratio approach would be non-deductible, while the interest income would be taxable, unless the OECD develops a linking rule that addresses the income inclusion.

In response to a question from the New Zealand delegate about whether there should be concern that businesses would lever up to the benchmark ratio, business participants noted that commercial reasons are needed for borrowing. In regard to the level of the fixed ratio, a US delegate commented that intercompany debt is tax-driven. An NGO representative expressed the view that fixed caps do not work to address BEPS.

Combined approaches

Many business participants favored a combined approach that used a fixed-ratio test as the main rule, with a group allocation rule as a fallback. It was noted that such an approach would provide needed flexibility. In response to a question from a UK delegate about how a combined approach would work given the computational issues of a group allocation rule, a business participant noted that it would be important to have the fixed ratio high enough to limit when the group rule would have to be applied. Another US delegate indicated that the fixed ratio should be set at a level that would encourage companies to leverage in line with their group ratio. An NGO representative expressed the view that a combined approach would not work because it would allow businesses to choose the structure they want.

It was noted that targeted rules addressing particular BEPS concerns should play an important rule. For carryovers, it was acknowledged that this would mitigate some of the issues with a group allocation rule if the carryover period is long enough, but it also was noted that a group approach would lead to a permanent structural disallowance. It also was noted that transition rules would be needed, given the long-term nature of financing arrangements.

Special industry issues

Regarding the financial services industry, business participants expressed appreciation that the discussion draft acknowledged the special circumstances for this industry, but also expressed concern about the possibility of an approach that focuses on regulatory capital, as noted in the Draft. In this regard, it was noted that stringent restrictions are imposed on regulatory capital in the form of debt, that regulation in this regard continues to evolve, and that tax rules that do not align with regulatory rules would create serious problems for the industry. It was suggested that the OECD should work with the industry and its regulators in developing an appropriate approach to address any BEPS concerns.

Business participants also raised special considerations about the oil & gas industry, the securitization sector and the aircraft-leasing sector. In addition, business participants commented on the special circumstances for infrastructure investment.

Concluding comments

In closing, a member of the OECD Secretariat expressed appreciation for the participation in consultation and for all the written comments submitted. She indicated that they are still working through all of the comments and may request additional input as the process moves forward.

Implications

The discussion at the consultation underscored the significant effect that the limitations on interest deductibility contemplated in the discussion draft would have on financing activities and capital structures of MNCs. Moreover, such changes are being proposed against the backdrop of country activity in recent years that has involved enactment of a variety of new restrictions on interest deductions. Thus, it is important for companies to keep informed of developments in this area in the OECD and in the countries in which they operate, to assess the implications of these developments for their business models and financing structures, and to consider actively engaging with policymakers in this international tax debate.

Tax Council Policy Institute (TCPI) honors EY Global Chairman and CEO Mark Weinberger at annual symposium

Thursday 12 February saw the Tax Council Policy Institute (TCPI) recognize Mark Weinberger, EY Global Chairman and CEO, and former U.S. Treasury Assistant Secretary for Tax Policy, with its Pillar of Excellence Award for his extraordinary accomplishments in the field of business and tax policy. The award will be presented at TCPI's 16th Annual Tax Policy & Practice Symposium in Washington, D.C.

"With an eminent career and track record of leadership in global tax policy on all platforms both inside EY and out, Mark is the perfect business leader for this year's Pillar Award," said Doug Bates, Chair of TCPI's Board of Directors and Vice President of Federal Relations at Northwestern Mutual. "His forward-thinking approach will continue to create positive change in the business and tax community."

Mark is only the sixth recipient of this award, which honors individuals in the tax community who consistently go above and beyond what is required to fulfill their professional obligations, proving to be true leaders in their field. TCPI searches for an outstanding tax professional whose performance and activities help further the knowledge and understanding of the tax community at large. Criteria for the Pillar of Excellence Award include: playing a key role in developing tax policy, recognizing its impact on business and the economy; and, improving the overall understanding of foreign and domestic tax policies among tax professionals, executives and policymakers.

Accepting the award, Mark said:

"I've been involved with TCPI for years, because it always offers a terrific conference and a great debate about the important issues that affect us all.

It's exactly the kind of dialogue we need today. What an honor it is to be up here today. And more importantly, I want to say how honored I am to have had the opportunity to work side by side with so many people in this room."

Mark assumed his current role in July 2013. In addition to his role at Treasury, he has also had an extensive career in public service and as an entrepreneur. He was appointed by President Clinton to serve on the U.S. Social Security Administration Advisory Board, and held other US government positions including Chief of Staff of President Clinton's 1994 Bipartisan Commission on Entitlement and Tax Reform; Chief Tax and Budget Counsel to US Senator John Danforth (R-Missouri); advisor to the National Commission on Economic Growth and Tax Reform; and Commissioner on the National Commission on Retirement Policy. Mark also co-founded Washington Counsel, P.C., a Washington DC-based law and legislative advisory firm that merged into Ernst & Young LLP and now operates as Washington Council EY.

TCPI's 16th Annual Tax Policy & Practice Symposium, "How Taxes Matter: The Globalization of Tax Policy and Implications for US Economic Growth and Investment," explored the globalization of tax policy and its implications on the economic growth of the United States and companies' investment decisions.

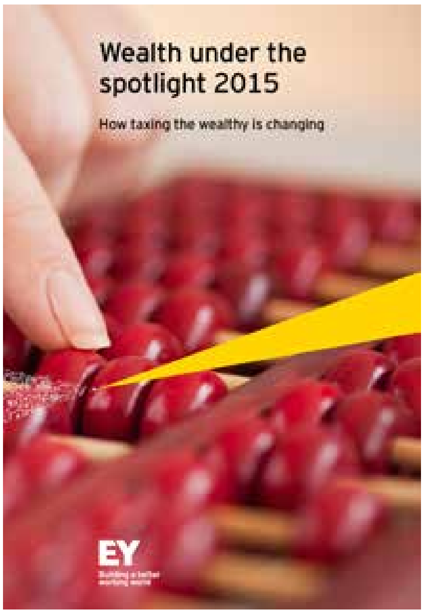
EY report: Wealth under the spotlight 2015

Access the report at **www.ey.com/wealthunderthespotlight**

Against a backdrop of growing public, media and activist intolerance of perceived abuse of the tax system, we continue to see unprecedented levels and speed of change in tax policy and tax administration approaches all around the world.

Wealth under the spotlight 2015 — following on from our 2010 *Wealth under the spotlight* publication — highlights some of these global changes and the subsequent impact being felt by High Net Worth Individuals. We explore current tax policy direction and the spectacular rise in collaboration and taxpayer information sharing among tax administrations.

As a result of these shifts, many High Net Worth Individuals are now starting to realize that their relationship with key taxing administrations needs to evolve and change, and in many cases, tax



administrations themselves are showing a desire to develop closer, more transparent relationships with their customers which can result in better use of time, resources and the gaining of higher levels of certainty sooner in the game. With many tax issues experienced by High Net Worth Individuals having a multi-year and in some cases, multilateral impact, managing personal tax compliance obligations has never been so important.

In our report, we provide coverage of many of the areas that governments and tax administrators are focusing on, as well as setting out a framework of recommendations which you may wish to consider when assessing your current global tax position. In preparing this framework, we drew upon EY's extensive global network of personal tax, tax policy and tax controversy professionals as well as exclusive interviews with leaders in many tax administrations around the world.

in the spotlight

OECD explains agreed approach on intangible property regimes under BEPS Action 5

Chris Sanger

Global and UK Tax Policy Leader
T: +44 207 951 0150
E: csanger@uk.ey.com

Ute Witt

Tax Policy Leader – Germany
T: +49 30 25471 21660
E: ute.witt@de.ey.com

On 6 February 2015, the Organisation for Economic Co-operation and Development (OECD) released a trio of papers that address three of the focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The OECD presented these developments during the G20 Finance Ministers' meeting on 9-10 February 2015. One of the documents, titled *Action 5: Agreement on Modified Nexus Approach for IP Regimes*, describes the consensus on the approach for a substantial activity requirement for intangible property (IP) regimes such as patent boxes in connection with BEPS Action 5 (harmful tax practices).

The agreed approach builds on the "modified nexus approach" developed jointly by the German and UK governments[1] which was made public on 11 November 2014. The Action 5 Paper describes conceptual issues with respect to the modified nexus approach and additional work that will be carried out in order to allow agreement on the detailed rules to be reached in 2015.

Background

The interim report on Action 5 of the BEPS Project, "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance," released on 16 September 2014,[2] reflected consensus on the importance of having appropriate substantial activity requirements with respect to preferential tax regimes in connection with the determination whether such regimes are to be considered harmful tax practices. However, full consensus had not been reached yet on defining substantial activity. For IP regimes, one of the proposed approaches was the "nexus approach," which would allow benefits granted with respect to IP income in line with the expenditures linked to generating such income. The German and UK Governments jointly proposed a modified nexus approach in November 2014, which has now been endorsed by all OECD and G20 countries.

Conceptual issues

The Action 5 Paper notes the general acceptance of the nexus approach, subject to modifications relating to the level of qualifying expenditure, grandfathering provisions, and the tracking and tracing of expenditure.

According to the paper, the agreement allows countries to provide for an "up-lift" of qualifying expenditure by the amount of actual expenditures on outsourcing and acquisition costs but not to exceed 30% of the amount of qualifying expenditure of the company, in order compensate for the fact that related-party outsourcing and acquisition costs will not constitute qualifying expenditure. An example of how the up-lift would be computed is also included.

Timing, grandfathering and reporting issues

The Action 5 Paper states that under the agreement there can be no new entrants to any existing regime after the date that a new regime consistent with the modified nexus approach takes effect and, in any event, no later than 30 June 2016. Further, any legislative process necessary to make this change must commence in 2015. For this purpose, "new entrants" include both taxpayers not previously benefiting from the regime and new IP assets owned by taxpayers already benefiting from the regime.

The paper also indicates that countries are allowed to introduce grandfathering rules, with final abolition required to be no more than five years after the date the regime is closed to new entrants, which would be no later than 30 June 2021.

Further work to be done

The paper notes that an approach to the tracking and tracing of research and development expenditure that is practical for tax authorities and companies to implement needs to be developed in order to implement the modified nexus approach. Agreement will also be needed on transitional provisions to enable companies to transfer IP from existing regimes into new regimes. The OECD will work to agree on practical methods that should be used for identifying qualifying expenditure, taking into account the particular issues associated with expenses incurred prior to introduction of the modified nexus approach.

Implications

Companies that are benefiting from IP regimes should continue to monitor OECD developments with respect to Action 5 and, more specifically, the discussion surrounding a substantial activity requirement and the agreed approach with respect to IP regimes. They also should monitor related developments in the countries where they operate or invest, as well as the European Commission's ongoing scrutiny of patent box regimes.

[1] See EY Global Tax Alert, *UK and Germany agree to joint proposal on preferential intellectual property regimes*, 13 November 2014.

[2] See EY Global Tax Alert, *OECD releases interim report under BEPS Action 5 on countering harmful tax practices*, 21 September 2014.

OECD releases revised discussion draft on follow up work on treaty abuse under BEPS Action 6

On 22 May 2015, the OECD released a revised discussion draft in connection with the follow up work on Action 6 on the prevention of treaty abuse under the Base Erosion and Profit Shifting (BEPS) Action Plan. The document titled, BEPS Action 6: Preventing Treaty Abuse describes proposals developed by the OECD after the issuance of a discussion draft on 21 November 2014 titled, Follow Up Work on BEPS Action 6: Preventing Treaty Abuse (the Discussion Draft). The Discussion Draft identified 20 different issues to be addressed as part of the OECD's follow-up work on its 16 September 2014 report, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances. Specifically, the Discussion Draft highlighted issues with respect to the proposed limitation on benefits (LOB) provision, in particular regarding the treaty entitlement of collective investment vehicles (CIVs) and Non-CIV funds; the proposed general anti-abuse rule based on a principal purpose test (PPT); and other issues involving the proposed new treaty tie-breaker rule, the treatment of permanent establishments in third countries, and the interaction between tax treaties and domestic anti-abuse rules.

The Revised Discussion Draft describes the current status of the discussions of OECD Working Party 1, the working group responsible for treaty matters (the Working Party), on each of the 20 issues. In some instances, new proposals that have been agreed by the Working Party are presented in the Revised Draft. In other instances, the Revised Draft includes proposed approaches that are to be further considered at the Working Party meeting scheduled for 22-26 June 2015. Last, the Revised Draft describes some issues that are to be discussed at the June meeting for which there is no specific proposal at this time. As with other BEPS discussion drafts, the Revised Draft includes the caveat that the views and proposals do not represent consensus views of the OECD's Committee on Fiscal Affairs or its subsidiary bodies.

Comments on the proposals in the Revised Draft should be submitted to the OECD by 17 June 2015. No public consultation meeting will be held on the proposals included in the Revised Draft, but issues raised in comments will be discussed at the June meeting. The OECD has indicated its intention to produce a final report on the recommendations under Action 6 by September 2015.

Access EY's full analysis at
bit.ly/1HAhzJG

OECD releases revised discussion draft on preventing artificial avoidance of PE status under BEPS Action 7

On 15 May 2015, the OECD released a revised discussion draft in connection with Action 7 on the artificial avoidance of permanent establishment (PE) status under its Action Plan on Base Erosion and Profit Shifting (BEPS). The document entitled BEPS Action 7: Preventing Artificial Avoidance of PE Status (the Revised Discussion Draft or Revised Draft) substantially refines the initial discussion draft on Action 7, which was released by the OECD on 31 October 2014. The Initial Discussion Draft sought comments on 14 proposed options for modifying the definition of PE under Article 5 of the OECD Model Tax Convention on Income and on Capital (the Model Convention), which generally would lower the PE threshold and tighten the exceptions to PE status.

The OECD received extensive comments on the Initial Discussion Draft and held a public consultation. With this input and following further discussion within the OECD group responsible for the work on Action 7, the OECD prepared the Revised Discussion Draft. Unlike the Initial Draft, which contained several alternative proposals for modifying Article 5 to address particular focus areas, the Revised Draft contains a specific proposal to modify Paragraphs (4), (5) and (6) of Article 5 to address each focus area. In addition, the Revised Draft contains proposed amendments to the existing commentary accompanying the Model Convention (the existing commentary, the Model Commentary and amendments, the Proposed Commentary).

As in the Initial Draft, the Revised Discussion Draft states that it does not represent the consensus view of the OECD's Committee on Fiscal Affairs or its subsidiary bodies and seeks comments on its proposals. Comments on the Revised Draft are to be submitted by 12 June 2015. The OECD has indicated that it does not intend to hold a public consultation on the Revised Draft.

Read EY's full analysis at
bit.ly/1GgBxyh

OECD issues discussion draft on mandatory disclosure rules under BEPS Action 12

Rob Hanson
Global Tax Controversy Leader – EY
T: +1 202 327 5696
E: rob.hanson@ey.com

On 31 March 2015, the Organisation for Economic Co-operation and Development (OECD) issued a discussion draft on mandatory disclosure rules under Action 12 (*Disclosure of aggressive tax planning arrangements*) of the base erosion and profit shifting (BEPS) project. The discussion draft makes a series of recommendations about the design of mandatory disclosure regimes intended to allow maximum consistency between countries while also being sensitive to local needs and to compliance costs.

The discussion draft focuses in particular on international tax schemes, which are viewed as an area of special concern and the primary focus of the BEPS project. It notes that disclosure schemes that are intended to address domestic avoidance might not be sufficient to capture cross-border arrangements and provides recommendations for an alternative approach.

The discussion draft includes a statement that it does not necessarily reflect consensus views of the OECD Committee on Fiscal Affairs or the working group responsible for Action 12. It reflects preliminary consideration of the issues and identifies issues for public comment.

The discussion draft requests that comments be submitted by 30 April 2015. A public consultation meeting on Action 12 is scheduled for 11 May 2015. The BEPS Action Plan calls for final recommendations on the design of mandatory disclosure regimes to be made by September 2015.

Detailed discussion

The Action 12 discussion draft begins with an overview of key features of a mandatory disclosure regime and its interaction with other disclosure rules and compliance tools. It sets out options for the modular design of a mandatory disclosure regime. Finally, it includes a discussion of international tax schemes in particular and how these could be covered by a mandatory disclosure regime. With respect to the element of Action 12 that is to focus on design and implementation of enhanced information sharing for international tax schemes, the document indicates that this work will be coordinated with the other parts of the BEPS Action Plan that involve information exchange, including Action 5 on harmful tax practices and Action 13 on transfer pricing documentation and country-by-country reporting.

The discussion draft considers the mandatory disclosure regimes that have been implemented in various countries to identify and evaluate design features that are commonly used. The United Kingdom's Disclosure of Tax Avoidance Schemes rules are a particular focus of attention because they have been in place since 2004 and are perceived to have had considerable success in reducing aggressive tax avoidance. Other forms of disclosure, such as tax rulings, reporting obligations in tax returns, and voluntary disclosure rules are also considered. The discussion draft indicates that mandatory disclosure is found to be most effective for accomplishing the objectives of obtaining information early; allowing the promoters and users of aggressive tax arrangements to be identified; and deterring the use of such arrangements.

Summary of design recommendations for mandatory disclosure regimes

The existing mandatory disclosure regimes considered in the discussion draft are either "transaction-based" or "promoter-based." The former depends on the tax authorities identifying transactions that taxpayers must report when they enter into them. "Promoter-based" regimes place the onus on promoters to disclose arrangements that display prescribed hallmarks. The design recommendations set forth in the discussion draft draw on elements from both kinds of regimes.

According to the discussion draft, all mandatory disclosure regimes should be enforced through financial penalties for non-compliance. Disclosure should include full details of how the arrangement work, why it is subject to disclosure, and who is using it.

Who has to disclose: The draft recommends that promoters should always be subject to disclosure obligations, although there could be a dual obligation on taxpayers as well. Where promoters have the primary disclosure obligation, the obligation should revert to the taxpayer when the promoter is outside the jurisdiction or asserts legal privilege or where the arrangement is developed by the taxpayer alone.

Where an arrangement is disclosed by a promoter only, the promoter should be required to draw up client lists and there should be a scheme reference number system. These client lists and reference numbers also are viewed as useful tools even when taxpayers are subject to their own disclosure requirement.

Threshold conditions: Mandatory disclosure regimes often have a threshold condition. For example, this might be a test of whether obtaining a tax advantage is a main benefit of the arrangement. Alternatively, a de minimis filter can be used. The discussion draft acknowledges that threshold conditions can be appropriate because they help keep the number of disclosures to a manageable level. However, the discussion draft indicates that a main benefit test should not be combined with a de minimis filter.

Hallmarks: In existing disclosure regimes, disclosure is triggered by an arrangement that includes certain hallmark characteristics. The discussion draft recommends that the existence of a single hallmark in respect of a scheme should be sufficient to give rise to a disclosure obligation.

Hallmarks can either be general or specific. General hallmarks include a promoter's desire to keep the arrangement confidential or requirement of a contingent or premium fee. The discussion draft recommends that regimes adopt both these hallmarks and indicates that a regime also may adopt a hallmark that applies to standardized tax products as well.

The discussion draft also recommends that countries use specific hallmarks designed for their local circumstances. Examples of specific hallmarks include leasing transactions, transactions similar to those included on a black list, or transactions with counterparties in low tax jurisdictions. Individual countries are left to design the specific hallmarks most appropriate to their local circumstances and may attach a de minimis filter to individual specific hallmarks.

Timeframe for disclosure: The discussion draft recommends that a promoter must disclose an arrangement when it is available for use. Where there is a disclosure obligation on taxpayers, the timing of disclosure should be linked to implementation of the arrangement.

International tax schemes

The discussion draft indicates that cross-border transactions raise particular issues for disclosure regimes because it may not always be clear in one jurisdiction whether a tax advantage has been obtained in another jurisdiction. To address this, the discussion draft recommends that special hallmarks be developed for "cross-border outcomes." These outcomes are broadly defined to include situations where taxpayers can obtain deductions for the same expenditure in two jurisdictions (such as where a sale and leaseback allows amortization of the same asset in two jurisdictions) or a tax deduction in one jurisdiction with no taxation on the corresponding income. Many such arrangements would be caught by the anti-hybrid rules proposed under BEPS Action 2 and could also be within the reach of other BEPS Actions such as Action 6 on treaty abuse or Action 7 on permanent establishment. The mandatory disclosure recommendations under Action 12 are intended to help tax authorities address aggressive tax avoidance that may not be addressed by the current BEPS project.

The discussion draft recommends that threshold conditions, such as the main benefit test, should not apply to arrangements with cross-border outcomes. This is because it is not always clear where a tax benefit arises in the case of a cross-border outcome. The discussion draft also recommends that taxpayers should only be required to disclose an arrangement to which they are a party or where the cross-border outcome arises in their group.

Implications

The discussion draft is the first draft of the output to be produced under BEPS Action 12. If the OECD's final recommendations under Action 12 are followed, more jurisdictions can be expected to establish mandatory disclosure regimes. Jurisdictions with existing mandatory disclosure regimes also can be expected to make changes to their rules as a result of the recommendations under Action 12.

Companies should evaluate how the proposed recommendations in the discussion draft may impact them, stay informed about developments in the OECD and in the countries where they operate or invest, and consider participating in the dialogue regarding the BEPS project and the underlying international tax policy issues.

OECD holds public consultation on BEPS Action 12 on mandatory disclosure rules

On 11 May 2015, the OECD held a public consultation in connection with the BEPS project that was focused on Action 12 on mandatory disclosure rules. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the work on this Action.

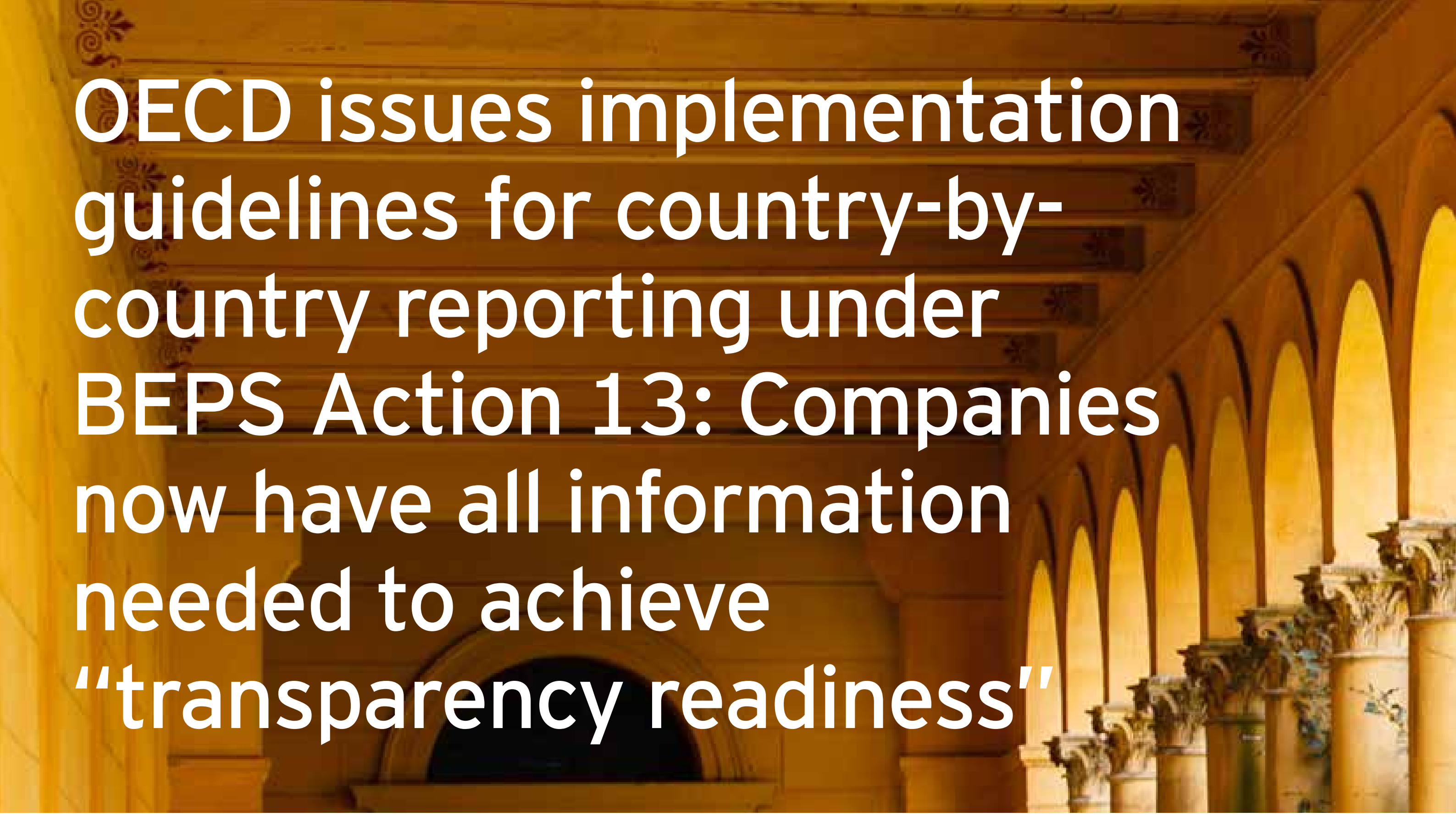
On 31 March 2015, the OECD issued a discussion draft on Action 12 on mandatory disclosure rules. The Discussion Draft makes a series of recommendations about the design of mandatory disclosure regimes, which are described as intended to allow maximum consistency between countries while also being sensitive to local needs and to compliance costs. The OECD received nearly 300 pages of comments on the Discussion Draft, which are posted on its website.

The public consultation on 11 May 2015 was a dialogue among stakeholders, country tax officials, and the OECD Secretariat on key issues and concerns raised in the comments. The consultation was hosted by OECD Working Party 11, which has responsibility for the OECD's work on Action 12. This working group also has responsibility for other BEPS Actions, including the work on Action 2 (hybrid mismatch arrangements), Action 3 (CFC rules) and Action 4 (interest deductions and other financial payments). The consultation was live-streamed by the OECD and a recording is available on the OECD website.

Business participants from various businesses expressed several common concerns. First, they stated that the proposed rules lack clarity. Subjective rules would create uncertainties and, with substantial penalties proposed, any failure with respect to compliance with such uncertain rules would be very costly. Some business participants stressed that transactions subject to the disclosure rule must not be assumed to be per se abusive.

In addition, business participants pointed out that the concept of "cross-border outcomes" should be narrowly defined to cover only transactions with material tax consequences. They noted that overly broad disclosure would make risk identification more difficult, especially for developing countries. Thresholds or filters should be used to better exclude from the mandatory disclosure rules low-risk transactions and transactions with clearly delineated non-BEPS tax benefits.

Read EY's full analysis at bit.ly/1Jm5D44



OECD issues implementation guidelines for country-by-country reporting under BEPS Action 13: Companies now have all information needed to achieve "transparency readiness"

Jean-Pierre Lieb

Europe, Middle East, India and Africa
Tax Controversy Leader – EY
T: +33 1 55 61 16 10
E: jean.pierre.lieb@ey-avocats.com

One of the documents, titled *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting*, provides much-anticipated guidance on a range of implementation measures related to the country-by-country report (CbC Report) that is part of the three-tier transfer pricing documentation approach developed under BEPS Action 13. With this new guidance in place, and the scope, timing and method of submission now known, companies should do everything possible to ensure their people, processes and technology are "transparency ready."

The new 10-page guidance documents two very key points (among others):

- Firstly that, while countries will essentially pick their own implementation timeline, OECD discussions have focused on requiring the first CbC Reports to be filed covering 2016 fiscal years

and

- Secondly, that CbC Reports, generally, will need to be filed in the home country of a multinational corporation (MNC) group's parent company and shared with other relevant countries under government information exchange mechanisms. Alongside these key messages, it also addresses other implementation matters related to the CbC Report and includes some high-level information regarding implementation of the master file and local file elements of the transfer pricing documentation.

Background

The OECD report on Action 13, dated 16 September 2014, is in the form of a revised chapter of the OECD Transfer Pricing Guidelines, which sets forth a three-tier approach for transfer pricing documentation that includes a framework for the master file and local file and a template for CbC Report.[1] The Action 13 Report also indicated that the OECD would undertake additional work on implementation and the approach for filing of the CbC Report and the master file.

The new OECD guidance focuses primarily on implementation issues related to the CbC Report. It addresses the following matters:

- The timing of preparation and filing of CbC Reports
- Those MNC groups required to file CbC Reports
- The conditions for obtaining and use of the CbC Reports by jurisdictions, and
- The framework for government-to-government mechanism to exchange the CbC Reports.

While the guidance relates primarily to the CbC Report, it does include the recommendation that the master file and local file requirements be implemented through local country legislation or administrative procedures and that MNC groups file the master file and local file directly with the tax administration in each relevant jurisdiction under the requirements of such administrations.

The guidance further states that countries participating in the BEPS project agree that both confidentiality and consistent use of the framework (for the content to be included in the master file and local file), as specified in the Action 13 Report, should be taken into account when incorporating these requirements into local law and procedures. The OECD also specifically acknowledged that the need for more effective dispute resolution may increase following adoption and implementation of the CbC reporting requirement and states that the work under Action 14 on improving dispute resolution should take that into account. Indeed, this was illustrated during a recent EY webcast, where 52% of respondents to a webcast poll expect an increase in controversy in Western Europe because of developments related to BEPS Actions 8 (Transfer pricing for intangibles) and 13.

Timing of preparation and filing of the CbC Report

The guidance recommends that the first CbC Report be required to be filed for, and contain information with respect to, an MNC group's first fiscal year beginning on or after 1 January 2016. The CbC Report would need to be filed within 12 months of the close of the fiscal year. For MNC groups with fiscal years ending on 31 December, the first CbC Report would therefore be required to be filed by 31 December 2017. The guidance provides that the term "fiscal year" refers to the consolidated reporting period for financial statement purposes (and not to taxable years or to the financial reporting periods of subsidiaries).

The Guidance indicates that countries participating in the OECD BEPS project agree that they will not require filing of CbC Reports based on the new template for fiscal years beginning prior to 1 January 2016. Of course, domestic legislative changes will also be necessary if countries are to adopt these new reporting obligations and the OECD also indicates that, to assist in the legislative process, it will develop language for key elements of statutory provisions that require ultimate parents of MNC groups to file the CbC Report in their jurisdiction of residence.

MNC groups required to file the CbC Report

The Guidance recommends that all MNC groups be required to file the CbC Report each year, subject to one exemption which would apply to MNC groups with annual consolidated group revenue in the immediately preceding fiscal year of less than €750 million (or a near equivalent amount in domestic currency). The guidance states that the OECD believes this exemption will exclude approximately 85-90% of MNC groups from the CbC reporting requirement, but will require CbC Reports from MNC groups controlling approximately 90% of corporate revenues.

The results of Action 13 are scheduled for full review in 2020 and the OECD set out in the guidance that it is the intention of the countries participating in the BEPS project to reconsider the appropriateness of this revenue threshold at that point. That review also will include whether additional or different data should be required to be reported. The guidance also indicates that it is considered that no other exemption from filing the CbC

1 See EY Global Tax Alert, *OECD releases report under BEPS Action 13 on Transfer Pricing Documentation and Country-by-Country Reporting*, 23 September 2014.

Report should be adopted. It states that, in particular, there should be no special industry exemptions, no general exemption for investment funds, and no exemption for non-corporate entities or non-public corporate entities.

It is noted, however, that the countries participating in the BEPS project agree that MNC groups with income derived from international transportation or transportation in inland waterways that is covered by treaty provisions which are specific to such income and under which taxing rights on such income are allocated exclusively to one jurisdiction should include the information required by the CbC template with respect to such income only with respect to the jurisdiction to which such taxing rights are allocated.

Necessary conditions for obtaining and use of the CbC Report

With respect to confidentiality, the OECD notes that jurisdictions should provide and enforce legal protections of the confidentiality of the reported information. Such protection would preserve confidentiality to an extent at least equivalent to the protections that would apply if such information were delivered to the jurisdiction under the provisions of the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, a tax information exchange agreement, or a tax treaty that meets the internationally agreed standard of information upon request. These protections include limitation on the use of information and rules on persons to whom the information may be disclosed.

With respect to consistency, jurisdictions should use their "best efforts" to adopt a legal requirement that the ultimate parent entities of MNC groups that are resident there prepare and file the CbC Report (unless exempted under the revenue threshold). In addition, jurisdictions should use the standard template as set forth in the OECD Transfer Pricing Guidelines (and included in the Action 13 Report).

With respect to appropriate use, jurisdictions should use the information in the CbC Report only as specified in the Action 13 Report. In particular, jurisdictions will commit to use the CbC Report for assessing high-level transfer pricing risk and may also use it for assessing other BEPS related risks. Jurisdictions should not propose adjustments on the basis of an income allocation formula using data in the CbC Report. Jurisdictions further commit that, if such adjustments are made by the local tax administration, the jurisdiction's competent authority will be required to promptly concede the adjustment in any relevant competent authority proceeding. However, jurisdictions would not be prevented from using the CbC Report data as a basis for making further inquiries into the MNC's transfer pricing arrangements and other tax matters during a tax audit.

In this regard, the guidance notes that the mutual agreement procedure (MAP) will be available when government exchange of the CbC Reports is based on tax treaties. Where the government exchange is under an agreement that does not contain MAP provisions, countries commit to developing a mechanism for competent authority procedures for discussions aimed at resolving cases of "undesirable economic outcomes."

Framework for government-to-government mechanisms to exchange CbC Reports

In its latter stages, the document describes a framework under which jurisdictions should require, in a timely manner, the filing of CbC Reports by the ultimate parent entities of MNC groups resident there and exchange this information on an automatic basis with the jurisdictions in which the MNC groups operate and which fulfill the conditions discussed above. It indicates that, if a jurisdiction fails to provide information to another jurisdiction, a secondary mechanism would be accepted as appropriate, through local filing or by moving the obligation for requiring the filing of CbC Reports and automatically exchanging such information to the next tier parent country.

The guidance further indicates that countries participating in the BEPS project have agreed to develop an implementation package for the government-to-government exchange of CbC Reports. This will involve the development of the key elements of domestic legislation requiring the ultimate parent entity of an MNC group to file the CbC Report in its jurisdiction of residence. Key elements of the secondary mechanisms noted above also will be developed. Jurisdictions then will adapt this language to their own legal systems where necessary.

In addition, implementing arrangements for automatic exchange of CbC Reports under international agreements will be developed. This will include developing competent authority agreements based on existing international agreements, with both bilateral and multilateral approaches explored and using the model of the OECD standard for automatic exchange of financial account information. The Guidance states that this implementation package will be available by April 2015.

Finally, the guidance indicates that participating countries will endeavor to introduce any necessary legislation in a timely manner and are encouraged to expand the coverage of their information exchange agreements. The implementation of the package will be monitored and taken into consideration in the 2020 review.

Implications for the tax function

The agreement on these implementation matters with respect to the CbC Report is an important development. It reaffirms the expectation that many countries will move forward with such requirements, consistent with the OECD recommendations. MNC groups should therefore closely monitor developments with respect to the CbC Report, and transfer pricing documentation requirements more generally, in their parent company's home jurisdiction and also in the home jurisdictions of other group members.

In addition, companies should focus on the necessary steps to ensure their ability to produce the required information, including preparing protocols for gathering the information and developing internal processes and responsibilities with regard to the new reporting. With this new guidance indicating that the first required CbC Report is to cover the 2016 fiscal year, it is important that companies begin their preparations sooner rather than later. Companies will need to assess whether their tax function is "transparency ready " in terms of meeting the rapid flow of new reporting and disclosure requirements – whether at OECD, European Commission, sector or national level (such as Mexico's new requirement to report significant transactions).

Indeed, interim solutions may need to be implemented in advance of more complex, tailored ERP linking and data warehousing solutions that are specifically designed for the task at hand. Current experience shows that even some of the most well-known global companies are reacting to the changing landscape with manual processes based upon email, spreadsheet-based data capture and storage of a snapshot of data outside traditional ERP systems or data warehouses.

This is a natural first step in advance of the formal software market catching up. This market is now reacting and solutions will be available. But so long as good governance and robust processes (including remediation, where appropriate) underpin data collection and analysis, this is an apposite initial solution, even if not the most efficient.

For many companies, the required skill will be in marrying up a year one solution at the same time as developing more sustainable approaches for future years that are grounded in automated data collection, fit for purpose data warehousing and sophisticated data analytics capabilities.

How to assess the data

While the risk assessment of financial and tax data varies depending on a number of different factors and no two situations are the same, some general conclusions can be drawn. The reporting obligations under the BEPS Action 13 (though not the only new reporting obligations for taxpayers) provide a robust illustration of some of the types of questions that business leaders should ask themselves when risk assessing the information they may submit. These include, but are certainly in no way limited to:

- How much information should the company submit? What is the balance providing sufficient information for tax authorities to make an informed decision about transfer pricing risk against the time and cost involved in producing the reports?
- Should parent company or local company GAAP be used as a basis for reporting?
- Can the supply chain be diagrammed and can the company provide a functional analysis of each of the nodes of the supply chain for the top five products and/or all products with more than 5% of sales?
- Is the company prepared to include royalty income, interest income and services income in revenue disclosures?
- Can the company manage the possibility that we may have different accounting periods for different entities in different countries?
- How can the company manage the possibility that financial data may be stored in different currencies?
- Can the company explain its transfer pricing compliance succinctly and consistently? Do you have a written transfer pricing policy with respect to intangibles and R&D? Do you need to change your advance pricing agreement (APA) strategy?
- Can the company disclose financial information and allocation schedules on a per-country basis showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements?
- How can the company avoid misinterpretation of data, such as reporting ordinary profits in addition to profits after extraordinary items?
- Does the company have accurate information on global operations – including headcount, revenues and profits by country?
- Has the company identified features listed as potentially indicative of transfer pricing risk?
- Does the company have significant transactions with a low tax jurisdiction?
- Does the company have transfers of IP to related parties?

Concluding thoughts

Beyond the implications for individual businesses, it's clear that current developments around the world are rapidly making tax transparency a reality. But as revolutionary as the transparency journey has been, it also demonstrates that many businesses must now deal with a completely disparate set of information reporting requirements. In that vein, while Action 13 is clearly front and center for all companies of a certain size, it is not the only new obligation that companies will be required to meet. Indeed, according to respondents to EY's 2014 *Tax risk and controversy survey*, 94% of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years. That means that transparency readiness has never been more important! Conversations with company management, finance and IT leaders should begin immediately, if not already underway.

EY report: 2014 Global transfer pricing tax authority survey

Our latest *Global transfer pricing tax authority survey* reviews transfer pricing (TP) practices and attitudes of tax authorities in 50 jurisdictions across the Americas, Asia-Pacific and Europe. Topics highlighted include transactions and industries of focus, penalties, dispute resolution options, influences on local developments and approaches to comparables benchmarking.

Our survey highlights the fact that TP will continue to be "front of mind" for both tax authorities and multinationals. Tracking trends, obtaining timely information on the TP environment and being ready to respond to an inquiry will be critical to effective risk management.

Key survey trends include:

- There has been a clear spike in TP resources in tax administrations, leading to a general increase in the number of tax inquiries and audits.
- Business restructurings are now increasingly a driver of tax authority scrutiny.
- The OECD's BEPS agenda is a key underlying influence on the methods being adopted by tax authorities when performing inquiries and audits. This includes the nature of information being requested, the use of profit and risk-based assessments when selecting cases and focusing on the returns derived from intangibles.
- On a global scale, industries that have attracted particular attention from tax authorities include pharmaceuticals, automotive, financial services in Europe and natural resources in territories that extract or trade these.
- Tax authorities continue to call for the use of local country comparables with respect to benchmarking, although wider regional analyses are typically accepted if sufficient local comparables cannot be identified.

Access the survey at
www.ey.com/TPsurvey

- Transfer pricing penalties are becoming more commonplace, but they can be reduced when taxpayers maintain local transfer pricing documentation.
- Formal Advance Pricing Arrangement programs are available in a wider number of territories, although the take up in new markets has typically been low to date.
- While the Mutual Agreement Procedure program is used widely in most mature TP jurisdictions, its use and effectiveness is limited in many emerging territories.
- The determination of importation prices separately by transfer pricing and customs valuations teams within Governmental bodies is still the norm. While there is some informal sharing and integrated audits, this is not commonplace.

Actions recommended for business

Corporate taxpayers face more transfer pricing challenges from empowered authorities, not only because of increased resourcing, but also from a wider range of tools outlined within the BEPS Action Plans. In order to meet the increased level of activity from tax authorities, we recommend that companies more effectively manage their transfer pricing risk profile in the following ways:

Get ready. Be proactive in identifying areas of risk by actively assessing if your transactions may attract special attention from authorities.

Examine your business. Understand business changes, what the TP impacts could be, and monitor if existing TP models can continue to be applied or if they need to be adapted.

Respond. As transparency demands will increase, put in place strategies and documentation platforms to be able to respond to enquiries as they arise.

Focus. The performance of multi-sided analyses, including a focus on the returns on intangibles, is becoming a clear requirement to be adopted.

Engage. You can enhance your pre-emptive defense strategies in key markets by engaging with local tax authorities where available, such as through APAs or other rulings.

in the spotlight

OECD holds public consultation on BEPS Action 14 on improving dispute resolution

Rob Hanson

Global Director – Tax Controversy
T: +1 202 327 5696
E: rob.hanson@ey.com

On 23 January 2015, the Organisation for Economic Co-operation and Development (OECD) held a public consultation in connection with the Base Erosion and Profit Shifting (BEPS) project that was focused on Action 14 on improving the effectiveness of dispute resolution mechanisms. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the work on this Action and to share their views on the 18 December 2014 discussion draft on the same action which was met with significant disappointment from business.

That discussion draft identifies obstacles that are preventing countries from resolving treaty-related disputes through the Mutual Agreement Procedure (MAP) and proposed a series of options for addressing those obstacles. The discussion draft stated that "there is no consensus on moving towards universal mandatory binding MAP arbitration." The OECD received over 400 pages of comments on the discussion draft, which are posted on its website.[1] On-demand video of the public consultation is also available on the OECD's website.[2]

The public consultation

The 23 January 2015 consultation was a dialogue among stakeholders, country tax officials, and the OECD Secretariat on key issues and concerns raised in the comments. The consultation was hosted by OECD Working Party 1, which has responsibility for the OECD's work on tax treaty matters. This working group also has responsibility for other BEPS Actions, including the work on preventing treaty abuse (Action 6) and on preventing the artificial avoidance of PE status (Action 7), which were the subject of public consultations during the same week.

Delegates from 13 countries participated in the consultation. Also participating were business representatives from around the world, including EY representatives, and representatives of non-governmental organizations (NGOs).

Opening remarks

The consultation began with opening remarks from the Belgian delegate who chairs the subgroup on Action 14. She stated that the recommendations from the BEPS project may result in increased uncertainty. She observed that dispute resolution mechanisms are not always functioning as effectively as they should, as evidenced by the increase in pending MAP cases and MAP cases that are not effectively resolved or are withdrawn. She also described the three elements of the mandate the subgroup expects to deliver:

(1) Political commitment to effectively eliminate double taxation

(2) New measures to improve access to the MAP and improved MAP processes

(3) A mechanism to monitor the proper implementation of the political commitment. She noted that the discussion draft focuses mainly on element (ii). With respect to arbitration, she stated that mandatory arbitration is considered to be an efficient tool, but has not been advanced further by the subgroup in the discussion draft because some countries are opposed to it.

The representative of the OECD's Business and Industry Advisory Committee stressed that a "political commitment" alone is not sufficient. He further expressed the view that the Forum on Tax Administration's (FTA) MAP Forum should be involved in the work on Action 14. He stated that binding arbitration must be included in the general standard for countries that are fully committed to avoiding double taxation, despite concerns about arbitration expressed by some countries. He further noted that sufficient resources and proper authority must be provided so that the MAP can be used to effectively and efficiently resolve cases.

[1] http://www.oecd.org/tax/dispute/public-comments-action-14-make-dispute-resolution-mechanisms-more-effective.pdf

[2] http://video.oecd.org/?action=video&id=1461

General discussion

Commentators described progress on Action 14 as crucial for the success of the BEPS project. They further stated that the success of the BEPS project will require that countries are willing to fully support the BEPS project and that businesses are willing to fully accept its outcomes. Commentators suggested that a country may not be willing to adopt certain BEPS recommendations if they are viewed as giving a strategic advantage to another country, either in terms of enhanced revenue viewed as taken from the first country or in terms of favoring local taxpayers. Therefore, commentators reasoned that a robust and widely supported dispute resolution mechanism aimed at ensuring a fair and predictable application of the newly agreed standards could give countries confidence that their tax base can be protected from the unilateral actions of other countries, and, in turn, the confidence to adopt recommendations produced by the BEPS project. Commentators further suggested that the BEPS recommendations will likely raise taxes on many businesses and impose significant new reporting and compliance burdens. If the recommendations also significantly increase cases of double taxation that cannot be effectively resolved, businesses may not feel they are being treated fairly in the BEPS project and "cooperative compliance" may break down due to loss of trust between businesses and governments. Therefore, an improved dispute resolution mechanism is essential from the perspective of business.

Mandatory binding arbitration

The bulk of the comments focused on the urgent need for agreement on mandatory binding arbitration. Commentators noted that BEPS-driven disputes are happening already. They viewed the discussion draft as not going far enough, noting that minor changes will not make the difference needed and encouraging the working group to be more ambitious. Several commentators noted how successful the arbitration provision in the treaty between Canada and the United States has been in improving the resolution of MAP cases.

Some commentators expressed the view that there is no proven alternative to arbitration in improving dispute resolution. Some indicated that mediation could be a second best option for countries that have sovereignty concerns about arbitration; others viewed mediation as not likely to contribute much to dispute resolution. A member of the OECD Secretariat agreed that mediation may not be a productive step.

Some statements were made regarding the lack of a common understanding about what type of arbitration would be appropriate. Some commentators noted that the design of the arbitration approach is key. Support was expressed for use of the "last best offer" approach. There was some discussion about commercial arbitration approaches, but commentators noted that such approaches raise concerns among governments. The OECD Secretariat member expressed the view that the "last best offer" approach is favored as it is faster and less expensive.

Publication of MAP results

An NGO representative stated that dispute resolution can only address a small percentage of matters and that therefore there is a need for rules that are clearer and easy to administer. In this regard, he described the transfer pricing rules as part of the problem. The NGO representative expressed the view that publication of MAP results is central to fairness and a principled tax system, objecting to what he described as a closed community deciding things behind closed doors. He cautioned that the discussion should not jump straight to arbitration with no basis for confidence in the outcome.

Improving MAP

In addition to the substantial focus on the need for arbitration as a dispute resolution mechanism, there also was some discussion of other ways to improve the operation of the MAP. Commentators called for the competent authority function to be independent and to be adequately funded. The suggestion was made that the recommendations reflected in the OECD Manual on Effective Mutual Agreement Procedures (MEMAP), which are viewed as valuable, should be made part of the commentary to the OECD Model Tax Convention. Several commentators also noted that the tone of the discussion draft should be elevated by replacing language stating that "countries could consider" the various MAP improvement options with language that states that countries "should" or "must" adopt the options. Some commentators stated that all countries should publish MAP statistics in order to better inform their treaty partners and businesses.

In addition, commentators stressed the importance of taxpayer involvement in resolving MAP cases, especially in MAP cases dealing with transfer pricing. It was explained that this is because the most time consuming aspect of a MAP case is getting a full understanding of the facts. As the taxpayer is the party that has the best knowledge, the involvement of the taxpayer in, for example, face-to-face meetings to answer questions on facts would be beneficial. Furthermore, commentators noted that the option of multilateral MAP cases was considered a useful tool for global operating companies that adopt global allocation models (e.g., for head office expenses).

The OECD Secretariat member noted that many of the issues raised in the consultation were previously considered by the OECD and that the guidance reflected in the MEMAP is relevant. However, the actual implementation of this guidance could be improved. The aim of the discussion draft was to identify areas in which these improvements could be made.

Some country delegates stated that current dispute resolution mechanisms are not as effective as they should be and recognized that the BEPS project will put more pressure on those mechanisms. In this regard, however, it was suggested by some that the resources needed to make improvements to the MAP may not be available as the other recommendations from the BEPS project are being implemented.

Closing remarks

Another member of the OECD Secretariat concluded the consultation with some high-level points. She noted that it became clear in the consultation that the business community believes the BEPS project will lead to a tsunami of new MAP cases and she stated that the OECD must address this perception. She also noted that real political commitments are required to improve the MAP. In this regard, mandatory binding arbitration is viewed by the business community not as a "silver bullet" but the "gold standard," as it will not solve all the issues but will have a positive effect. She referenced the discussion about types of arbitration approaches and also the question of whether arbitration decisions should be published in some form.

The OECD Secretariat member indicated that it is clear that the business community views Action 14 as critical to the success of the BEPS project and stressed that the OECD will treat it as such. In addition, she stated that the OECD should not look at dispute resolution in isolation. The OECD should focus on both the technical aspects of BEPS and the clarity and administrability of its recommendations. Finally, she noted that MAP statistics are useful but cautioned that not all countries provide statistics and that the information that is provided can be difficult to understand.

In terms of next steps, the working group was scheduled to meet in March to discuss modifications to be made to the discussion draft.

Implications

The discussion at the consultation underscored the business community's deep disappointment that the discussion draft on Action 14 did not include agreement on arbitration, which is viewed as a necessary mechanism for resolving disputes. This is particularly concerning in light of the expectation that recommendations under other BEPS Actions will increase disputes and the associated risk of double taxation.

Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration noted on a 12 February 2015 OECD webcast[3] that, after receiving written comments and feedback from the public consultation, it is clear that the current discussion draft is inadequate. He indicated that changes will be made to expand the scope and modify the conditions related to dispute resolution to prevent double taxation. He reiterated that there is no consensus with respect to arbitration, but said that the working group is currently looking at options, including a stringent peer review proposal that has the endorsement of the G20. In this respect, Saint-Amans highlighted the agreement adopted in the last Committee of Fiscal Affairs meeting where all countries decided to make progress towards achieving an effective and efficient dispute resolution procedure in the context of tax treaties.

[3] http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-hosts-sixth-webcast-update-on-BEPS-project

EY report: Managing operational tax risk

Download the report at
www.ey.com/taxriskseries

Our first 2014 *Tax risk and controversy survey* identified four heightened sources of risk — reputation, legislative, enforcement and operational — based on results from 962 tax and finance executives in 27 countries, including more than 130 chief financial officers.

Managing operational tax risk is our second report in this series. Using the survey results, inputs from tax function leaders and EY professionals, it provides a deeper exploration of the many sources of "operational" tax risk. We define operational tax risk as those arising inside the organization from the people, policies and processes and technology.

In this report, we examine what companies are doing with the resources they have now, as well as how they build flexibility and resilience. We also investigate the divide that some companies may have to cross as they move from current to future tax risk management models.

Finally, we identify eight key components of an optimal tax framework that can be adopted to mitigate operational tax risks and achieve control, value and efficiency across the entire record-to-report process.

The fact is, now is the time for businesses to make sure their tax functions have the right people, processes and technology in place. Getting things right the first time can pay dividends — from higher levels of control, greater efficiency and value in the tax function to reducing the incidence of risk.

in the spotlight

OECD holds public consultation on BEPS Actions 8-10 on transfer pricing

Ronald van den Brekel

International Tax Services
T: +31 88 407 9016
E: ronald.van.den.brekel@nl.ey.com

On March 19 and 20, 2015, the Organisation for Economic Co-operation and Development (OECD) held a public consultation in connection with the Base Erosion and Profit Shifting (BEPS) project that was focused on Actions 8 through 10 on transfer pricing, specifically risk and recharacterization, profit splits, commodities, and low value-adding services. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the OECD's transfer pricing work.

The OECD issued several discussion drafts in late 2014 on transfer pricing aspects of the BEPS project. On December 19, 2014, the OECD issued a discussion draft, *BEPS Actions 8, 9 and 10: Discussion draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterisation and special measures).*[1] The document consists of two parts. Part I is a proposed revision to Section D of Chapter I of the OECD Transfer Pricing Guidelines, which emphasizes the importance of accurately delineating the actual transactions and contains guidance both on the relevance and allocation of risk and on recharacterization (or non-recognition), including criteria for determining when it would be appropriate for the actual transaction not to be recognized. Part II sets out five options for potential "special measures" in connection with intangible assets, risk, and over-capitalization.

On December 16, 2014, the OECD issued a discussion draft, *BEPS Action 10: Discussion draft on the use of profit splits in the context of global value chains*.[2] The document addresses nine scenarios in which, in the OECD's view, it may be more difficult to apply one-sided transfer-pricing methods to determine transfer-pricing outcomes that are in line with value creation such that application of a transactional profit split method may be appropriate.

Also on December 16, 2014, the OECD issued a discussion draft, *BEPS Action 10: Discussion draft on the transfer pricing aspects of cross-border commodity transactions*.[3] The document proposes additional guidance in Chapter II of the OECD Transfer Pricing Guidelines that address cross-border commodity transactions.

On 3 November 2014, the OECD issued a discussion draft, *BEPS Action 10: Proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services*.[4] The document contains proposed modifications to the OECD Transfer Pricing Guidelines relating to such services.

The OECD received over 2,000 pages of comments on these discussion drafts, which are posted on its website.

The public consultation on March 19-, 2015 was a dialogue among stakeholders, country tax officials, and the OECD Secretariat on key issues and concerns raised in the comments to these transfer pricing discussion drafts. The consultation was hosted by OECD Working Party 6, which has responsibility for the OECD's work on transfer pricing matters.

Approximately 270 participants representing over 43 governments; multinational businesses, industry bodies and advisors, including EY representatives; and non-governmental organizations (NGOs) participated in the two-day consultation. The consultation was live-streamed by the OECD and a recording is available on the OECD website.

[1] See Tax Alert 2014-2330.

[2] See Tax Alert 2014-2279.

[3] See Tax Alert 2014-2293.

[4] See Tax Alert 2014-1966.

The consultation: Opening remarks and general comments

The consultation began with opening remarks from the Canadian delegate who chairs Working Party 6. She stated that the aim of the working party is to arrive at consistent, balanced guidance.

A representative of the Business and Industry Advisory Committee (BIAC) expressed the view that the arm's-length standard, when properly applied by both taxpayers and governments, offers the best prospect of classifying transactions according to "real-world" economics and equitably and consensually dividing income between countries based on economic activity.

Concerns were expressed that a broad interpretation of "BEPS principles" could be used to justify new unilateral theories and the automatic application of non-arm's-length approaches in routine situations. Therefore, elements of the proposed guidance covering areas that are ambiguous were welcomed. Such guidance, however, should build on established concepts rather than new concepts such as "moral hazard."

Recharacterization, or "special measures," which recasts a contract or other legal arrangements from the form agreed by the parties into a new and different form, may be justified in extreme cases, but only when other alternatives, particularly the proper application of transfer pricing principles, have been tried and failed. Concern was expressed that there is a risk that a broad population of companies could be required to apply rules that are targeted at a very small number of cases involving BEPS.

It was stressed that it is of the utmost importance that the OECD design effective mechanisms to resolve double taxation.

Risk and recharacterization

The US delegate, who co-chairs the work on risk and recharacterization, opened the discussion by indicating that the proposed rewrite of Chapter I of the OECD guidelines places emphasis on accurately delineating transactions by functional analysis of conduct and not necessarily respecting contractual arrangements. While there seemed to be consensus that there is a need to recognize the "real deal" of parties' arrangements, many commentators requested greater clarity on the types of situations when contractual terms would not be respected. Concerns were raised that the current draft proposals could result in tax authorities' having too much discretion as to respecting contracts, which could lead to double taxation.

The delegate from Italy asked business participants whether they believe there should be a hierarchy in comparability factors, putting more weight on contracts than on other factors. He also questioned whether contracts are helpful in analyzing the value chain when functions are performed at various places.

The OECD Secretariat put forward similar questions. In the OECD's view, the contract is the context for interpreting the functions performed. From that perspective, does the order matter? When interpreting facts, should a different weight be put on contracts as a fact than on functions performed? For the OECD, this is a very important issue, as the secretariat believes that there should be some way for tax authorities to verify the contractual allocation of risk.

The delegate from France expressed the view that contracts have to be respected, except in specific circumstances. He also indicated that the working party is aware that looking for the "real deal" may increase the instances of double taxation. He stressed that the working party should carefully draft the guidance to avoid double taxation.

Business commentators requested re-wording of the somewhat negative connotations in the re-draft of Chapter I, which could imply that intra-group transactions, or transactions with lower-tax jurisdictions, should automatically be treated with more rigorous scrutiny than external transactions or transactions with higher-tax jurisdictions. Businesses expressed the view that this should not be the case when conduct aligns with contractual terms.

The OECD's revised Chapter I also includes more comprehensive guidance on defining risk and the allocation of risk between group companies, either under contractual arrangements or as a result of conduct. The draft guidance is focused on aligning risks with functions in order to prevent BEPS, such that risks, and the reward to capital supporting risks, are allocated to functions that are capable of controlling, managing, and monitoring such risks. Specific input was requested by the country delegates on the notions of control and management of risk, in particular a comparison with similar notions in the existing Chapter IX of the OECD Transfer Pricing Guidelines.

There was much discussion of the OECD's proposals regarding non-recognition of transactions. Business commentators expressed concern that the guidance is not explicit enough in determining under what circumstances non-recognition would be permitted. In particular, clearer, less nuanced examples were requested to illustrate the boundary of the proposed rules. Many commentators felt that without better examples, the threshold for recharacterization could be too low.

Businesses stated that the current proposals would place a significant additional compliance burden on taxpayers in delineating many more, or even all, transactions and that instead the burden of proof that a contract is not accurately delineated or should not be respected should be on the tax authorities.

Special measures

In addition to revising Chapter I of the OECD Transfer Pricing Guidelines, the OECD has proposed options for the introduction of "special measures" to further address BEPS concerns. Many business commentators expressed the view that, with the exception of "Option 1: Hard-to-value intangibles," the other four options extend beyond the arm's-length principle and could not therefore be implemented through the transfer-pricing guidelines. These options include addressing "inappropriate" returns for providing capital, "thick" capitalization, minimally functional entities, and ensuring taxation of excess returns. Such proposals represent fundamental changes to the existing taxation principles and would likely result in double taxation. Several commentators expressed concern that the current options for special measures outlined by the OECD are not detailed enough at this stage and that it is premature to discuss them without first considering the conclusions of the work currently underway on transfer pricing and other BEPS actions, including the work on controlled foreign companies.

Overall the OECD seemed to recognize that capital and risk are the "stock in trade" for financial services businesses and that it may be necessary to consider these businesses differently in the context of risk, recharacterization and special measures.

Profit splits

In the discussion draft on profit-split methods, the OECD invited clarification on the use of those methods in the context of global value chains. Building on the revised Chapter I draft, and looking at the accurate delineation of transactions through aligning functions, assets and risk, the OECD recognizes the difficulty in establishing comparables for certain transactions. As such, the OECD believes a profit-split method may be the most appropriate transfer-pricing method. The discussion draft recognizes that profit splits typically are applied in global trading and other integrated financial services businesses.

The OECD stressed that it is not making any suggestions or recommendations at this stage as to the use of profit splits but is instead looking to better understand experiences and views. In particular, the OECD wants to understand the relevance and context of third-party arrangements close to profit-split methods, especially in the context of understanding the role of capital. The country delegates expressed some diverging views. The US delegate stated that it is very important to perform an analysis based on Chapters I and III of the OECD Transfer Pricing Guidelines and that the most appropriate method should still apply. One should not simply conclude that the existence of a global value chain implies that the profit-split method should apply.

Business commentators expressed a similar view. They also stated that both losses and profits should be referenced in the guidance as allocable under any profit-split method because the upsides and downsides of operating as a global group need to be allocated.

Other country delegates seemed to welcome further guidance on applying profit-split methods, noting that reliable comparables can be difficult to find.

Some business commentators felt that transactional profit-split methods are complex to apply and maintain in practice, as such methods often would be outside the group's finance system. In some circumstances, for example, in the context of acquisitions or groups with divisional-based data, it can be difficult to access data. This likely would lead to increased disputes between taxpayers and tax authorities. Many delegates expressed concerns that global formulary apportionment could result.

Intragroup services

The session on intragroup services addressed the proposed revisions to Chapter VII of OECD Transfer Pricing Guidelines on those services, particularly the proposal to define a certain class of "low value-adding" services as eligible for simplified treatment in cost allocation and recharging models.

The comments focused on the need for the guidance to support businesses in achieving deductions for all costs, noting that service-provider jurisdictions currently tend to argue for a wide definition of services and service-recipient jurisdictions argue for a much narrower one, often suggesting that intragroup services do not provide benefit locally.

Some commentators requested that the OECD provide greater flexibility in the guidance on the definition of services that may qualify for the special "low value-adding" treatment, noting that some activities that the discussion draft excludes from such definition could in fact be routine and add little value. Specific examples given included activities of senior management and contract R&D services. Other commentators suggested that the OECD should provide a comprehensive list of services that would be treated as "shareholder" services deemed to be performed for the benefit of the ultimate parent in its capacity as a shareholder of the group. The costs of such services would not to be charged to group members.

Commentators also noted that the suggestion that all low-value adding services should be accumulated in one cost pool and subject to a single mark-up might be difficult to apply in practice. Some suggested that a divisional approach with divisional cost pools might be more appropriate and practical to apply.

The discussion that followed focused on several points that currently cause difficulties for multinational groups. Business commentators argued that the language at paragraph 7.35 of the discussion draft, which suggests that it may be appropriate to compare the costs of services being charged with the hypothetical costs of obtaining similar services in the local market, should be amended, as it is a highly subjective test and would likely lead to disputes in practice.

There was a discussion about the appropriate level of mark-up. Business commentators were concerned that the interaction and inconsistency with other guidance might lead to difficulty in practice in applying the OECD's guidance on mark-ups for low value-adding services. For instance, under the US services cost method, some services may be recharged at cost, whereas some territories either have statutory mark-ups or in practice apply minimum mark-ups.

The US delegate responded to some of these points. On the question of mark-up, the delegate noted that the real issue is in which country the base costs are deducted. For low value-adding services, the US view was that the level of mark-up is too immaterial to debate. The delegate also noted that, although businesses would find it helpful to have a list of low value-adding services identified, it is not practical for the OECD to do so because the context and circumstances in every case would determine whether a service is a low value-adding service.

Transfer pricing of commodity transactions

In the discussion draft on the transfer-pricing aspects of cross-border commodity transactions, the OECD advocates the use of the CUP method for pricing cross-border commodity transactions and suggests that quoted prices can form a suitable CUP in many circumstances. When a taxpayer has based the price for a transaction on the quoted price on a specified date, but the tax authorities cannot determine that the transaction actually took place on that date, the OECD suggests that tax authorities should be permitted to substitute a "deemed-pricing date", such as the bill of lading date for a cargo shipment, similar to the so-called "sixth method" that tax authorities in some emerging countries are now using.

Commentators representing the oil and gas industry noted that the use of the CUP method, while appropriate in some instances, would not be suitable in every case. For oil and gas, it was noted that there are often multiple different quoted prices for the same commodity and judgment is needed in determining which one should be used. It was also noted that quoted prices for physical delivery of commodities rarely represent the actual price paid, because there are almost always quality and delivery premiums or discounts. Finally, the use of a CUP or quoted price in many circumstances would not be appropriate because it ignores the value created by the activity of traders who hedge commodity price risk. In some cases, a "netback" price is viewed as more appropriate.

For agricultural commodities, two commentators representing Latin American grain producing businesses strongly criticized the sixth method used in some countries. They noted that a grain shipment might be sold up to a year in advance and that the floating market price could move substantially from one harvest to the next. The problem they highlighted with the sixth method is that, in practice, it seems to allow tax authorities to choose the most advantageous option, either accepting the price used or substituting the index price on the deemed pricing date if higher. They suggested that, rather than a deemed pricing date, countries should establish a contract registry and make it a legal requirement for commodity producers to register the contracts with the registry on the date they are entered, thereby eliminating disputes over the date on which the price for a related-party transaction was agreed.

Another commentator, focusing on the interests of developing countries, spoke in favor of the sixth method as a more practical alternative to the CUP. She argued that the advantages of the sixth method are that it is simple to apply in practice and it leaves very little room for debate over prices. Therefore, it is viewed by some as a practical tool for tax authorities in developing countries to use to ensure that they receive some tax revenue from the production activity in their countries.

Concluding comments

The chair of the working party concluded that the meeting provided useful input and thanked the participants for their input. The working party will discuss the comments at its next meeting. A common theme observed was that more clarity is needed. The OECD expects to issue revised discussion drafts on these transfer pricing topics in April.

Implications

The discussion at the consultation underscored the broad scope of the transfer-pricing changes the OECD is considering. The changes could significant affect global businesses. Moreover, countries already are applying some of the concepts in practice, even in advance of any changes in international transfer-pricing rules. Thus, it is important for companies to keep informed of developments in this area in the OECD and in the relevant countries in which they operate, to assess the implications of these developments for their business models, and to consider actively engaging with policymakers in this international tax debate.

Taking on taxes: The board's role in tax oversight

Access Board Matters Quarterly at **www.ey.com/bmqtax**


Board Matters Quarterly

Taking on taxes

The board's role in tax oversight

Tax has moved nearer the top of both the boardroom and newsroom agendas in the last few years. The media has been buzzing about the taxes companies pay, and all indications are that corporate taxes will remain a key issue in the coming years.

EY's 2014 *Tax risk and controversy survey* of large multinational companies shows that 89% are "somewhat" or "significantly" concerned about the media coverage of the taxes companies pay. Board members and C-suite executives told Lloyd's of London in a similar survey that uncertainty about current and future tax commitments is the biggest risk they face, according to the company's *Risk Index 2013*. Meanwhile, more countries are adopting legislation or modifying their laws to push tax issues into the boardroom, including laws that extend the responsibility for tax-significant transactions to boards of directors.

This issue of *Board Matters Quarterly* focuses on some of the key tax risks businesses face today. It outlines strategies, policies, checks and balances and technologies that can be put in place to manage the risks more effectively.

In this issue of EY's *Board Matters Quarterly* publication, we cover the following key topics:

- A wave of tax risks: developing the right tax strategy to meet rising challenges
- Global focus on tax base erosion and profit shifting: what boards should know about the OECD initiative
- Income tax accounting challenges can lead to errors: how the board and audit committee can help
- Managing tax controversy: identifying disputes early can reduce risk

in the spotlight

OECD releases 2013 Mutual Agreement Procedure statistics

Frank Ng

Executive Director –
Tax Controversy and
Risk Management Services
T: +1 202 327 7887
E: frank.ng@ey.com

On 25 November 2014, the Organisation for Economic Co-operation and Development (OECD) released its annual statistical publication on the Mutual Agreement Procedure (MAP) caseloads of all OECD member countries and partner economies for the 2013 reporting period.[1] The report covers opening and ending inventory of MAP cases for 2013, the number of new MAP cases initiated, number of MAP cases completed, cases closed or withdrawn with double taxation, and average cycle time for cases completed, closed or withdrawn.

[1] http://www.oecd.org/ctp/dispute/map-statistics-2013.htm.

Overall 2013 inventory

The ending inventory of MAP cases has steadily risen in the last few years as a result of the relatively large number of newly initiated cases, coupled with reduced closure rates. At the end of 2013, there were 4,566 cases in ending inventory, a 12% increase over 2012 and a 94.1% increase compared to the 2006 reporting period. Germany (858), United States (732) and France (618) had the largest ending inventory of MAP cases in 2013.

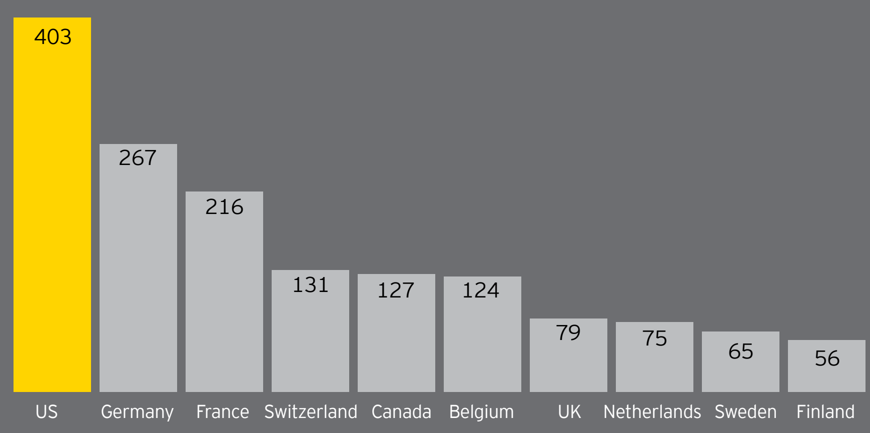
The separation of reported MAP cases into cases between OECD member countries and cases between OECD and partner economies continues to show that more than 90% of OECD member countries' MAP inventories are cases with other OECD member countries.

MAP cases initiated during 2013

According to the OECD data, member countries witnessed a 14% increase in new MAP cases initiated in 2013, rising to 1910 cases from 1678 in 2012. The United States experienced the largest overall number of new MAP cases of all OECD member countries (from 236 in 2012 to 403 in 2013) while New Zealand experienced the largest percentage growth of new cases, at 367% (an increase from 3 cases in 2012 to 14 cases in 2013). Table 1 below presents the 10 OECD member countries with the largest number of MAP cases initiated in 2013.

Table 1

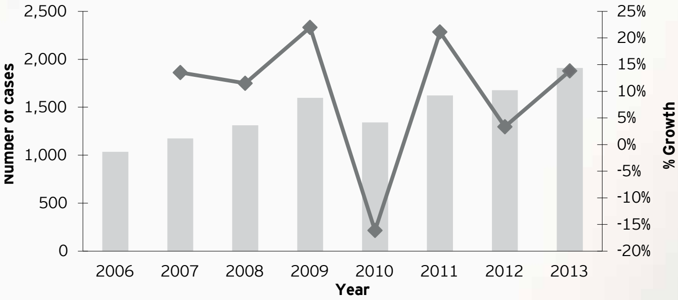
Countries with the highest number of new MAP cases in 2013



Source: OECD

The total number of MAP cases has increased steadily since 2008, other than declining slightly only in 2010. Figure 1 below presents the number of new cases initiated from 2006 to 2013, along with year-on-year growth rates.

Figure 1:
New MAP cases, 2006-2013



Source: OECD

MAP cases completed in 2013

While 1,910 new MAP cases were initiated in 2013, only 197 cases (including those with partner countries) were reported to have been completed in 2013. This is a reduction of approximately 30% from the 279 cases reported completed in 2012. While many of the 197 closed cases will have been initiated before 2013, the closure rate represents just 10.3% of the 2013 case initiation rate and only 4.3% of the total stock of open MAP cases.

The five countries completing the most MAP cases in 2013 were Luxembourg (27), Belgium (25), Netherlands (23), Sweden (23), and Switzerland (23). The United States did not report how many cases were closed in 2013.

Some MAP cases were reported to be closed or withdrawn with double taxation during 2013. The five countries with the highest ratios of cases closed or withdrawn with double taxation to cases closed are illustrated in Table 2 below.

Table 2:
Highest ratios of cases closed to cases closed or withdrawn with double taxation

Country	Number of cases closed	Number of cases closed or withdrawn with double taxation[2]	Percentage rate
Spain	1	3	300%
Germany	4	4	100%
Canada	9	3	33%
Netherlands	23	6	26%
Denmark	4	1	25%

Source: OECD

Average cycle time for cases completed, closed or withdrawn[3]

The average time for the completion of MAP cases with other OECD member countries in 2013 was 23.57 months, a reduction of the 2012 cycle time of 25.46 months.[4] Very few countries reported average cycle time in 2013, but interestingly, New Zealand, Portugal, Luxembourg and Netherlands all reported average cycle times average cycle time for completed, closed and withdrawn cases of less than three months.

Conclusion

The release of this data by the OECD is part of its effort to improve dispute resolution processes, in line with the Multilateral Strategic Plan on Mutual Agreement Procedures[5] launched by the Forum on Tax Administration, as well as Action 14 of the G201 OECD's BEPS (Base Erosion and Profit Shifting) Action Plan. Both initiatives set out to achieve more effective dispute resolution results and the availability of this data enables interested groups to access the effectiveness of the MAP processes in the OECD member countries and partner economies.

[2] The United States did not provide this data.
[3] Ibid.
[4] Not all countries reported average cycle time.
[5] http://www.oecd.org/site/ctpfta/map-strategic-plan.pdf.

Webcast replay: Addressing China's wave of new anti-avoidance measures

Replay the webcast at **www.ey.com/Notice7webcast**

Recent weeks and months have seen a broad range of key new anti-avoidance regulations and circulars from China's State Administration of Taxation. With revised general anti-avoidance rule (GAAR) guidance preceding the announcement of long-awaited Notice 7 on the indirect transfer of assets (replacing Circular 698), Friday, 27 February 2015 saw a group of EY tax professionals review the key developments and suggest actions for companies to consider.

Topics discussed included:

- China's Base Erosion and Profit Shifting (BEPS) position
- Administrative guidance on China's GAAR
- Release of the long-awaited Notice 7 on Indirect Transfer Regulations which replaces Circular 698
- A discussion draft on revised Tax Collection and Administration Law, which may pave the way for an advance ruling system
- Tax controversy trends in China — including new anti-avoidance investigations on service fee and royalty payments, and an internal notification on the examination of dividends paid to nonresidents

webcast

European Union update: A dark horse on the final bend?

Rob Thomas

Director – Tax Policy & Controversy
Ernst & Young LLP
T: +1 202 327 6053
E: rob.thomas@ey.com

A common sporting adage holds that it can be beneficial to not lead from the very start. Instead, a dark horse, on an outside lane and out of view for much of the course, can sometimes steam through at the last minute, upsetting the whole field. While many spectators have been fixated on the rapid succession of BEPS discussion drafts, public comments and consultations, 2015 sees the European Commission, under the leadership of a new President, Jean-Claude Juncker, and a new Commissioner for Taxation and Economic Affairs, Pierre Moscovici, launching measure after measure designed to tackle what they perceive as tax avoidance, unfair tax competition and base erosion. Is this the real thing, or is it fantasy?[1]

[1] With apologies to the rock band, Queen.

Some commentators have questioned whether, with all the BEPS work at the OECD, and the recent history of launching ambitious tax initiatives only to see them wither on the vine, the Commission has become largely irrelevant in this space. But in fact, the opposite may well be becoming true — the EU has become the motor for much of the work that is being done in the BEPS space. The Commission, in many ways, is picking up the baton on behalf of EU Member States and using its own momentum to forge many decisions on which the OECD has struggled to find consensus among its members.

So how best to structure and explain recent events, of which there have been bombardments? Alphabetically? Split them between transparency, anti-avoidance and harmonization initiatives? Between developments that are legislative in nature versus those that are non-legislative? None of these models are particularly attractive. The tried and tested chronological timeline may be a more fitting approach, although with developments typically spanning many months, we may need to jump around a bit.

December 2014: seeds of the next phase of action are sown

1 December 2014 saw the Finance Ministers of Germany, France and Italy send a joint letter to Pierre Moscovici. According to media reports, the letter called upon the Commission to rapidly develop a new EU Directive on anti-base erosion and profit-shifting issues, which they suggested should be presented for consideration before the end of 2014 (a virtually impossible task), with a view to EU Member States adopting the measures therein by the end of 2015. The ministers noted that the G20 and the Organisation for Economic Co-operation and Development (OECD) are already one year through a two-year-long comprehensive Base Erosion and Profit Shifting (BEPS) initiative, but also said that it is important that the EU should also adopt a common set of binding rules that go beyond greater transparency and company registries, to a "general principle of effective taxation" to stem the EU's lack of "tax harmonization."

According to the letter, these rules should include mandatory and automatic exchange of information on cross-border tax rulings (including Advance Pricing Agreements in the field of transfer pricing), a register identifying beneficiaries of trusts, shell companies and other non-transparent entities, and measures against tax havens.

Given that the EU is itself one of the 20 members of the G20, this issue was already on the Commission's agenda and these requests in fact provided a suitable prompt for the Commission to publish its own development plans. These plans were delivered on 16 December, embedded in the Commission's 2015 Work Programme.

Tax never used to figure that highly in the Work Programme and it's interesting that two out of the 23 key initiatives for the Commission in 2015 are tax issues. The first is the promised proposal for the disclosure of tax rulings between tax administrations, proposals for which were issued on 18 March 2015 (see below), while the second is the action plan on efforts to combat tax evasion and tax fraud. Reading the fine print, it's about building up a system that taxes profits in the country where they are generated. This will bring the discussion to the core of the BEPS Project.

The Commission has been quite explicit in saying that it aims to stabilize corporate tax bases in the EU, including relaunching work to establish a Common Consolidated Corporate Tax Base (CCCTB). This points to a push for the introduction of the Common Consolidated Corporate Tax Base (CCCTB), or at least a CCTB (i.e., without the consolidation). It's supposed to be a non-legislative initiative, so we might expect a communication that will set out ideas, with an argument that some kind of legislative underpinning in the form of a CCTB is essential.

Fast-forward to February 2015

Fast-forward by ten weeks and the College of Commissioners (the grouping of 28 Commissioners) commenced activity on what the Commission is describing as work for a "fairer and more transparent taxation approach within the European Union" with a first orientation debate where possible action points were discussed. According to a post-meeting press release, the Commissioners agreed that the main focus should be to ensure that companies pay their fair share of taxes in the country where economic activity generating the profit is based, by encouraging greater tax transparency.

In this respect, the Commission committed to present a Tax Transparency Package in March 2015, which would include a legislative proposal for the automatic exchange of information on tax rulings, which the Commission feels should enable Member States to share information about rulings with respect to their corporate tax regimes, ensuring that Member States should be able to determine where the real economic activity of a multinational is taking place and to apply tax rules fairly on that basis.

Pierre Moscovici, Commissioner for Economic and Financial Affairs, Taxation and Customs, illustrated just how serious the Commission is on opening up transparency in this area, saying that "abusive tax practices and harmful tax regimes breed in the shadows; transparency and co-operation are their natural foes. It is time for a new era of openness between tax administrations, a new age of solidarity between governments to ensure fair taxation for all. The Commission is fully committed to securing the highest level of tax transparency in Europe."

Several legislative and non-legislative measures to increase tax transparency were discussed at the meeting and will be included in the proposal to be presented in March. According to sources near to the Commissioners, serious consideration is being given to making the rulings info public (as opposed to between tax administrations) and also to providing be some degree of retroactivity.

Commission extends information enquiry on tax rulings practice to all Member States

Closely linked to the transparency package are the myriad state aid investigations currently underway within the Commission. On 17 December 2014, the European Commission (EC) announced that it has expanded its inquiries into the tax ruling practices under EU state aid rules, asking all EU Member States to provide full information on rulings made to all companies during the period 2010 to 2013. As background context to this development, since June 2013 the Commission has been investigating, under state aid rules, the tax ruling practices of several Member States. Of course, many countries provide rulings to taxpayers, including to taxpayers intending to make significant investments in a country, in order to provide certainty in advance on how transactions will be taxed. The question the Commission posed in earlier requests (the investigations of which remain ongoing) is whether specific rulings provided by the countries concerned are preferential rulings, giving discretionary incentives, or whether they simply set out for the taxpayer how the generally applicable law applies in their circumstances.

The information requests made by the Commission of several Member States in the last 18 months or so are driven by questions around whether a Member State's tax-reducing measures constitute state aid. The current EU state aid legal framework allows for the Commission to demand from the Member State a repayment of an illegitimately granted tax benefit respectively from the recipient of the illegitimately granted tax advantage, i.e., the ruling. Such a repayment could potentially be demanded with retroactive effect from when the benefit was first granted. Additionally, contingent on the individual case, the EU State Aid legal framework allows for the Commission to impose fines and penalties on the Member State. As part of this prior scrutiny, the Commission requested an overview of tax rulings provided by six Member States (Cyprus, Ireland, Luxembourg (two requests), Malta, the Netherlands and the UK). The Commission has also requested information from Belgium on certain specific tax rulings. Furthermore, the Commission has also requested information regarding intellectual property taxation regimes, so-called patent boxes, from the 10 Member States with such a regime (Belgium, Cyprus, France, Hungary, Luxembourg, Malta, the Netherlands, Portugal, Spain, and United Kingdom). In several cases, this scrutiny led to formal investigations.

The expanded inquiry

Under the expanded inquiry, the Commission has asked all EU Member States to provide information regarding their tax ruling practices, in particular to confirm whether they provide tax rulings, and, if they do, to submit a list of all companies that have received a tax ruling during the period 2010 to 2013. The press release announcing these developments, however, does not note whether the specific technical detail of each individual ruling must be supplied by the country concerned as well as the name of the company receiving such ruling.

A further development — scrutinizing Luxembourg

Fast-forward (again!) to February 2015, where, on the third of that month the Commission announced that it had opened an in-depth state aid investigation into Belgium's so-called excess profit ruling system. According to the Commission, the system allows group companies to substantially reduce their corporation tax liability in Belgium on the basis of "excess profit" tax rulings. Under this system, multinational entities in Belgium may reduce their corporate tax liability by those "excess profits" that the Belgian government believes result from the advantages of being part of a multinational group.

According to the Belgian tax provision under investigation (Article 185§2, b) *Code des Impôts sur les Revenus/ Wetboek Inkomstenbelastingen*), a company's tax may be reduced by "excess profits," which are profits registered in the accounts of the Belgian entity that allegedly result from the advantage of being part of a multinational group. These perceived advantages include intra-group synergies and economies of scale. In order for the deductions to apply, a company must secure a tax ruling from the Belgian tax administration.

European Commission concerns

In announcing their investigation, the Commission noted that they believe the scheme appears to only benefit multinational groups, while Belgian companies active only in Belgium may not claim similar benefits. In that regard, the Commission has doubts as to whether the tax provision complies with EU state aid rules, which prohibit the granting to certain companies of selective advantages that distort competition in the Single Market.

Speaking on this issue, Competition Commissioner Margrethe Vestager said: "The Belgian 'excess profit' tax system appears to grant substantial tax reductions only to certain multinational companies that would not be available to stand-alone companies. If our concerns are confirmed, this generalized scheme would be a serious distortion of competition unduly benefiting a selected number of multinationals. As part of our efforts to ensure that all companies pay their fair share of tax, we have to investigate this further."

The Commission notes its concern that the "excess profit" alleged under the tax rulings, (i.e., the deductions that a company may claim for), may significantly overestimate the actual benefits of being in a multinational group. According to the Commission's press release announcing the investigation, "deductions granted through the excess profit ruling system usually amount to more than 50% of the profits covered by the tax ruling and can sometimes reach 90%."[2]

Moreover, the Commission notes that their assessment of the excess profits regime thus far concludes that such a system cannot be justified by the objective of preventing double taxation as the deductions in Belgium do not correspond to a claim from another country to tax the same profits.

Having examined past administrative practice, the Commission notes that these tax rulings are "often granted to companies that have relocated a substantial part of their activities to Belgium or that have made significant investments in Belgium."

According to the Belgian authorities, this tax provision only implements the general OECD "arm's length" principle. However, at this stage the Commission has doubts that this interpretation of the OECD principle is valid.

Sources inside the Commission indicate that the scrutiny of Luxembourg will draw conclusions in a rapid manner. This is a good thing, as successive investigations of this type are rapidly raising uncertainty levels for business.

What can be said of all this?

Let's start with something less controversial: It is both fiscally and commercially prudent for businesses and tax authorities to agree about tax positions in advance rather than haggle over them many years later on audit or in the courts. These "cooperative compliance" agreements are endorsed and encouraged by the G20 and the OECD because they provide certainty to taxpayers and significantly reduce tax authorities' workload. And where certainty exists, investment follows.

So the EU Commission contends that some of the agreements between tax authorities and businesses are in breach of these State Aid rules. Yet, in the same cases where it has alleged selective favoritism, the Commission has not yet demonstrated there has been a departure from the "normal" tax rules for that jurisdiction or indeed that other businesses in the jurisdiction in question would not have been able to benefit from a similar agreement.

[2] http://europa.eu/rapid/press-release_IP-15-4080_en.htm

This thrusts the fundamental tension of the EU Commission's inquiry into the limelight: tax competition remains a sovereign right of EU member states, provided their policies don't harm others in the union. But the lack of a bright light defining what constitutes harm while simultaneously casting aspersion on agreements only introduces tax uncertainty into the region's economy. As India's experience with declining FDI since 2009 proves, tax uncertainty is one of the most sensitive variables guiding investment decisions.

The Commission may also be overstepping. The OECD has issued guidelines — not mandatory rules — allowing for countries to interpret them within their own practices. However, the Commission is overlooking countries' obligations by failing to interpret the guidelines on intercompany pricing within the context of the relevant jurisdiction; the Commission is, rather, suggesting that local country rules be replaced with newly constructed terminology and methodology as a basis for its investigations.

Whether tax competition in the cases targeted by the Commission has overstepped into the area of harmful practices is one thing. But practicality and sensibility must also be considered within the context of what is occurring. As noted, the State Aid rules allow for the Commission to demand from the Member State a repayment from the recipient (i.e., the taxpayer) of an illegitimately granted tax benefit respectively from the addressee of the illegitimately granted tax advantage. The rules further allow for penalties on Member States who have deemed to have transgressed. At a time when Europe's recovery is in jeopardy and the European Central Bank is actively buying bonds to the tune of €60b euros a month, taking money out of the system is undesirable, not least from the pure monetary effect but also from the serious knock it will have to business confidence. It will effectively be viewed as business being fined for something that countries told them was perfectly fair and legal in the first place.

That is a very dangerous precedent to set and, all things considered, I hope the Commission will consider the full and real impact of pursuing this line too far, and consider alternatives.

January 2015: A new GAAR for EU Member States

On 27 January 2015, the European Council[3] formally adopted a binding general anti-abuse rule to be included in the Parent-Subsidiary Directive (PSD). This new rule aims at preventing Member States from granting the benefits of the PSD to arrangements that are not "genuine," i.e., that have been put into place to obtain a tax advantage without reflecting economic reality. The clause is formulated as a "de minimis" rule, meaning that Member States can apply stricter national rules, so long as they meet the minimum EU requirements.

The PSD aims to remove double taxation in the case of profit distributions made by a subsidiary located in one Member State and received by its parent located in another Member State.

In November 2013, the Commission proposed amending the Directive to stop the it from being misused for the purposes of tax avoidance.

Two amendments were proposed:

i. Provisions designed to prevent corporate groups from using hybrid loan arrangements to benefit from double non-taxation under the PSD
ii. Introduction of a general anti-abuse rule

In July 2014, the Council adopted a specific linking rule that seeks to prevent corporate groups from using hybrid loan arrangements to benefit from double non-taxation under the PSD. The deadline for transposition of the linking rule is 31 December 2015.

Since then, work has continued on the general anti-abuse clause, the aim of which is to stop the PSD from being misused for the purposes of tax avoidance, and to achieve greater consistency in its application in different Member States. In December 2014, political agreement was reached on the wording of the general anti-abuse rule, whereby in Directive 2011/96/EU, Article 1(2) is replaced by the following paragraphs:

"2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.

An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."

Member states will now have until 31 December 2015 to implement the general anti-avoidance rule into national law. In applying the general anti-abuse clause, the Council anticipates that Member States will endeavor to inform each other when information may be useful to the other Member State. Member States are required to apply the general anti-avoidance rule only to situations that fall under the scope of the PSD. Member States may apply stricter national rules, however, as long as they meet or surpass the minimum EU requirements. Finally, the Council will take into consideration the binding anti-abuse provision in its future work on a possible anti-abuse provision to be included in the Interest & Royalty Directive.

[3] The European Council is the EU institution that defines the general political direction and priorities of the European Union. It consists of the heads of state or government of the member states, together with its President and the President of the Commission.

January 2015: Efforts to revive the Financial Transaction Tax

With so much focus on transparency and anti-avoidance, it might be tempting to think that efforts at tax harmonization have fallen by the wayside. This is far from the truth. Aside from efforts to revive CCCTB discussions, which will fall under the Summer 2015 action plan on efforts to combat tax evasion and tax fraud, Europe's Financial Transaction Tax has also seen a reinvigoration of efforts in early 2015. In late January, the Finance Ministers of France and Austria (Michael Sapin and Hans Jörg Schelling, respectively) sought to break deadlocked talks on a European Financial Transactions Tax (FTT) by writing to the other nine countries[4] pursuing the European Union's (EU) "enhanced cooperation" procedure to introduce such a tax. The joint letter, dated 21 January 2015, was sent around a week in advance of the next meeting of the ECOFIN[5] council, scheduled for 27 January 2015. In the letter, the Ministers seek to "breathe new life into talks on the FTT" and set out their "desire to see the tax introduced in 2016." The letter states that fresh talks are needed both in terms of the concepts underpinning the FTT and the procedures necessary for it to be adopted. The Ministers further propose that all 11 countries should agree that an FTT should be applied to "the widest possible tax base, with low rates," from 2016 onwards.

Substance of the FTT

The letter notes that discussions to date have focused on which products should be taxed, with each participating Member States expressing a desire to exempt certain assets. According to the letter, this approach has watered down the tax base of the FTT: "*Each participating Member State has consequently expressed a desire to exempt certain sensitive assets. As a result, the very tax base has been stripped of meaning, particularly in the case of derivatives*."

Instead, the letter proposes a fresh direction, based on the assumption that the FTT should have the "widest possible base and low rates." It does not, however, make any specific recommendations on how an agreement to take the FTT forward may differ from the 2013 proposals in terms of tax base or rates. The letter does, however, note the need to mitigate the risk of relocation of the financial sector so as to avoid financial transactions simply by moving away from the counties that had implemented the FTT.

Procedural suggestions

The letter suggests appointing one of the 11 Finance Ministers to steer forward the proposals with one of the members of the group of national technical experts to report on the progress of the technical work. An approach would also be made to the European Commission to see how it could provide additional technical support.

Ten countries reiterate their commitment to an FTT

As noted, the letter from the Finance Ministers of Austria and Germany was sent a few days in advance of the ECOFIN session. Although not formally on the agenda at ECOFIN, on 28 January 2015 (the day after the ECOFIN session) the Finance Ministers of Austria, Belgium, Estonia, France, Germany, Italy, Portugal, Slovakia, Slovenia and Spain (the "participating Member States" or PMS) issued a joint statement setting out their renewed commitment to the FTT. Echoing the earlier letter, the new statement asserts that the FTT should be taxed on the widest possible base and at low rates. While the statement itself is silent on the definition of "widest possible base" and "low rates," an article posted on the official website of the Austrian Federal Ministry of Finance indicates that "a lower rate of tax than originally planned is also conceivable." In this context, it should be noted that the draft EU FTT directive published by the European Commission on 14 February 2013 proposed minimum tax rates of 0.1% for equities and bonds, and 0.01% for derivatives.

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[4] Belgium, Estonia, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.

[5] ECOFIN is a configuration of the Council of the European Union, and is composed of the economics and finance ministers of the 28 European Union Member States, including Budget Ministers, when budgetary issues are discussed.

There are a number of observations to make regarding the FTT statement's content, as well as on those issues it does not address.

1 **Basis of tax**: The statement does not clarify the basis on which the tax will apply; i.e., whether the tax will be based on all or some of the issuance, residence or counterparty principles. However, the reference to the risk of relocation of the financial sector may reflect concerns that have been expressed, in particular, in relation to an FTT based on the counterparty principle. This remains to be clarified.

2 **Have the PMS now been reduced to 10 Member States?** The statement was signed by only 10 countries. Greece (previously included as a PMS) did not sign the statement. While the news has reported that Greece did not sign the statement because of the recently-held elections and therefore there was no representative to agree to the statement, it is yet to be confirmed whether the new Greek Government will retain the position adopted by the outgoing Greek Government. It is also notable that Slovenia, which did not sign the May 2014 Joint Statement (leading to speculation that it had dropped out of the enhanced cooperation process), has signed the statement indicating that it remains in the process. A minimum of nine Member States are required for a legally valid enhanced cooperation procedure.

3 **Scope**: As noted, the statement does not elaborate on the definition of "widest possible base." In particular, it is unclear whether this is simply a political statement of intent or a clear decision to move back toward the European Commission's proposal of 14 February 2013 which sought to apply EU FTT to "all instruments" (i.e., equities, bonds and derivatives). The article posted on the official website of the Austrian Federal Ministry of Finance excludes government bonds from the scope of taxation. This is arguably a significant departure from the 2014 discussions where only equities and "some derivatives" were being considered as initial focus areas. Notably, this broad-based approach was opposed by France, which appears to have recently shifted its position. This development may itself have contributed significantly to the new impetus for advancing EU FTT discussions. However, given that the PMS are conscious about the risk of relocation in the financial sector and have agreed to give full consideration to the impacts on the real economy, this leaves open a very wide range of options in the scope and design of the tax.

4 **Timetable**: The start date of 1 January 2016 as stated in the statement is extremely ambitious, given (a) that the statement is essentially a political statement, and there is a need to reach agreement among the PMS and flesh out both high-level and detailed technical rules and finalize the form of a Directive; (b) the need for sufficient time to complete the EU legislative process, allowing the PMS time to transpose the Directive into national laws (which would typically be at least six months from the date the Directive is passed into EU law); and (c) the need to give sufficient lead time to financial market participants to build the requisite systems to ensure collection and payment of EU FTT.

5 **Exemptions**: The statement does not set out the position of the PMS on exemptions from EU FTT, which has been a key concern for the financial markets. This concern was reiterated in the joint letter written by the European banking sector (European Association of Cooperative Banks (EACB), the European Association of Public Banks (EAPB), the European Banking Federation (EBF) and the European Savings and Retail Banking Group (ESBG)) to EU Finance Ministers. The article posted on the official website of the Austrian Federal Ministry of Finance only references government bonds as excluded from the scope of taxation.

6 **Sharing of EU FTT revenues amongst the PMS**: One of the most important reasons for breakdown in the EU FTT talks last year was whether the tax collected in smaller countries would be sufficient enough to compensate for the cost of collecting. The statement does not make any reference to this.

Where next for the FTT?

As with any New Year's resolution that could either encourage change in the year to come or completely fall apart, at this stage, it is difficult to form a clear view on whether this political New Year's resolution in the form of the statement will meet its goal in reaching agreement upon and implementing an EU FTT or prove the theory that the majority of New Year's resolutions fail. Nonetheless, the renewed statement indicates a refreshed desire to proceed, and therefore financial institutions and others affected should continue to watch developments closely. The PMS have not yet outlined publicly any timetable for progressing their discussions. It should be fully expected, however, that there will be intensive discussions, at both the political and technical levels.

European Commission presents a package of tax transparency measures

18 March 2015 saw the European Commission present a new Tax Transparency Package.[6] A key element of the transparency Package is a proposal to introduce quarterly, automatic exchange of information between Member States regarding their cross-border tax rulings, including Advance Pricing Arrangements (APAs), while a second element also calls for a one-off exchange of tax rulings made within the last 10 years, where such rulings remain active at the point the revised Directive is adopted.

The proposal takes the form of new requirements to be included in the existing legislative framework for information exchange, via amendments to the Directive on Administrative Cooperation (the Directive). The Commission notes that this will enable automatic information exchange on tax rulings to be rapidly implemented, as the procedures, processes and framework to do so are already in place.

Alongside the proposal to automatically exchange information regarding rulings, the Transparency Package also contains a communication outlining a number of other initiatives designed to advance the tax transparency agenda in the EU, including assessing possible new transparency requirements for multinational companies, reviewing the Code of Conduct on Business Taxation, quantifying the scale of tax evasion and avoidance and repealing the Savings Tax Directive.

As noted by the Commission itself, there are strong links here to the earlier news of a new GAAR within the PSD: "Member State Y would find out about the artificially high prices that the subsidiary is charging to the parent company, in order to shift profits to Member State X. As a result, it may be able to apply the anti-abuse element of the Parent-Subsidiary Directive, and deny the company the usual tax exemption for dividends".

The two legislative proposals of the Transparency Package (the automatic exchange of information regarding rulings and the repeal of the Savings Tax Directive) will be submitted to the European Parliament for consultation and to the Council for adoption. The Commission in its press release calls upon Member States to agree on the rulings proposal by the end of 2015, allowing it to enter into force on 1 January 2016. On the basis that the European Council in December 2014 called for the proposal, the Commission expects full political commitment on reaching a timely agreement.

[6] See EY Global tax alert for full details: http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--European-Commission-presents-a-package-of-tax-transparency-measures.

Key messages

It has been a busy quarter for the Commission, and the remainder of 2015 looks to be a make or break period for its tax work. A key message for business is that the Commission is increasingly changing direction and working on what seems to be wanted by the Member States – namely more measures to combat tax avoidance and evasion, with less focus (at least from the Commission itself) – on tax harmonization to improve the functioning of the internal market. Looking back to 2014, we already saw action on hybrid mismatches and exchange of information, echoing OECD work.

New initiatives including the exchange of rulings and a new action plan on efforts to combat tax evasion and tax fraud similarly echo work at the OECD. Are they aligned and united with OECD efforts? Perhaps. Are these efforts representative of a new trend for the Commission to take up the mantle on behalf of EU Member States who feel that their tax bases are being eroded not only by companies from within the Union but also by non-EU companies? Probably. Will these efforts create more work and uncertainty for business? Yes, definitely.

This dark horse needs watching, closely.

European Commission foreshadows proposal for a Common Consolidated Corporate Tax Base – with consolidation element postponed

On 27 May 2015, The European Commission's College of Commissioners held an orientation debate on measures designed to make European corporate taxation fairer, more growth-friendly and transparent.

At the meeting, it was agreed that a "new EU approach to corporate taxation is needed to successfully address tax abuse, ensure sustainable revenues and foster a better business environment in the internal market."

Focusing on four specific objectives and five key actions, the new approach will be delivered in the form of an action plan by the European Commission (the Commission) on 17 June 2015, and such measures will center upon the re-launch of the Common Consolidated Corporate Tax Base (CCCTB) - but with the consolidation element "postponed" - alongside a number of short-term measures designed to integrate the results of the OECD's BEPS project at EU Member State level.

The debate orientation paper (the Paper) notes that such measures will also include a public consultation in relation to options for public disclosure of tax information. That consultation will commence on 17 June 2015.

Read EY's full analysis at bit.ly/1co3AxN

Digging into the data: the global tax policy outlook for 2015

Rob Thomas
Director – Tax Policy & Controversy
Ernst & Young LLP
T: +1 202 327 6053
E: rob.thomas@ey.com

This past year, globally, we have experienced tax changes that have become more rapid, complex and voluminous than we have seen in recent memory. To help clients and professionals understand and put into context all the changes and what to expect going forward, policy leaders from 32 countries have contributed their knowledge and insights to create EY's 2015 Global Tax Policy Outlook. In it, we help to explain all the drivers of policy, the financial situation that may dictate which levers of policy are used, and which elements of their tax regime countries have announced will change or we feel they are likely to change in 2015. This is before getting into the impact of oil prices, currency fluctuations and national elections.

Each of the six annual reports we have researched and produced has been eye-opening. Seeing the stimulus trends play out in 2009 was fascinating. Seeing VAT rates fall, and then rise, in unison across the European Union and elsewhere between 2009 and 2011 demonstrated just how important this tax type has and will become. And, most recently, seeing the rise of tax coordination that found its genesis in the global financial crisis bloom fully in 2013 has been illuminating.

This year has delivered once again, but has required more discrimination. In the latest round of analysis it has become harder to identify trends due to the existence of the OECD's BEPS project. Many countries already have pressed forward and put in place changes in anticipation of the BEPS project's final recommendations. The most prevalent technical change for the year ahead is the tackling of hybrid mismatches, where 11 of the 32 report their governments have either enacted new legislation or will likely do so. That would indicate 2015 will see additional volumes of BEPS-related change. Expect to see national activity in the areas of CFCs, transfer pricing and hybrid instruments, as the year plays out.

So what do we see in the data for 2015?

The year ahead

The direction of headline corporate income tax (CIT) rates and the overall CIT burden comprised the first two data points. Across these metrics, seven of 32 countries (22 percent) surveyed already have announced headline CIT rate decreases for 2015. Chile is the only country of the 32 reporting a known CIT rate increase in 2015, while 24 countries are forecasting steady headline CIT rates. So from that data set, one might assume that the corporate tax burden is going to be steady, if not falling, in 2015? Not so. Ten of the 32 (31 percent) also report an increase in the overall CIT burden for 2015. So last year's trend of falling rates and broadening tax base continues to accelerate. (The ratio was 26 percent of countries in 2014). Just five of the 32 — Denmark, Greece, Japan, Portugal and UK, all of which have known or expected CIT rate reductions in 2015 — forecast a decreased CIT burden for 2015. The remaining 17 countries forecast the same overall CIT burden in 2015.

Outliers

There are a couple of prime examples. First is Chile: in September 2014, a major tax overhaul came into effect. The key driver for this reform was to finance the significant educational reform that is being discussed by Chile's Congress and which itself has been the source of much civil unrest in the last few years. As a result of this reform, EY's tax policy leader for Chile, Pablo Greiber, reports that Chile will see a staggering increase of 12 of the 18 data points we are tracking for 2015. These burden increases will come from an increased headline CIT rate and widened base; widened bases for both Personal Income Tax (PIT) and Value Added Tax (VAT); changes to interest deductibility; hybrid mismatches; tax treatment of losses; capital gains taxes; controlled foreign companies; and thin capitalization. At the other end of the spectrum, sits Mexico, where EY tax policy leader Jorge Libreros reports that President Enrique Peña Nieto's signature on February 2014's "Certainty Tax Agreement" represents his commitment to make no changes to the current tax structure from 2014 to 2018.

Impact of BEPS on national policy formation

Looking into the detail, it is easy to see that the 2014 BEPS actions have had a significant impact on national policy decisions, oftentimes ahead of their final form being published. In that vein, it is probably safe to say that the 2015 BEPS actions also will have a similar impact.

Thin capitalization

Thin capitalization changes is the second most popular area of BEPS-related change after actions to tackle hybrid mismatches. Of the 28 countries with a thin cap regime, eight (29 percent) forecast a known or expected increase in tax burden. The remaining 20 countries forecast stable tax burden. No country forecast a reduced tax burden in relation to thin cap.

CFCs

Policy activity in the areas of Controlled Foreign Companies is expanding compared to prior years. Of the 29 countries surveyed which have a CFC regime, six (21 percent) report a rise in tax burden for 2015. Only Japan and Italy report that a reduced tax burden may occur, while the remaining 21 countries report the same burden for 2015. The OECD's recommendations about CFC changes later in 2015 may have a significant impact on EY's 2016 outlook, though it remains to be seen how widely-drawn the proposals may be.

Interest deductibility

The same outcome is quite possible for changes to the deductibility of interest expenses. In this year's outlook, seven of the 32 countries (22 percent) report that the corporate tax burden will rise in their country in 2015 as a result of changes to interest deductibility. The remaining 25 report no known changes to interest deductibility. That percentage could be far higher in 2016.

Transfer pricing

Transfer pricing has been a source of constant change in each and every outlook we have produced. Business and government alike tell us annually that it sustains its place a prime focus area. This is reflected by the core place transfer pricing takes in the BEPS action plan, and no doubt we will see substantial changes ahead at the national level. As it is, nine of the 32 countries (28 percent) forecast a rising tax burden in 2015 in relation to known or potential changes to transfer pricing. Twenty-two countries forecast the same tax burden in this area, while only Spain reports a known change that will result in a falling burden. The changes countries are adopting range far and wide: in China, nationwide investigations about substantial outbound payments of service fees (which include management fees) and royalty payments to overseas related parties have been launched by the SAT. In the Slovak Republic, the tax base is being broadened by making transfer pricing rules also apply to transactions between domestic related parties. In South Africa, transfer pricing secondary adjustments are to be treated as deemed dividends.

Losses

The tax treatment of losses was another of the most active areas of policy change as the financial crisis played out. At first, countries tried to stimulate business by providing more generous tax treatment of losses. But as the cost of servicing this policy rose, more countries have been making their loss rules less generous since 2012. In 2015, a full six years after the height of the crisis, the reduced incidence of changes in tax legislation in relation to the treatment of losses continues to dissipate, generally speaking. Just four of the 32 countries (Chile, Hungary, Japan and the UK) report that the tax burden will rise in their country in 2015 as a result of changes to the tax treatment of losses. Japan's less generous treatment of losses is one of the policy measures that partially will pay for 2015's CIT rate reduction from 35.64 percent to 33.10 percent (Tokyo base). There, the current 80 percent utilization limitation of an annual NOL deduction will be lowered to 65 percent for taxable years beginning on or after 1 April 2015 and on or before 31 March 2017, and further lowered to 50 percent for taxable years beginning on or after April 2017.) Japan's aim is to further lower the rate in the 2016 reforms, targeting a rate of less than 30 percent within a few years.

Incentivizing research and development (R&D)

Rapid advancements in technology, telecommunications and science have bought tax and other incentives for research and development to the forefront in the last decade. They were one of the key ways in which governments chose to try and stimulate business spending during the global financial crisis. Lately, though, many countries have made moves to restrict the availability of broad-based R&D incentives to the largest companies, instead focusing their funds on specific sectors, geographies or business segments such as small- and medium-sized enterprises. Eight of the 32 countries (25 percent) surveyed report that their R&D incentives are either known or expected to become more generous overall in 2015, holding pace with data reported in our 2013 and 2014 outlooks. Some countries are making their R&D incentives less generous, with Finland and Poland both reporting moves in this direction. Finland is abolishing its incentive altogether. Australia's potentially reduced incentive, already reduced in 2014, is the result of a new measure to deny R&D tax incentives for large companies with incomes of A$20 billion or more.

Value-Added Taxes

Value-Added Tax (VAT) is sometimes thought of as a tax that is only of interest to consumers. However, tax directors worldwide know they play the role of unpaid tax collector for the government, and VAT can be described as a color-blind tax, in that you have to pay it whether your bottom line is black or red. Following the high pace of change in 2009-11, the pace of change today continues to slow. Five of the 32 countries surveyed forecast their overall VAT burden will increase in 2015, while three forecast that it will decrease. Two countries, Germany and India, forecast a mixed picture, while the remaining 25 forecast the same overall VAT burden in 2015. Rate changes, as mentioned, are reducing in incidence. Three of the 32 countries (Luxembourg, Malaysia and South Africa) report a known or potential increase in the headline VAT rate, while 29 forecast a stable rate. No country within the 32 sampled forecast a VAT rate reduction.

Tax enforcement

Governments have two levers to pull when taxing their citizens. The first is tax policy: what is taxed; to what extent; at what time; and under what circumstances. The second is tax enforcement: how those laws are administered? Here, 10 of the 32 countries (31 percent) surveyed report known or forecasted increases in tax enforcement in 2015. This has slowed a little from our 2014 Outlook publication, where the percentage was 39 percent. It does still represent an upward trajectory. It also echoes the sentiments put forward by business in EY's 2014 *Tax Risk and Controversy Survey* where 68 percent of respondents felt that tax audits had become more frequent and aggressive in the last three years.

Reviewing the key messages

- The broad-base, low-rate business tax trend continues to play out, and business can learn much by understanding where each country stands in terms of its own policy mix.
- The impact of BEPS on national legislation is only going to grow, likely to reach a crescendo in 2016. However, countries may not wait for final recommendations to be unveiled to make national changes. Many would rather enact legislation now, and then adapt it later, if needed, to align to globally agreed standards.
- While not a direct output of our outlook data, consensus in terms of BEPS can be hard to reach, particularly on more complex issues such as permanent establishment. The possibility of policy replication in more novel areas, such as the UK's new Diverted Profits tax, will be carefully monitored by business, government and multilateral bodies alike.
- Oil prices and currency fluctuations have the potential to drive policy change in 2015, particularly if low oil prices are either sustained or fall further. Currency fluctuations may drive the possibility of currency controls or devaluations at the national level.
- Elections in a number of jurisdictions have the potential to turn tax policies on their head. Examples include Canada, Denmark, Finland, Greece, Poland, Spain, Switzerland and the United Kingdom. Increasingly, and as shown by Japan's snap election in December 2014, taxation forms a central focal point of any election campaign. Much the same is true of Greece's recent election where finances, if not tax, were the central debate.
- High levels of tax enforcement are set to be sustained, if not increased, given the ever-increasing volume of information available; the incidence of new transparency requirements including country by country reporting; transfer pricing master and local files; not to mention whatever BEPS action 12 brings. All this means that business is really going to have to be alert if they want to manage the requirements effectively.

Actions companies should consider

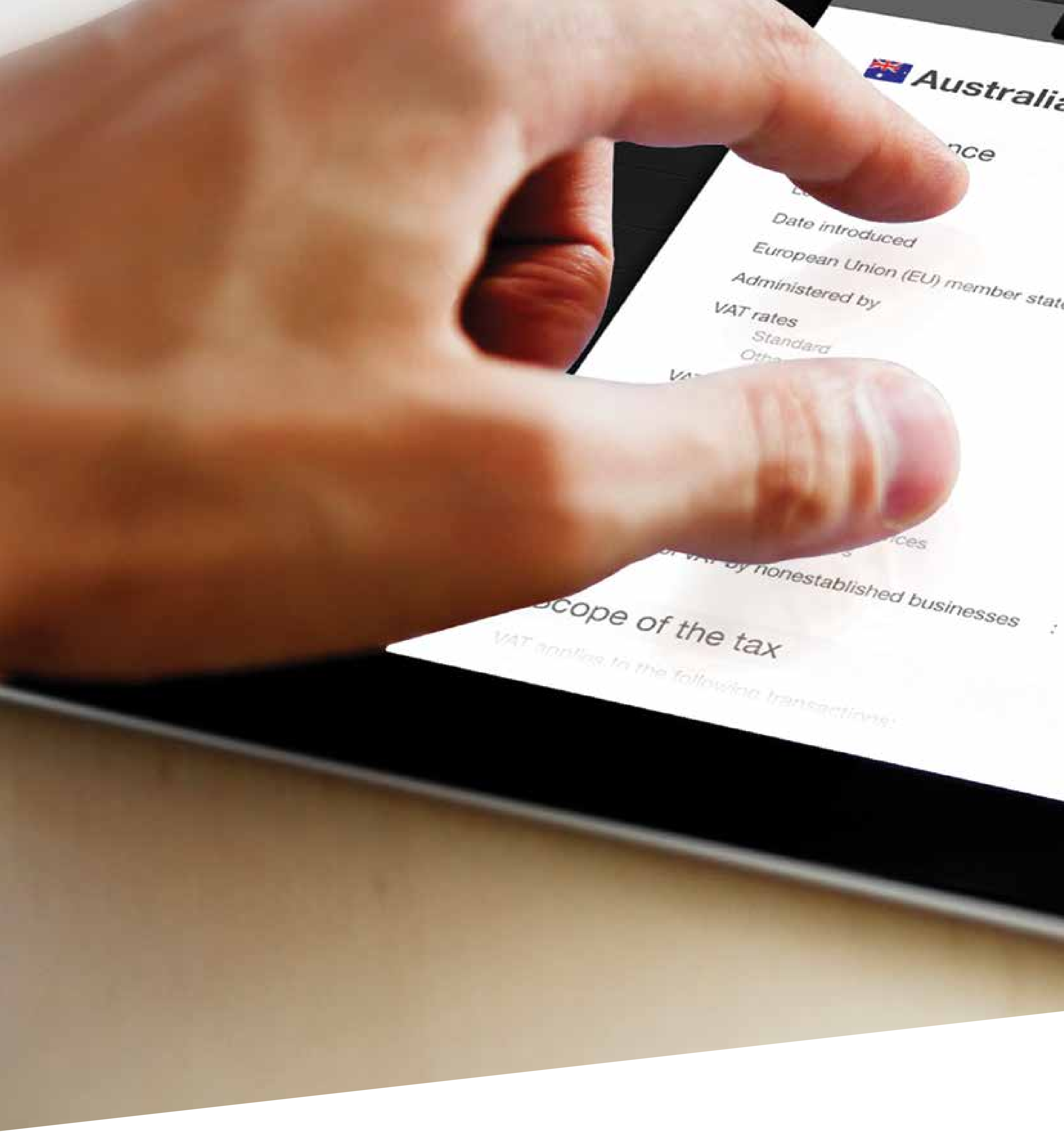
1 It is more important than ever to have clear, well-resourced processes to monitor and assess possible future tax policy shifts. Having this information is one thing. Acting on it is another.

2 Be an active participant in tax policy development. In such a rapidly shifting economic, legislative and regulatory environment, new tax laws may sometimes impede commercial decisions in ways that were unintended by policymakers. Companies faced with this issue can either adapt their business plans accordingly or work collaboratively with the government to explain the impediment, model the potential outcomes and develop alternative policy choices.

3 Consider the possibility of joining forces. Will forming a new industry or trade group be an appropriate way to develop a collective voice? Alternatively, are there opportunities to add your voice to an existing group?

4 Regularly assess the impact of change. If change is clear and documented, create an impact assessment that contains economic modeling. Policymakers need information to develop good tax and economic policy, and comparative tax studies and insightful analysis of tax policy proposals' effects on competitiveness can help in this effort. Use this information to inform the debate. We're all in this together, and together we can help build a better working world.

EY's full 2015 Global tax policy outlook is available for download from www.ey.com/2015taxpolicyoutlook.



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Indirect tax developments in 2015 and beyond: Four trends that shape the global indirect tax landscape

Gijsbert Bulk
Global Director of Indirect Tax
Ernst & Young LLP
T: +31 88 40 71175
E: gijsbert.bulk@nl.ey.com

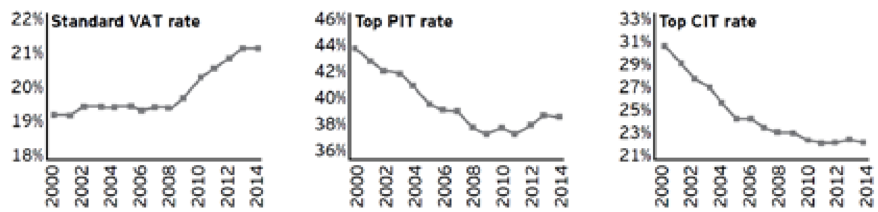
The indirect tax world is in constant motion. What was true yesterday or even today may prove to be wrong tomorrow. Ignoring recent developments in indirect taxes or not being compliant with indirect tax obligations has definitely become an expensive oversight for companies of all sizes, whether they are active in the local market or on a global level. This article discusses the latest trends and developments in indirect tax around the world and what business leaders should watch out for in 2015 and beyond. The article has been excerpted from EY's "Indirect taxes in 2015 – A review of global indirect tax developments and issues." This can be downloaded at www.ey.com/indirecttax2015.

Four trends that shape the global indirect tax landscape

1. Indirect taxes continue to grow while direct taxes stagnate

In the aftermath of the financial crisis, governments in many countries still have a strong need for cash. Whether the need is to finance targeted stimulation programs for the economy, or to generally make up for the gaps left behind by a shrinking economy, indirect taxes have proven to be the first choice for generating revenue for a number of years. And they continue to be as seen by the large number of prominent advocates who all promote the shift from direct to indirect taxes, such as the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the European Commission. A number of international studies have indicated that value-added taxes (VAT) have the least impact on growth, while corporate income taxes have a negative impact on growth.[1]

Figure 1. Evolution of standard VAT rates and of the top personal income tax (PIT) and corporate income tax (CIT) rates in the EU-28 (simple arithmetic average)[3]



Source: European Commission, 2014

In practice we see three main ways that indirect taxes are used to generate more revenue:

- VAT/GST systems are spreading. According to the OECD's "Consumption Tax Trends 2014," 164 countries in the world levied a VAT as of 1 January 2014: 46 in Africa, 1 in North America, 18 in Central America and the Caribbean, 12 in South America, 28 in Asia, 51 in Europe, and 8 in Oceania. As a result, only a minority of countries now apply retail sales taxes, i.e., single-stage taxes on goods and services supplied by final consumers. Furthermore, the number of "VAT countries" continues to grow, especially in emerging economies, such as Bahamas, Egypt, India, Malaysia, Puerto Rico and Suriname.
- VAT/GST rates are rising. In countries where a VAT/GST already exists, average VAT/GST rates have increased in recent years, and those increases seem set to continue. This upward rate trend is particularly true for Europe and the OECD countries, where the average standard VAT rate has now reached 21.6% (EU Member States) and 19.2% (OECD Member Countries) compared with 19.5% and 17.5% average rates, respectively, before the crisis in 2008.

[1] "Taking stock of reform action and identifying priorities in 2013" chapter as part of *Economic Policy Reforms 2013: Going for Growth* (OECD Publishing, 2013).

For the OECD countries, the main reason for the increased average is because of the consumption tax rate increase in Japan from 5% to 8% in April 2014. Again, this trend is likely to continue, with the already scheduled next increase in Japan due in 2017. Other than Europe and the OECD countries, the VAT rate development is more stable. In contrast to Europe, Angola, Peru and Sri Lanka all lowered their standard rates.

- Excise taxes are increasing. A truly global trend that leads to higher indirect tax revenue is the increase of excise taxes. Excise taxes on tobacco have increased or will soon increase in many countries. Not only are the rates increasing, but governments are being creative in inventing new taxes. For example, a relatively new trend is the introduction of excise taxes on health-related products.

  In addition, there are still attempts to increase the tax burden on financial transactions, although there is no common global approach to achieving this. Some countries have increased the supervision of the banking industry and tightened regulations.

2. Indirect taxes are adapting to new economic realities

One of the peculiarities of indirect taxes is that they are very strongly intertwined with the economy. Their tax object usually is an economic transaction, such as the sale of a good or the provision of a service. If the nature of these transactions or the way that such transactions are handled change, this immediately has a strong impact on indirect taxation.

- The challenge of e-commerce. A striking example of such a change that has disrupted indirect taxes is the boom of e-commerce. E-commerce may be defined as trading in products or services using computer networks, such as the internet. The world started to be only "one click" away.

  Over the last few years, e-commerce has been the fastest-growing sector in many countries. It is expected that the internet economy will account for 5.3% of GDP in the G-205 countries in 2016.

  The international community reacted quickly to this new reality, and already in 1998, the OECD Member States agreed on the Ottawa principles on the taxation of e-commerce:

  - Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
  - An international consensus should be found on which supplies are held to be consumed in a jurisdiction.
  - For the purpose of consumption taxes, the supply of digitized products should not be treated as a supply of goods.
  - Where a business acquires services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms.
  - Countries should develop appropriate systems to collect tax on the importation of physical goods, and such systems should not impede revenue collection and the efficient delivery of products to consumers.

- Virtual currency. Another interesting development in the digital age is the use of virtual currencies such as bitcoin. Although it is clear that the use of these currencies to conclude transactions triggers many VAT/GST questions. From a GST perspective, businesses need to charge GST when they supply bitcoins, and they may be subject to GST when receiving bitcoins in return for goods and services.

  It appears that the positions being adopted by these different countries are not consistent, and that pattern may be expected to continue. Some countries have banned bitcoins outright, whereas others are currently assessing the tax treatment.

  Additional country-specific guidance is expected going forward (from both an indirect and direct tax perspective). This lack of global consistency may lead to a number of challenges for businesses operating in this market.

3. The global trade landscape is changing fast

While everyone agrees on the importance of free trade to boost the global economy, the reality shows a different picture. On the positive side, countries are negotiating measures to facilitate trade. G-20 economies applied 79 trade-liberalizing measures between May and October 2014. This amounts to close to US$370 billion — almost three times the trade value of the new trade-restrictive measures. In addition, the number of free trade agreements (FTAs) that are negotiated and signed steadily increases. The WTO currently reports 604 active and pending reciprocal regional trade agreements among its members.

Despite the growing number of FTAs, in many cases, businesses are not actually obtaining the potential benefits offered by FTAs because they cannot, or do not, meet the qualifying conditions. Where countries are not bound by FTAs, import duties are still a common and often-used means to steer trade and production development.

Although customs duty rates are generally reducing, these taxes still play a very significant role in meeting countries' budgetary needs. In many cases, duty rates are high and duties form part of the cost base of affected goods, because duties charged at one stage in the supply chain are not offset against taxes due at later stages (unlike VAT/GST). On the more practical side, many countries are making changes to their customs legislation that reflect a number of these trends. In the EU, for example, the legislation that governs customs activities is currently being rewritten as the Union Customs Code (UCC). It will entail profound changes to some customs regimes and controls that should facilitate trade, such as:

- The introduction of Self-Assessment and Centralised Clearance
- Mandatory guarantees for special procedures and temporary storage
- The ability to move goods under temporary storage rather than national transit or New Computerised Transit System (NCTS)
- All communications between customs authorities and economic operators must be electronic

4. Tax authorities are focusing on enforcement of indirect taxes

Tax audits are changing. Tax and customs inspectors are increasingly using modern technology tools to access real-time comparative figures and data when auditing businesses. They are sharing more information, and more tax administrations around the world are implementing electronic auditing of businesses' financial records and systems. In many cases, taxpayers' information is under scrutiny even without an onsite audit taking place.

A recent survey carried out among EY Indirect Tax professionals based in 82 countries revealed that the tax authorities in 59 of those countries use electronic data extraction to perform tax audits. The benefits for tax administrations are clear: the more efficient use of technology lowers costs of collection and compliance and increases the amount of errors detected. In addition, tax and post-importation audits are becoming much harder to deal with for those companies that are not well prepared. On the flipside, knowledgeable and prepared taxpayers may also find it easier to deal with more professional tax and customs administrations.

These developments in technology and e-auditing are also paving the way for mandatory electronic invoicing and electronic filing of tax returns, which are fast becoming the global norm.

What do these trends mean for business?

All of the developments trends identified in the report have a direct impact on business activities; however, not all of them may have a direct impact on your organization. Confirming that the latest changes and developments in a country's legislation have been correctly implemented into your ERP system is essential to ensuring accurate local compliance. The importance of accuracy increases as indirect tax rates increase, because the consequences of applying the wrong rate become more severe. The impact of rising VAT/GST rates is particularly significant for businesses that do not recover VAT/GST in full (e.g., because of VAT exempt activity), such as banks and insurance companies.

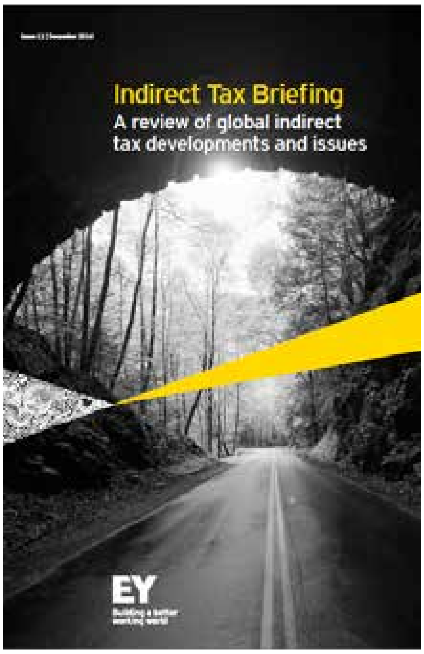
Our experience shows that many companies still pay too much indirect taxes, often because they do not identify and manage these duties and their associated costs effectively. Companies that operate in the digital economy are directly affected by the increasing trend to tax these activities.

More than ever, it pays out to proactively manage indirect taxes. Establishing a clear indirect tax strategy will help you keep your business up to date with the rapidly changing tax environment.

This article has been excerpted from EY's "Indirect taxes in 2015 – A review of global indirect tax developments and issues."

This can be downloaded at **www.ey.com/indirecttax2015**.

Indirect Tax Briefing: planning for the future



In this edition, we examine a variety of developments in the taxation of cross-border trade, which continue to be influenced by globalization and advances in technology.

In a series of articles on Africa, we focus on the East African Community and some of the benefits available for companies that are looking to trade and invest in the area. Taxes continue to evolve to keep pace with the ever-changing world that we live and work in. We reexamine several aspects of how businesses are dealing with the indirect tax challenges of the digital age.

Preparing for an e-audit

We consider the electronic-audit capabilities being developed by tax administrations and how businesses can prepare for an e-audit, focusing on the rules that apply to foreign companies registered for VAT in France.

We also look at the new e-invoicing rules that will apply in Italy for supplies to public bodies and the introduction of new invoicing rules and e-invoices in Hungary.

The recent report issued by the Organisation for Economic Co-operation and Development (OECD) under its Action Plan on Base Erosion and Profit Shifting (BEPS) on the tax challenges of the digital economy identifies the need to also address indirect taxation and the effective collection of consumption taxes with respect to the cross-border supply of digital goods and services.

Download the Indirect Tax Briefing at **www.ey.com/indirecttaxbriefing**

The impact of EU VAT changes and digital services

This need is being addressed in the EU with changes in the application of VAT to telecommunications, broadcasting and e-services supplied to private consumers from 1 January 2015.

In addition, we look at the impact of these EU VAT changes on financial services providers and look at the practical implications in a number of key areas.

We report on similar changes for supplies of digital services made to non-taxable persons coming into force in Albania, as well as how Albania is bring its VAT system closer to the EU model.

Our country section articles include developments that illustrate the continuing importance of indirect taxes, particularly VAT, as a source of government revenues. Illustrations of this trend include Luxembourg, for example, which has recently confirmed the VAT rate increases that will come into effect on 1 January 2015, and Slovakia, which has confirmed that the planned reversal of its increase in the standard rate has been canceled.

At the same time, new VAT and GST systems continue to be introduced, for example in the Bahamas on 1 January and in Malaysia on 1 April 2015, while recent news reports also predict that the long awaited GST in India will likely roll out in April 2016.

New indirect taxes being introduced

New indirect taxes are also being introduced, such as the advertising tax in Hungary, and the plastic bag levy already introduced in Scotland that is being introduced in England in 2015.

In 2014 we have seen countries moving back and forth from stimulus to austerity and a continued reliance on indirect tax as a source of revenue. More countries continue to add indirect taxes to their tax tools overall and developments in technology impact on those working in indirect tax.

Staying on top of indirect tax changes and developments remains a challenge for all who work in this field.

in the spotlight

Country updates

Australia

New Australian anti-avoidance measures for multinationals

The Australian Government has announced a change to its General Anti-avoidance Rule (Part IVA) to tackle perceived tax avoidance by MNEs. The draft law it has released has measures clearly directed at US technology companies but will require consideration by many other foreign enterprises operating in the Australian market. The new rules will affect global groups with annual revenue exceeding A$1b based on accounting principles.

This change comes ahead of the conclusion of the OECD base erosion profit shifting (BEPS) projects and any recommendations for a globally coordinated response to the issue. It also precedes the conclusion of any of the high profile tax audits that the ATO has publicized in the technology sector. Since it has yet to be established whether foreign MNEs operating in Australia are, or are not, paying the right amount of tax, there are no revenue estimates of collections from this measure.

Importantly, the change does not create a new tax similar to the UK style Diverted Profits Tax. Although Part IVA can override Australia's various double tax treaty obligations, it appears that these new rules will operate within the existing framework of Australian tax law. Whether treaty protection will be available to protect against an assessment of tax will need further consideration.

The change raises many questions that hopefully will be clarified in the consultation period (submissions on the draft law were due 9 June 2015) and by ATO published guidance.

Australia
Dealing with a BEPS-based tax review

Fiona Moore
Tax Policy & Controversy
T: +61 2 9248 5931
E: fiona.moore@au.ey.com

Ermelinda Kovacs
Tax Policy & Controversy
T: +61 2 9248 5573
E: ermelinda.kovacs@au.ey.com

As the OECD's work on base erosion and profit shifting (BEPS) continues, many national tax administrations are also undertaking heightened scrutiny of multinational companies in order to secure their revenue base. The Australian Taxation Office (ATO) is once again at the forefront of activity and lessons learned from the ATO's compliance focus and approach shine a light on processes and procedures other administrations may adopt as the BEPS project continues to play out. This article is an excerpt of a more detailed analysis of ATO activity in this area, which can be accessed at **ey.com/bepsreview**.

Many respondents to EY's 2014 Tax risk and controversy survey reported that the OECD's BEPS project is having a galvanizing effect on tax enforcement in some countries, and companies reported that tax administration approaches seem to be changing ahead of any law changes that may be made as a result of BEPS recommendations. While some changes (such as new or strengthened general anti-avoidance rules (GAAR)) are written directly into law, others are far more subjective and difficult to identify, let alone manage;

74% of respondents, for example, report that taxing authorities are now challenging existing structures due to changes in the law or in their enforcement approach.

Current Australian experiences

Many technology companies with a presence in Australia will already be under some form of scrutiny by the ATO, particularly those who report ongoing tax losses in Australia. More recently, however, the Commissioner's BEPS activities have extended beyond taxpayers in the technology industry to taxpayers in industries such as transportation, media and entertainment, and consumer products, and the ATO has convened a specialist team to scrutinize BEPS-related structures and transactions. Broadly, the areas of concern identified in these reviews include business restructures, use of hybrid entities and instruments for tax arbitrage, perceived treaty abuse, pricing mismatches, debt dumping into Australia, and compliance with thin capitalization safe harbors.

In addition to this scrutiny, the ATO's perceived tax treatment of the sales and marketing support business model employed by foreign inbound companies is twofold, focusing on whether:

- The foreign company has a permanent establishment (PE) in Australia, and that profits should be correctly attributed to this Australian PE.
- The transfer pricing methodology employed by the taxpayer is at arm's length. A recently emerging element of this analysis is the so-called "Australia tax," referring to the premium that Australian end users pay on goods and services, and the impact that this has on the allocation of functions and risk to activities performed in Australia.

What is different in a BEPS-based review or audit?

"Companies are putting these structures in place and asserting they have tax compliance. That might be their assertion, **but we are going to test every single aspect of those structures. We will want to know whether what purports to happen, actually happens on the ground.** ... It is one thing to put in place a fancy structure, but it is another to have it tested five years later, because by their nature these schemes are quite, sort of, artificial."

— Chris Jordan
Commissioner of Taxation,
Australian Parliament's Public Account
Meeting dated 26 June 2013

The above quote from Commissioner of Taxation Chris Jordan highlights the difference in emphasis when a typical ATO compliance activity is compared with a BEPS-based review or audit. Typical key features of a BEPS-based review or audit can be characterized as follows:

- Information gathering: the level of minutiae investigated by the ATO is highly granular, designed to confirm that the business model adopted has been carried out. This includes scrutinizing details such as:
  - Employment arrangements, including job descriptions, remuneration and key performance indicators

- Evidence from third parties to support the taxpayer's statements regarding their business dealings with customers
- Functional interviews: early in the information-gathering process, the ATO conducts functional interviews with key staff to check that activity assertions made to the ATO in support of the tax technical position actually occur.

- Coercive powers: the ATO is increasingly willing to use its "coercive powers" to request information or seek an interview with personnel. These powers are akin to a subpoena that requires a taxpayer to produce certain information or be interviewed under penalty of prosecution or fine.
- Information sharing between revenue authorities: tax administrators are testing the statements made by taxpayers to different authorities. We understand that there are six countries sharing information with respect to BEPS-related issues.

Surviving information fatigue

A BEPS review or audit can often be a long, drawn-out and sustained process. An overload of information and communication can often fatigue the parties involved, with information often misinterpreted or not properly maintained, causing further unnecessary delays in the review or audit process.

To avoid this, we have identified a number of strategies taxpayers employ to survive information fatigue:

- Selecting one specific point of contact to manage all communication with the ATO
- Managing information – when notified that the taxpayer may be subjected to a BEPS review or audit, the leading companies are taking the time to organize any internal or external documents that the ATO may request
- Taking the time to clearly understand the drivers of Aggressive Tax Planning (ATP) behavior
- Taking the time to fully understand the ATO's compliance processes and, if unclear, taking the time for external assistance, if required
- Being prepared to be open and transparent and ensuring that all key stakeholders involved or who may become involved in the BEPS review or audit are also aware of the importance of transparency with the ATO
- Developing methods to proactively explain live transactions to the ATO that affect the taxpayer's company, business and its dealings, in order to avoid confusion or misinterpretation
- Preparing and anticipating the need for adequate resources to be involved as required in a BEPS review or audit
- Taking the time to consider and identify any issues or areas the taxpayer may wish to raise in advance and/or voluntarily disclose to the ATO
- Agreeing to a clear management plan with the ATO and communicating this plan to any other internal or external stakeholders who may be involved or may be asked to be involved in the BEPS-based review or audit

What are the expected outcomes?

While taxpayers under BEPS-based review or audits may be enduring information fatigue, it is crucial that they appropriately manage the information gathering by tax administrations across jurisdictions. Taxpayers may have a sense of inevitability as to where these reviews will lead, but our experience indicates that managing these reviews and any progression to audit can significantly streamline the taxpayer's work and also result in more desirable outcomes, including:

- Fewer functional interviews/workshops being conducted, minimizing disruption to the taxpayer's business
- More effective management of ATO relationship, allowing the taxpayer opportunity to negotiate time frames, access to information and scrutiny of third-party customers
- Closure of the review before it progresses to audit or litigation, by settlement, mediation, and/or go-forward compliance (such as an advance pricing agreement)

For further information, please see EY's published paper "Dealing with a BEPS-based tax review" at ey.com/bepsreview.

Update

On 13 March 2015, the Australian Tax Office (ATO) released a consultation paper on how it intends to comply with its requirement to publicly report certain tax data for large companies and corporate tax entities. This measure was enacted in 2013 and requires the ATO to publicly report certain income tax data in relation to corporate tax entities having incomes over AUD$100 million per annum, plus details of entities paying minerals resource rent tax (MRRT) and petroleum resource rent tax (PRRT). Beginning with the 2013-14 income year, the ATO will publish:

- Income tax information of companies and corporate tax entities (including some trusts and partnerships) with total incomes of AUD$100 million or more annually, disclosing taxpayers' ABN (Australian Business Number), total income, taxable income and tax payable.
- Payments of MRRT/PRRT, regardless of the entity's total income amount.

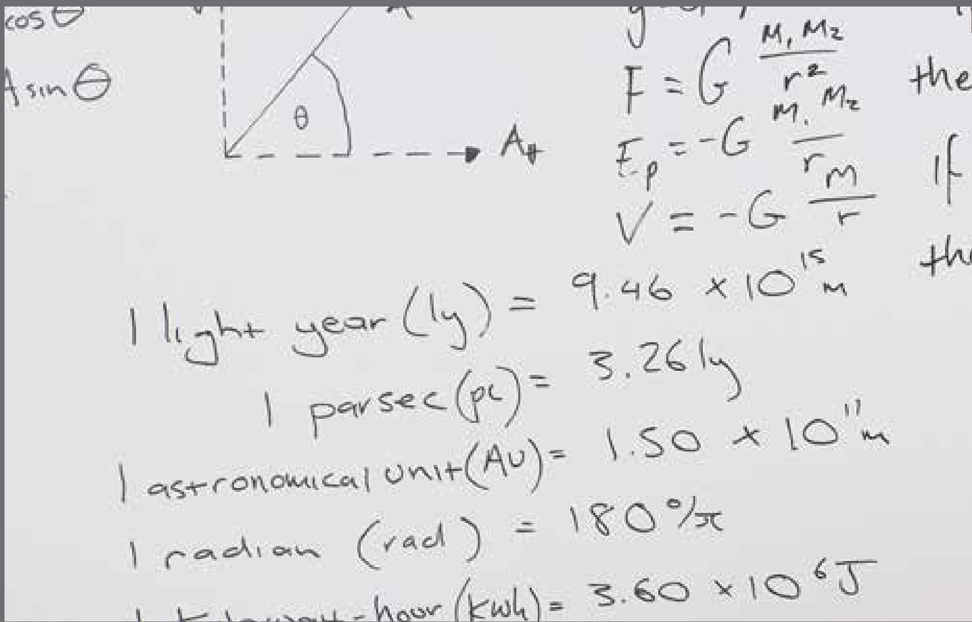
The ATO proposes that one single report will be released in late 2015, covering approximately 2,300 entities.

China

State Administration of Taxation looks to provide clarity on China's General Anti-Avoidance Rule

Henry Chan
Leader, Tax Controversy (Greater China)
T: +86 10 5815 3397
E: henry.chan@cn.ey.com

Andrew Choy
Leader, International Tax Services (Greater China)
T: +86 10 5815 3230
E: andrew.choy@cn.ey.com



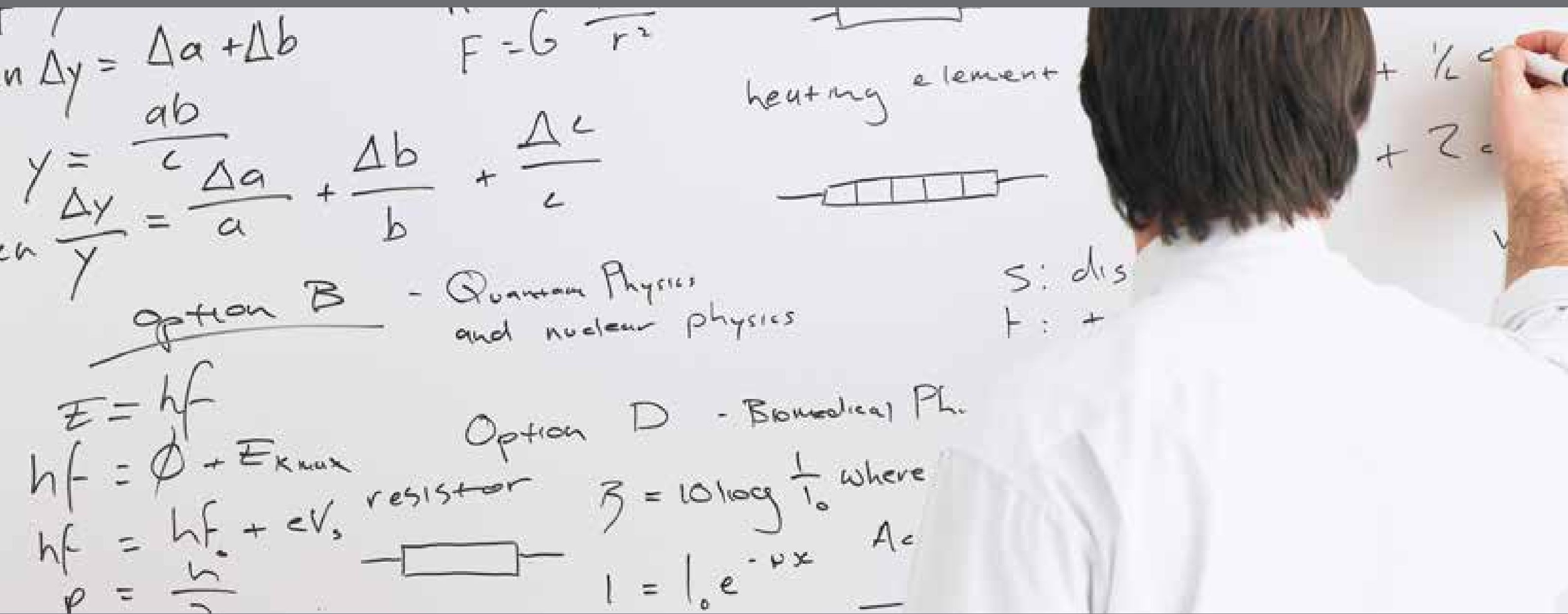
In China, alongside the introduction of the New Corporate Income Tax (CIT) Law and its Detailed Implementation Rules (effective from 1 January 2008), China's General Anti-Avoidance Rule (GAAR) has emerged as one of the most widely discussed and contentious elements of the prevailing CIT regime. On 2 December 2014, China's State Administration of Taxation (SAT) published the Administrative Measures of GAAR (referred to as SAT Order No. 32 hereafter) which aims to provide greater clarity and transparency on the fundamental principles, procedural guidelines and relevant documentation requirements in relation to the application of GAAR.

Background and context

In reaction to increasing deficits and deteriorating tax revenues stemming from the global financial crisis, countries around the world have been asserting greater efforts to curb what they see as abusive tax acts through implementation of General Anti-Avoidance Rules (GAAR).

In a nutshell, GAAR is a set of broad, principles-based rules embedded in a jurisdiction's tax laws or revenue code that is designed to counteract tax avoidance acts, and accordingly it provides tax authorities with the necessary legal basis and mechanism to claw back or deny tax benefits on transactions or arrangements that they judge to be lacking commercial substance or purpose.

While China has already commenced implementation of GAAR measures based on relevant principles and provisions cited under the CIT Law and its Detailed Implementation Rules prior to the issuance of SAT Order No. 32 (including necessary actions taken with respect to offshore indirect transfer of Chinese company shares via the reporting mechanisms stipulated under Guoshuihan [2009] No.698 ("Cir698")), China's GAAR has been criticized for having insufficiently clear principles, procedural guidelines and relevant administrative requirements or measures when dealing with such cases.



With a view to providing greater transparency and certainty, China's SAT issued SAT Order No. 32 on 2 December 2014.

International context

In brief, GAAR is viewed by many countries as a tool that can be employed (or at least available, as a visible deterrent) by a jurisdiction to defend its tax revenue (or taxing rights). The GAAR will be calibrated based on taxpayers' attitudes in relation to avoidance, and designed and administered accordingly.

Although a GAAR may be the most visible of anti-avoidance measures available, many jurisdictions take extra steps to prescribe more specific anti-avoidance rules (SAAR) under their domestic tax regime. No matter whether GAAR or SAAR is adopted, the fundamental intention and spirit behind the anti-avoidance measures adopted by relevant jurisdictions are inherently consistent, notwithstanding the varied legal basis that applies.

Well-accepted GAARs (containing effective and fair approaches) should share common characteristics as discussed below.

Characteristics of well-accepted GAAR

While GAAR should be designed with a core objective of tackling tax avoidance, its application of which should ideally be "balanced," i.e., GAAR should be enacted within parameters that aim to stop tax avoidance behavior but should not inhibit or interfere with taxpayers' ability to organize their affairs in an ordinary manner. In broad terms, authorities should realize the potential adverse impacts on the local economy's development, as well as the discouraging message that may be conveyed through overuse (or aggressive use) of GAAR.

In order to achieve the desired balance — effectively tackling unwanted behaviors that primarily or solely aim to reduce tax liabilities through holding structures or arrangements without bona fide commercial purpose, while minimizing any jeopardizing effect to the jurisdiction's economic development agendas (or sending discouraging messages to foreign investors) — a well-accepted GAAR system should ideally possess the following features that are generally seen as the fundamental "foundations" of GAAR.

- GAARs should be built upon clear and concise policies, principles and laws that reflect the Government's objectives and parameters in tackling tax avoidance behaviors.
- Taxpayers should have reasonable access to detailed and comprehensive guidance on how GAAR should operate, and what would be referred to as the so-called "unwanted" behaviors not welcomed by the relevant tax authorities.
- Opportunities for taxpayers to obtain advance rulings from the tax authorities to ascertain whether a specific case and relevant fact patterns should or should not trigger GAAR.

- Fine-tuning of GAAR should be based upon consultations between tax authorities and representatives from specific industry groups and/or professional advisors.
- Cases subject to an authority's scrutiny should be undertaken with sufficient transparency through analysis and review on specific fact patterns.
- A consultative panel should be employed to conduct reviews on the application of GAAR in order to enhance consistencies on interpretations and implementation of relevant provisions.
- Provisions should be laid down to provide specific guidance on, and examples of, circumstances or cases where GAAR should not be invoked.
- Clarity is provided on whether GAAR applications would override treaty provisions (for instance, treaty provisions can be overridden by the Australian or Japanese GAAR, but this is not the case for South Africa).

What constitutes an avoidance behavior, and what triggers the application of GAAR?

This is a difficult question that academics, tax authorities and taxpayers have been trying to address and debate since the introduction of GAAR because each jurisdiction has its own sets of definitions and interpretation of "abusive" or "avoidance" acts via statute, regulations and published guidance or case law.[1]

China's GAAR and relevant guidance

The prevailing domestic GAAR in China predominantly employs a purpose test to identify impermissible arrangements or transactions and, in relation to which, Chinese tax authorities are empowered to adjust or recharacterize the relevant transaction(s) pursuant to Article 47 of the CIT Law. At a high level, GAAR is targeted at arrangements or transactions that lead to a reduction of taxable income and that lack reasonable or bona fide commercial purposes. On this front, arrangements that "lack reasonable commercial purpose" are (generally and broadly) defined as those with a "primary objective" to "avoid, defer or reduce China tax liabilities" (Article 120 of Detailed Implementation Rules).

Similar to other jurisdictions, listening to taxpayers' comments and feedback has been an essential component of refining China's GAAR implementation. This is evidenced by various supplementary circulars issued by the Chinese tax authorities that provide further guidance on how local tax authorities should evaluate tax avoidance arrangements based on the "substance over form" doctrine and that take on board the specific and enumerated fact patterns, as well as the timing, manner and steps needed to put the transactions or arrangements in place. It is also worth noting that, prior to, and in preparation for the formal issuance of SAT Order No. 32, a discussion draft on Administrative Measures of GAAR[2] was issued by the SAT on 3 July 2014 with the intention to solicit comments and opinions from the general public.

With a view to tackling abusive or misuse of preferential tax treatments and/or corporate organizational structures, "economic substance" has also emerged as one of key areas of focus of GAAR investigations. In particular, Guoshuifa [2009] No. 2 stipulates that, where an enterprise lacks economic substance (especially those established in a so-called "tax haven" jurisdictions) and where that enterprise's Chinese tax liabilities are being avoided, deferred or reduced, Chinese tax authorities could launch GAAR investigations on such cases pursuant to Article 47 of the CIT Law and Article 120 of the Detailed Implementation Rules. These may ultimately result in negating or disregarding the existence of the enterprise for Chinese tax purposes.

How is "economic substance" defined?

In China, tax officials tend to focus on a foreign entity's operational substance, namely business activities and operations, number of employees, office space, and assets (among other factors) in determining whether GAAR should potentially be invoked. While such assessment parameters seem easier to quantify, general observations from the limited GAAR cases reported since its introduction indicate that local Chinese tax authorities sometimes have a tendency to pay more attention to the operational substance and may not have given due consideration to the underlying commercial purposes or non-tax objectives of an arrangement.

[1] China follows a civil law rather than case law system, and it is still not common for taxpayers to bring tax cases/disputes to court in China.

[2] The intention of issuing the discussion draft was to solicit comments and opinions from the general public, which indicates Chinese tax authorities' increasing willingness to provide opportunities to taxpayers and other stakeholders to voice out their opinions and concerns on important regulations.

Positive steps taken by Chinese tax authorities

Notwithstanding the above, the issuances of SAT Announcement [2012] No.30 ("Announcement 30") and Shuizonghan [2013] No.165 ("Circular 165") demonstrate SAT's growing degree of understanding of taxpayers' business models and holding structures and its increased willingness to consider the genuine commercial attributes and non-tax objectives. In this regard, some of the key messages and features of Announcement 30 and Circular 165 are important:

- For the same-country exception for listed companies, if a treaty benefit applicant is a listed company, or is 100% owned (directly or indirectly) by a listed company located in the same country, Chinese tax authorities could accept the applicant as the Beneficial Owner (BO) of the income for treaty benefit claim purpose.
- BO status should not be denied merely because an investment company is established for a single project.
- Investment activities carried out could be regarded as business operations for BO assessment purposes.

With a view to aligning its GAAR implementation and relevant interpretations with international practices, and taking into account the introduction of OECD/G20 Base Erosion and Profit Shifting (BEPS) project, in which the Chinese authorities have actively participated and made valuable contributions to relevant discussions, we expect that the SAT would consider and utilize the applicable commentaries and recommendations of the BEPS project to further fine-tune its GAAR application. This could provide greater degrees of transparency and practicality, all of which should benefit both the tax authorities and taxpayers.

Latest developments in China's GAAR

As the above discussions indicate, there remain considerable uncertainties around China's GAAR, particularly as to when and how GAAR may be invoked. In order to reduce such uncertainties and achieve the "balance" as emphasized earlier, SAT released SAT Order No. 32 on 2 December 2014 to provide greater clarity and transparency on the fundamental principles, procedural guidelines and relevant documentation requirements in relation to the application of GAAR.

The key contents of SAT Order No. 32 is summarized as follows:

- A tax avoidance scheme intended to obtain a tax benefit without reasonable commercial purpose[3] shall be subject to GAAR investigations and adjustments
- Key features of a tax avoidance scheme are:
  - The sole or main purpose[4] is to obtain a tax benefit (i.e., a reduction, exemption or deferral of CIT payable)
  - The legal form of the scheme is in compliance with the tax results, but not in conformity with or commensurate with its commercial or economic substance (this is consistent with the "purpose" focus of prevailing GAAR and relevant substance over form approach).
- Tax authorities should evaluate GAAR cases via tests from both the "purpose" and "substance" perspectives.
- Stipulation of a comprehensive set of procedures with respect to GAAR implementation that entails
  - Case selection
  - Case investigation
  - Case conclusion
  - Dispute resolution

It should be noted that SAT Order No. 32 is silent on how to assess "reasonable commercial purpose" and "economic substance". The SAT nevertheless stated that the tax authorities should consider the facts and circumstances of each individual case in its totality when performing the corresponding assessment, whilst reiterating that:

- Lack of "economic substance" remains as one of the key indicators of tax avoidance arrangements.
- "Substance over form" doctrine/test should be followed or undertaken when assessing a transaction that is suspicious for tax avoidance in nature.

[3] It is worth noting that the onus of proof rests with the taxpayer(s) under scrutiny. Other relevant parties, such as the related parties and/or other parties involved in the subject transaction may also be requested by the in-charge PRC tax authority(s) to provide relevant information and/or assist in the investigation.

[4] Note that under the discussion draft issued in July 2014, the term "one of the primary purposes" was also used. It is good to see that the SAT has decided to stick with "sole or main purpose" on this front. Such wording change significantly reduces the applicable scope of the GAAR measures and provides more certainties to taxpayers.

Other recent tax enforcement developments in China

Alongside the Administrative Measures of GAAR discussed in this article, recent months have seen a steady flow of other enforcement news.

On 29 July 2014, the General Office of SAT issued an internal notification, Shuizongbanfa [2014] No.146 (Notification) which requires local tax bureaus in China to investigate significant amounts of service fees and royalty payments remitted to overseas related parties from 2004 to 2013, in particular, those in low tax jurisdictions. The SAT requires local tax bureaus to assess the reasonableness of such payments on both a business purpose and commercial substance basis. For more information, please see **http://ow.ly/D9SKf**. More recently, SAT announced a plan to investigate dividend distributions made to nonresidents in calendar years 2012 and 2013. The first phase of the plan is to focus on the following as part of the data collection process:

- Declared dividends not yet distributed, or dividends paid to a related party or a controlled party in China designated by the foreign shareholder without withholding tax
- Potential disguised dividends
- Conversion of dividends to capital or used for reinvestment without withholding tax
- Treaty benefits obtained by using an agent or a conduit company in a jurisdiction with a favorable withholding tax rate on dividends under a treaty
- Other tax avoidance risks associated with dividends and equity investment

After completion of the data collection, the SAT may undertake risk analysis, risk verifications and assessment of appropriate penalties for tax violations.

The initiative is in conjunction with anti-treaty shopping rule under Circular Guoshuihan [2009] No.601 (Circular 601) issued in 2009. Circular 601 focuses on true beneficial owners of treaty benefits and therefore the notification may measure how effective Circular 601 has been. In light of recent BEPS developments, further anti-treaty shopping provisions may be expected. For more information, please see **http://ow.ly/D9SW5.**

Impact of SAT Order No. 32

The release of SAT Order No. 32 undoubtedly reflects the Chinese authorities' willingness to enhance the transparency and standardization of GAAR implementation, whereby one of the key intentions is to provide taxpayers with greater certainty and a better "feel" on how and when Chinese tax authorities would invoke GAAR.

While further clarifications on the fundamental GAAR principles are set forth under SAT Order No. 32, there remains a number of key uncertainties, including:

- While local PRC tax authorities are now encouraged to adopt the "purpose" test and "substance" test, as cited under SAT Order No. 32 for the purpose of identifying tax avoidance arrangements, "purpose" is not something that can be easily quantified and thus whether a purpose is the "main" purpose of a transaction is subject to uncertainty
- The "economic substance" test may go beyond the traditional paradigm surrounding the underlying facts, and may therefore require more in-depth analysis from various perspectives (e.g., geographies, related industry, risks and benefits and so forth), and may imply that the entire business structure could be subject to review and evaluation, thus potentially lead to different interpretations and perceptions of different parties

Setting aside the uncertainties around SAT Order No. 32, as well as the potential to further fine-tune China's GAAR Measures, SAT Order No. 32 undoubtedly reflects Chinese tax authorities' effort to tackle tax avoidance arrangements and protect its taxing rights.

Future direction for China's GAAR?

In light of the issuance of SAT Order No. 32 and the increasing attention being given to the BEPS project, it is obvious that the SAT is ever more ready to combat tax avoidance and provide greater protection to its taxing rights.

Having said that, we are seeing early signs of SAT's willingness to consider business and non-tax objectives (in addition to the current practice of relying heavily on operational substance) when assessing whether GAAR should be invoked. In addition, with countries more aligned on certain international tax principles as a result of the BEPS initiatives, we hope that GAAR would be invoked only as a last resort to counter tax avoidance rather than for the purpose of countering legitimate and commercially driven tax planning.

Finally, in order to provide greater transparency and certainties on the application of GAAR, we hope that the SAT would consider the introduction of an advanced ruling system, as well as a GAAR panel, at an appropriate time.

Other recent tax developments

China issues circular to encourage corporate restructuring

In March 2014, the State council issued Guofa [2014] No. 14 (Circular 14), urging various government bodies to improve their policies so as to encourage mergers and acquisitions activities in China. In response to Circular 14, the SAT recently released Caishui [2014] No. 109 (Circular 109) to improve the corporate income tax restructuring rules by relaxing the special restructuring treatment criteria under Caishui [2009] No. 59 (Circular 59).

The favorable changes within Circular 109 include a reduction of acquired equity or assets threshold for tax deferral treatment. For equity acquisition, the minimum equity interest acquired is reduced to 50% of the target's equity interest from the previous threshold of 75% for acquisition of equity interest. For asset acquisition, the minimum assets acquired is changed to 50% of the target's total assets from the previous threshold of 75% for acquisition of assets. The provision is applicable to both domestic and cross-border transactions.

Circular 10 also offers new benefits for tax deferral on business restructuring of Chinese tax resident companies, A domestic transferor is eligible for tax deferral treatment if all of the following conditions are satisfied:

- Transferor and transferee are:
  - Parent and 100% owned subsidiary, or
  - Brother-sister companies that are 100% owned by the common Chinese tax resident parent company or the group of Chinese tax resident companies. The common Chinese tax resident parent company or the group of Chinese tax resident companies may be held by a foreign common parent.
- The transaction is effected at net book value.
- Neither the transferor nor the transferee recognizes gain or loss on the transferred asset or equity under China GAAP.
- The transaction is based on valid business purposes and its primary objective is not tax avoidance, reduction or deferral.
- The nature of the business activities associated with the transferred equities or assets must remain unchanged for 12 months following the transfer.
- Circular 109 is effective retroactively as of 1 January 2014 and applies to transfers that are still pending.

China releases discussion draft on revised Tax Collection and Administration Law for public comments

On 5 January 2015, China's Legislative Affairs Office of the State Council released a discussion draft on revised Tax Collection and Administration Law (Draft Law) for public comments by 3 February 2015.

The Draft Law proposes various changes to the existing Law but the following two additions are particularly noteworthy:

- Introduction of an advance tax ruling procedure: A taxpayer may apply for an advance ruling with provincial and higher tax authorities for complicated future transactions. The final ruling will be issued in writing and be binding to the requesting taxpayer unless facts change.
- Tax dispute administration process: Unlike the current law, a taxpayer will be allowed to defer a tax payment until the appeal process is completed.

As noted, the Draft Law contains other changes but whether they will survive further reviews is yet to be seen. There are some uncertain issues such as whether the advance ruling procedure would apply to cross-border tax disputes. Such issues may be addressed in the final law and implementation rules.

India

2015 budget delivers key developments for inbound investors

Ganesh Raj
Tax Policy Leader – India
T: +91 12 0671 7110
E: ganesh.raj@in.ey.com

Rajan Vora
Tax Controversy Leader - India
T: +91 22 6192 0440
E: rajan.vora@in.ey.com

India's Union Budget for 2015-16 was presented by the Finance Minister on 28 February 2015. The Finance Bill, 2015 (FB 2015), that was introduced in Parliament as part of budget contains a number of international tax proposals, potentially amending the Indian Tax Laws (ITL) to provide clarity on taxation of the indirect transfers of Indian assets and also deferring implementation of General Anti Avoidance Rules (GAAR) by two years. Other significant proposals include introduction of Place of Effective Management (POEM) as a test for determining corporate residency, taxation of interest paid by a branch of a foreign bank in India to its head office, enabling provisions to frame foreign tax credit rules, taxation of offshore funds which have fund managers based in India and reporting requirements for foreign payments. The Finance Minister also announced a phased reduction in the corporate tax rate from the current 30% to 25% over the next four years.

International tax proposals of Finance Bill 2015

Taxation of indirect transfers

The ITL was amended by the Finance Act, 2012 to tax gains arising from transfer of a foreign entity whose value is derived directly or indirectly substantially from assets located in India. Concerns were raised by various stakeholders on the scope and impact of the indirect transfer provisions. This resulted in formation of an Expert Committee to examine the rules and various recommendations were given by the Committee pursuant to a public consultation process. The Indian tax administration has also set up a Committee to decide on the ongoing cases relating to the indirect transfer provisions.

With the objective of providing clarity on taxation of indirect transfers the FB 2015 proposes the following amendments effective from tax year 2015-16:

- The share or interest in a foreign entity shall be deemed to derive its value substantially from assets located in India if, the value of Indian assets:
  - Exceeds INR100 million; and
  - Represents at least 50% of value of all assets owned by the foreign entity
- "Value of an asset" refers to the fair market value (without reducing the liabilities) as on the last day of the accounting period of the entity preceding the transfer. However, if the book value of assets has increased by 15% or more from such date till the date of transfer, the date of transfer would be the valuation date.
- The capital gains on indirect transfer will be taxed on a proportionate basis in India. The method of determining the proportionality as well as the manner of determination of fair market value (FMV) of the Indian assets vis-à-vis global assets will be prescribed through specific rules.
- The Indian entity (in which assets are held by the foreign entity) is obliged to furnish information on the offshore transfer which has the effect of directly or indirectly modifying the ownership structure or control of the Indian entity. Failure on the above would result in an onerous penalty of 2% of the value of overseas transfer or INR0.5 million.

Exemptions from indirect transfer provisions

The following transfers are exempt:

- If the transferor of share or interest in foreign entity, along with associated enterprises (AEs), does not hold
  - Right of control or management and
  - Voting power/share capital/interest exceeding 5% in the foreign entity
- In case the shares or interest in the foreign company or entity which is transferred holds Indian assets indirectly and transferor, along with AEs does not hold
  - Right of management or control in relation to such company or the entity; and
  - Any rights in such company by which it can exercise control or management or voting rights exceeding 5% in the direct holding company or entity holding Indian asset
- Transfer of shares of foreign company or entity which derives its value substantially from assets situated in India which are transferred in a scheme of amalgamation or demerger, subject to conditions

Deferral of GAAR

The ITL contain General Anti-Avoidance Rules (GAAR), broad based anti-avoidance provisions which have the effect of invalidating an impermissible avoidance arrangement which has been entered into by a taxpayer with the main purpose of obtaining a tax benefit. GAAR are aimed to address aggressive tax planning and codify the doctrine of "substance over form." GAAR provisions were introduced in 2012 and their applicability has been deferred since then to come to effect from tax year 2015-16.

Certain contentious issues relating to GAAR need to be resolved. Further, the tax avoidance aspects are a part of OECD's Base Erosion and Profit Shifting (BEPS) project to which India is an active participant. In view of the above, the FB 2015 proposes to defer GAAR by two more years — i.e., to come in effect from tax year 2017-18, to be implemented as part of a comprehensive regime to deal with BEPS and aggressive tax avoidance.

Further, it is announced that GAAR should be applicable prospectively and investments made up to 31 March 2017 will be grandfathered. A statutory amendment to give effect to the above is awaited.

Residential status of foreign companies

Under the ITL, foreign companies become resident of India if, during the year, control and management of such company is situated wholly in India.

The FB 2015 proposes that a foreign company will be treated as a resident of India if its POEM is in India at any point during the year from tax year 2015-16 onwards. Further, POEM is defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made. The above amendment is proposed to align the provisions of the ITL with the tax treaties.

Source rule in respect of interest paid by branch of foreign bank to head office

Under the ITL, interest paid to a non-resident (NR) is taxable in India if it is debt incurred or moneys borrowed and used for the purposes of a business or profession carried on in India.

Indian tax administration had issued a circular[1] directing that interest paid by an Indian branch to its head office is taxable in India and should be subject to withholding tax. However, subsequent judicial precedents[2] had held that such payment is deductible while computing taxable income of the Indian branch as per the tax treaty but is not taxable in the hands of the head office being payment to self. Such legal fiction created under the treaty is noted to result in base erosion.

To clarify the issue and prevent future disputes, the FB 2015 proposes that:

- The permanent establishment (PE) (branch) in India will be deemed to be a separate and independent person from the NR (head office)
- Interest paid by the PE to its head office or any other PE of the NR is an interest income sourced in India. Such interest would be taxable in India subject to withholding tax.
- This would be in addition to any income attributable to the PE in India under the tax treaty.

This proposal would be effective from tax year 2015-16.

Furnishing information on payments to NR

Presently, under the ITL, any person making a taxable payment to a NR is liable to withhold tax at the appropriate rates. In addition, the payer is also obliged to furnish certain information to the Tax Authority on such payments. This requirement was understood to apply only to payment of amounts taxable in India.

In order to identify payments on which there is a failure to withhold taxes and to ensure withholding tax at appropriate rates, the FB 2015 proposes that the payer is required to furnish prescribed information on all payments to NR irrespective of whether such payments are taxable in India. Failure in complying with the above provision will result in a penalty of INR 0.1 million. These provisions are proposed to come in effect from 1 June 2015.

Tax treatment of REIT and InviT

The ITL had a special tax regime in respect of a Real Estate Investment Trust (ReIT) and an Infrastructure Investment trust (InviT) [collectively, referred to as Business Trust]. However, there was disparity on capital gains taxation for Sponsor (one who exchanges shares of special purpose vehicle with units), and the normal unit holders (who pick up units

[1] Circular No. 740 dated 17 April 1996.

[2] Including the ITAT Special bench in the case of Sumitomo Mitsui Banking Corporation [136 ITD- 66 TBOM].

after the Business Trust is listed). In order to provide parity, FB 2015 proposes to tax sale of listed units (subjected to securities transaction tax) as follows: (i) long term capital gain is exempt, and (ii) short term capital gain is taxable at 15%.

Rental income earned by ReIT is proposed a "pass through" status and, accordingly, such income is not taxable in the hands of ReIT but taxable in the hands of the Sponsor/ unit holders. ReIT is, however, required to withhold appropriate taxes. The "pass through" status on rental income is not applicable for InvIT.

The above proposals would be effective from tax year 2015-16.

Reduction of tax rates on income from Royalty/FTS for NR

Under the ITL, NRs' income from royalty/ Fees for Technical Services (FTS) which is not effectively connected with a PE in India is taxed at the rate of 25%.

In order to reduce the hardship faced by small entities due to the high rate of tax and to facilitate technology inflow to small businesses at low costs, the FB 2015 proposes to reduce the rate of tax rate on royalty and FTS payments made to NRs to 10% from tax year 2015-16 onwards.

Rules for Foreign Tax Credit (FTC)

The ITL provides a relief in respect of income which is doubly taxed in India as well as in another jurisdiction by way of a credit in respect of foreign taxes paid on income which is taxed in India. The FB 2015 proposes to amend the ITL to empower the Indian tax administration to prescribe rules regarding the procedure for granting FTC under the ITL.

Minimum Alternate Tax on Foreign Institutional Investors

The FB 2015 proposes that income of foreign institutional investors (FII) from transactions in securities (apart from short term capital gains on which Securities Transaction Tax is not applicable) would be excluded while computing book profits for computation of Minimum Alternate tax (MAT).The corresponding expenditure in relation to earning such income would be added back.

Taxation of offshore funds

Under the ITL, income of an NR is taxable in India if it arises, inter alia, through a business connection in India.

Presence of a fund manager in India may create a business connection/taxable presence in India for the overseas fund and lead to income of the fund being taxable in India. Such presence may also trigger exposure of creating residency of the fund in India on the basis of its control and management in India.

In order to facilitate location of offshore fund managers in India, a specific regime in line with international best practices is proposed so that tax liability of the fund from investment in India would not be impacted by the engagement of a fund manager in India and income of the funds from investments made outside India would not be taxable in India merely because fund manager is located in India. The proposed regime provides that:

- In the case of an "eligible investment fund", the fund management activity carried out through an "eligible fund manager" acting on behalf of such fund will not constitute business connection in India.
- An eligible investment fund will not be a resident in India merely because the eligible fund manager undertakes fund management activities in India.
- Offshore fund and the fund manager must satisfy certain conditions to be eligible for the proposed regime, illustratively:
  - The fund is a tax resident of a country with which India has a tax treaty
  - Certain capital and investment related limits are satisfied
  - Fund manager is not an employee of the fund or a connected person of the fund and is appropriately regulated by SEBI and fulfils the prescribed conditions
- The fund is required to furnish a statement in the prescribed form within 90 days from the end of the year. These proposals are effective from tax year 2015-16.

Extension of concessional tax rate on interest on borrowings by FIIs/QFIs

Under the existing provisions of the ITL, interest income earned by FII/ Qualified Financial Institution (QFI) in respect of rupee denominated corporate bonds or a government security is eligible for lower withholding tax rate of 5%. The concessional rate was valid up to 30 June 2015. The FB 2015 proposes to extend this concessional rate of 5% on income earned by FII/QFI till 30 June 2017. This is to bring the above concession in line with the lower rate of withholding tax on External Commercial Borrowings (ECBs) under the ITL.

Key takeaways

The international tax proposals announced by the Finance Minister are far reaching. Taxes are a crucial component of a country's international competitiveness. In today's globalized economy, the structure of a country's tax code is an important factor for businesses when they decide where to invest. In recent years, many countries have recognized this fact and have moved to reform their tax codes to be more competitive. The Finance Minister's announcement of a phased reduction in Indian's corporate tax rate from 30% to 25% would be a catalyst in improving the competitiveness of the Indian economy. The proposal to defer GAAR by two years and the proposal to provide clarity on circumstances when indirect transfer of Indian assets would be taxable would improve the ease of doing business in India. The reduction in tax rate on import of technology would also be welcome. Investors will need to review the impact of these proposals on their operations in India.

South Africa

South Africa's BEPS position: Recent developments provide insight and direction

Justin Liebenberg
Tax Policy and International Tax Services Leader –
EY South Africa
T: +27 11 772 3907
E: justin.liebenberg@za.ey.com

Both transfer pricing and the concept of the G201 Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan have been receiving attention in the South African media and Parliament for quite some time. Two recent developments indicate the importance of the BEPS project to South Africa and provide insight into potential considerations for national implementation as we move through into the second half of the highly ambitious BEPS project.

BEPS and transfer pricing: session in Parliament

On 19 November 2014, a session on transfer pricing was held during a meeting of Parliament's mineral resources and finance committees. Presentations by the National Treasury and the South African Revenue Service (SARS) during this session provide insight into possible future transfer pricing legislation in South Africa. Most notably:

- Over the last three years, the SARS Transfer Pricing unit has audited more than 30 cases and made transfer pricing adjustments of over R 20 billion (about US$1.7 billion) with an income tax impact of R5 billion.
- A similar number of cases are currently in progress and others are in the process of being risk assessed.
- Legislative requirements for multinational enterprises (MNEs) to maintain specific transfer pricing documentation is to be considered.
- Legislative measures to address outcomes of the BEPS Action Plan (e.g. country-by-country reporting) are to be considered.
- Legislative framework for Advance Pricing Agreements (APAs) is to be considered, as such advance agreements on transfer pricing between taxpayers and SARS could alleviate the enforcement burden and encourage compliance.
- While tighter legislation may be needed, SARS recognizes the vital importance of a balanced response within the confines of domestic and international law, while not posing a deterrent to foreign direct investment.

Over the past few months, transfer pricing and BEPS have been the subject of discussions by Members of Parliament on various occasions. In September, one Member of Parliament called for a "comprehensive and clearly articulated law which forbids transfer pricing" during a beneficiation colloquium of Parliament's portfolio committee on trade and industry.[1] Earlier this year, transfer pricing and the possible instances of BEPS in the mining sector were a topic of discussion during a meeting of the Portfolio Committee on Mineral Resources.[2] Against this background, the National Treasury and a research executive of SARS presented on South Africa's Tax Policy Structure and Transfer Pricing and BEPS respectively during the meeting of Parliament's mineral resources and finance committees on 19 November 2014.

Corporate income tax, BEPS and transfer pricing

The presentation by National Treasury on South Africa's tax policy structure (with a focus on corporate income tax) and the presentation by the SARS research executive provided a brief overview of the current corporate income tax act and an explanation of what transfer pricing entails. While the presentations were part of the meeting of the mineral resources and finance committees, it was noted that the extractive industry from a transfer pricing and BEPS perspective is essentially no different than any other sector and is therefore not the sole cause of concern.

Measures against BEPS

The issues of transfer pricing and BEPS were touched upon in the context of South Africa's need for foreign investment in light of the twin budget and current account deficits. Most significant foreign investment comes from MNEs, which are inherently engaged in cross-border transactions with related parties, e.g., through the sale of goods, intangibles transactions, the provision of services and the provision of funding. While such cross-border transactions are in principle beneficial, they can be used to shift profits in order to exploit differences in tax rates between the countries involved. In other words, transfer pricing itself is an essential feature of cross-border activities of MNEs and only "transfer mispricing" is unacceptable.

[1] Linda Ensor, "Clamour to end transfer pricing abuse," 4 September 2014. See http://www.bdlive.co.za/business/2014/09/04/clamour-to-end-transfer-pricing-abuse

[2] Portfolio Committee on Mineral Resources, National Assembly, Wednesday, 2 July 2014.

The threat of BEPS for the corporate income tax base and the tax implications of cross-border transactions and international taxation were addressed. It was noted that South Africa plays a key role as a member of the BEPS Bureau Plus and that a number of measures have already been implemented to address BEPS, some even before the BEPS Action Plan was released by the OECD in July 2013.[3] Such measures include rules and regulations regarding transfer pricing, controlled foreign companies, interest deduction limitations, hybrid instruments and entities, the digital economy and exchange of tax information.

In addition, the Transfer Pricing unit established at the Large Business Centre of SARS was mentioned as one of the responses to the threat of BEPS. In this regard, it was noted that:

- Audits require scarce skills, are resource intensive, requiring understanding of company, industry, global value chain, strategic decision making, business models, etc., and take at least 18 months.
- As a result of limited resources there is a focus on strategic auditing – high risk, high-value transactions.
- Over the last three years the Transfer Pricing unit has audited more than 30 cases and made transfer pricing adjustments of just over R20 billion (at a conservative measure) with an income tax impact of R5 billion.
- A similar number of cases are currently in progress and others are in the process of being risk assessed.
- Due to the size and significance of the extractive industry in South Africa, it remains a key area of focus for SARS.

Insights and implications

SARS indicated there will be an ongoing focus on strengthening SARS capacity and capability. At the same time, there will be a continual review of audit and risk assessment processes and an ongoing dialogue with MNEs on levels of tax compliance. On an international level, SARS will continue its participation in and cooperation with, inter alia, the OECD, the United Nations, the African Tax Administration Forum (ATAF) and the World Bank. It will also continue its cooperation with other tax administrations and review international approaches to the extractive industry.

With respect to the future of transfer pricing and possible measures against BEPS, it was specifically mentioned that:

- Legislative requirements for MNEs to maintain specific transfer pricing documentation is to be considered.
- Legislative measures to address outcomes of the BEPS Action Plan (e.g., country-by-country reporting) are to be considered.
- Legislative framework for Advance Pricing Agreements (APAs) is to be considered, as such advance agreements on transfer pricing between taxpayers and SARS could alleviate the enforcement burden and encourage compliance.

SARS noted there is no easy solution and it has to work within the confines of both domestic and international law. While tighter legislation may be needed, SARS recognized it is vitally important to respond in a manner that is balanced and does not pose a deterrent to foreign direct investment. In this regard, it is worth noting that additional measures may come from the Davis Tax Committee following its review of the corporate tax system with special reference to tax avoidance (e.g., base erosion, income splitting and profit shifting).[4]

Davis Tax Review Committee issues a draft interim report on BEPS

November's Parliamentary session was followed shortly afterwards by the publication of the first interim draft report of South Africa's Davis Tax Review Committee on 23 December 2014. As background, the Government established this committee in 2013 to investigate the various aspects of the South African tax policy framework. The report asks for interested parties to provide comments by 31 March 2015.

Once the report is finalized, its recommendations will inform future tax policy development in South Africa and may translate into domestic tax legislative amendments if accepted by the Minister of Finance. Not all of the OECD's BEPS Action items are covered in the report, which focus on Action 1 (Digital economy), Action 2 (Hybrid mismatches), Action 5 (Harmful tax practices), Action 6 (Treaty abuse), Action 8 (Transfer pricing with regard to intangibles), Action 13 (Transfer pricing documentation) and Action 15 (Develop a multilateral instrument).

[3] See http://www.oecd.org/ctp/BEPSActionPlan.pdf for more information.

[4] On 17 July 2013, the South African Minister of Finance announced the members of a tax review committee (the Davis Tax Committee) to inquire into the role of the tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability. See http://www.taxcom.org.za/ for more information.

Digital economy

The report notes that there is no urgent need for the amendment of the rules to address various aspects relating to outbound e-commerce businesses. The main recommended adjustments related to e-commerce include:

- Adjustment of the foreign tax credit provisions
- Adjustment of the source rules for the digital economy and supply of digital goods and services
- Rules on the characterization of typical e-commerce payments
- Rules to require nonresidents that derive SA sourced income (other than passive income) to file income tax returns even if they do not have a permanent establishment in SA

SA will continue to monitor the OECD work on the permanent establishment threshold for the digital economy.

Hybrid mismatches

The report notes industry sentiment that SA is ahead of the curve in terms of legislating anti-avoidance measures to curb the use of hybrid instruments and entities. In the main, the key domestic provisions are: coordination rules prescribed in the definition of "foreign partnership" and dividend, interest deduction limitation rules, and hybrid debt and hybrid equity rules.

Key recommendations of the report include:

- Legislative simplification and refocusing the various rules on legal principles underlying hybrids rather than specific transactions
- Balancing the need for interest deduction limitation rules to curb BEPS against SA economic imperatives of attracting foreign direct investment and encouraging international trade
- Considering the use of the UK approach to matching "manufactured payments" instead of anti-avoidance legislation
- The use of the general anti-avoidance rules and common law substance versus form rules to combat BEPS, as a last resort

The report also calls for the focus to be honed on mismatches that erode the SA tax base in the context of Double Taxation Agreement (treaty)

Harmful tax practices

The report highlights the importance of South Africa's aspiration to remain an investment gateway to Africa as noted, in among others, the National Development Plan (the Government's economic transformation blue-print). This aspiration is assessed against SA's international obligation not to engage in harmful tax practices. To this end, the report recommends that the current headquarter company regime (which provides for investment gateway into Africa) should prescribe the minimum substance requirement as per the OECD recommendations. Currently, there is no minimum requirement for setting up a HQ company in South Africa. However, substance is impliedly required for a HQ company to qualify for treaty benefits.

The report also notes that SARS should not sanction advance tax rulings "that foster harmful tax practices and hamper transparency." Furthermore, it is recommended that, in line with OECD recommendations, SARS should exchange rulings with foreign tax authorities on a spontaneous basis, where SARS is aware that the ruling affects residents of that country.

Preventing treaty abuse

Several recommendations are made on the improvement of SA treaty network with a language that would counter treaty abuse, in line with OECD recommendations. The recommendations include:

- Adjust the preamble to treaties to express a clear statement that treaties are not intended to avoid or create opportunities for double non-taxation or reduced taxation
- Introduce a limitation on benefits clause (along the lines of the US treaties)
- Use of the "principal purpose test" in treaties to counter the use of aggressive financing structures. The principal purpose test is in line with the existing domestic general anti-avoidance provisions and would follow the example of Article 11(9) of the SA – Brazil treaty. The test will target the assignment and cession of underlying financial instruments with the main or one of the main purposes of taking advantage of treaty provisions.

The report also calls for the renegotiation of treaties with zero withholding tax rates and that do not allocate source taxing rights for land rich shares and notes the stalling of the finalization of the SA-Mauritius revised treaty. The policy of renegotiating favorable treaties with low tax jurisdictions has been a key focus for a while and the report adds significant impetus to that initiative.

Finally, it is proposed that the policy of granting foreign tax credits (cash flow relief pending engagement by competent authorities) for South African sourced income should be reconsidered. The policy apparently encourages treaty partners to impose income tax on SA sourced income in total disregard of the treaties.

General transfer pricing considerations

The report recommends the official adoption of OECD standards through express legislative provision or general binding ruling. Currently, the OECD TP Guidelines are applied as a matter of practice. The adoption of the OECD standards would be adjusted without deviating from the core, in order to reflect the SA reality. No additional information is provided on the nature and extent of the adjustments to be considered. In addition, the report notes that the SARS capacity on transfer pricing should be bolstered.

Transfer pricing of intangibles

Measures to curb the export of intellectual property (IP), capping royalty rates and preventing the erosion of SA tax base through deduction of royalties related to previously SA owned IP currently exist within the exchange control and tax framework. The key tax rules are transfer pricing rules, prohibition of claiming deductions in relation to previously SA owned IP, limited or no controlled foreign corporation (CFC) exemptions for IP and the beneficial ownership requirements in the treaties. Given the extent of these measures, no general action is recommended in relation to the implementation of the OECD BEPS Action 8. However, concerns were noted in relation to the valuation of IP and limited remuneration of SA counterparties in the context of a contract research and development (R&D) arrangement.

Transfer pricing documentation

The current transfer pricing rules do not expressly require transfer pricing documentation, although such documentation is recommended from a risk mitigation perspective. The report recommends the adoption of the OECD three-tiered structure in relation to transfer pricing documentation, i.e., master file, local file and country by country reporting. The threshold for compulsory documentation will relate to large multinationals with over a R1 billion group turnover.

Development of a multinational instrument

The report supports the OECD approach to adoption of a multinational instrument to effect amendments in numerous treaties. SA is currently party to several multilateral instruments on mutual assistance in tax matters.

Given that the DTC report is still in draft format and Treasury has not yet considered industry views on the recommendations, it is unlikely that the more onerous recommendations will translate into immediate legislative amendments in the current fiscal year.

Conclusions

While both the Parliamentary session and the interim draft report of the Davis Tax Review Committee have both occurred well in advance of the final BEPS recommendations, together they indicate the broad range of implementation measures each country will be considering. In respect to South Africa specifically, the news that Legislative requirements for multinational enterprises (MNEs) to maintain specific transfer pricing documentation is to be considered is not surprising at all, given the groundswell of countries who have already moved in that direction in recent years. Perhaps more welcome is the news that a legislative framework for Advance Pricing Agreements (APAs) is to be considered. The lack of an APA has long been a bone of contention for business and it is hoped that, in the context of the potential for a rising number of transfer pricing disputes, all efforts will be made to put this in place sooner rather than later.

More broadly, the Davis Committee report provides an early, highly interesting insight into just how many areas of legislation the BEPS project will potentially impact in each country. While not every country may give such clear opportunities for business to engage in the process, it is clear that where that opportunity is granted, business should take every chance to provide input. This really is the period when changes are going to occur and any feelings of "BEPS fatigue" need to be shaken off.

Featured Perspective

The UK's Diverted Profits Tax: A Roundtable Discussion

by Mat Mealey, Simon Atherton, Chris Sanger, Jenny Coletta and Rob Thomas

Mat Mealey is International Tax Services National Office Leader and Simon Atherton is Transfer Pricing and Operating Model Effectiveness Leader for EY in the United Kingdom. Chris Sanger is Global Tax Policy Leader for EY and Jenny Coletta is EY's EMEIA Insurance Transfer Pricing Leader; both are also based in London. Rob Thomas is a director in EY's Tax Policy and Controversy global network and is based in Washington.

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In this roundtable discussion, the group discusses the objectives, workings, and application of the UK's proposed diverted profits tax, which were passed and became effective on 1 April 2015.

Rob Thomas: Mat, before we get into the mechanics of the diverted profits tax (DPT), can you tell us a little bit of the background about how it came about and what was driving the UK government to introduce it?

Mat Mealey: There are three key drivers. First, it is political. The UK government believes that the UK electorate is hostile to international tax avoidance, which they understand to be the type of arrangements that they've read about in newspapers and that have been before the UK Parliament's Public Accounts Committee. This is where there are profits in low-substance, low-tax entities and where the source of the revenue that generates the profits is in the UK. Secondly, it's revenue raising – this new tax is predicted to raise about a billion pounds over a five-year period. The DPT has cross-party political support in the UK and because of this it seems unlikely that there will be any scope for delay or fundamental
policy change.

Thirdly, it is about driving behavioral change. In this regard, I have a feeling that HM Revenue and Customs, the UK's tax administration, is sometimes frustrated that in the case of certain transactions that they believe might erode the UK's tax base it's very difficult to get full information about the transactional flow. They feel they are being held at a distance, being told that the counterparty with the direct transaction with the UK doesn't have access to the information higher up the chain. Now with DPT, they can stimulate a change of behavior, because, in simple terms, if the taxpayer doesn't provide the information, then there will be a penal charge and they won't get money back until the information is provided

Thomas: I know we've had a consultation process in early 2015 – what was the outcome from that?

Mealey: Unsurprisingly, while the consultation process was very real, we didn't see the withdrawal or fundamental amendment the rules. However, it is clear that the rules are intended to be closely targeted on what the UK perceives to be abusive arrangements. The consultation showed that the literal design of the rule didn't achieve that objective, and we saw the provisions narrowed down. As an example, HMRC recognize the "notification requirements" may need to be narrowed.

The UK says its policy is to be "open for business" but tough on avoidance, having a competitive tax system and low rate of tax – but they expect you to pay the low rate of tax on the net profits you generate here. So the UK government would say that the rule forces alignment of profits with substance and is aligned both with that policy and the base erosion and profit-shifting initiative.

"There is a second category of taxpayers for whom HMRC is unsure of the transfer pricing arrangements, and hence notifies the company that the DPT applies to their situation. These companies will get an assessment, they will have to pay quite a penal amount of tax, but then will have that tax refunded when they provide the transparency over their arrangements and prove their transfer pricing."

Chris Sanger: What about legality? Won't there be questions about whether the rules are legal and enforceable, both under treaty provisions and EU provisions?

Mealey: What we can say at this stage is that they've been designed to be legal and enforceable, with full recognition that they are intended to contradict treaties and they are intended not to be susceptible to EU law override. In my view, the UK has generally judged this well in the past. There will inevitably be some questions around legality of the tax but it will be risky and expensive to challenge. In the vast majority of cases, the DPT can be switched off with arm's-length transfer pricing where all relevant arrangements have been made transparent to and agreed with HMRC. We can expect that is likely to be the preferred way forward in most cases. The DPT applies from 1 April 2015, and there are two charging provisions. First, there will be a charge if there is avoidance of a permanent establishment, and second, if there are transactions involving entities or transactions without economic substance. It's a penal charge with a penal rate and a penal tax base, certainly during the assessment period and sometimes afterwards if there is recharacterization. This incentivizes restructuring out of DPT as well as increased value chain transparency as you need to prove the robustness of your transfer pricing, through multiple tiers of transactions if they affect the UK. Controversially, the mechanics of the assessment rules shift the balance of power in negotiations over transfer pricing in high-risk cases toward HMRC.

Triggering the DPT

Thomas: Jenny, why don't you take us through the three circumstances where we think the DPT might be triggered?

Jenny Coletta: There are three high-risk circumstances. First is PE avoidance transactions, where you would have a transaction with UK customers and the transaction is designed to avoid a PE. In those circumstances, when the other threshold conditions are met, we have a deemed PE of a nonresident created in the UK. Profits would be attributed to the deemed PE on an arm's-length basis and would be taxable at 25%, being a penal tax that is 5 percentage points higher than the 20% rate due to apply when the DPT comes into force on April 1, 2015.

Second, we have non-arm's-length transfer pricing. If there is a transaction that involves arrangements that reduce the UK tax base and involve non-arm's-length transfer pricing, then there would be a 25% penal DPT adjustment on the non-arm's-length portion of the transfer price.

It's not obvious how you would have a non-arm's length transfer pricing transaction into the UK because the UK has arm's-length transfer pricing rules, but the DPT impact could be possible in two circumstances. Firstly, since the DPT rules can be imposed through HMRC issuing a charging notice, this may be as a result of HMRC deeming the transaction to be non-arm's-length based on their interpretation of the transfer pricing rules — which may differ from the taxpayer's own self-assessment. Secondly, on indirect transactions — transactions that don't directly touch the UK.

Then finally, there is recharacterization of transactions, where you have UK nexus with offshore assets or risks. If the right conditions are met, then the legislation can apply to recharacterize the transaction, so the asset or risk is assumed to be held onshore, and therefore again, you would have the diverted profits tax of 25% in the UK.

Simon Atherton: The gateways into the rules are different, depending on which part of the rules you are in. Firstly, many taxpayers will be obliged to give notification that they are potentially liable to DPT; it's a broad test for entry into the regime. However, many of those taxpayers will probably get a nil assessment.

Then there is a second category of taxpayers for whom HMRC is unsure of the transfer pricing arrangements, and hence notifies the company that the DPT applies to their situation. These companies will get an assessment, they will have to pay quite a penal amount of tax, but then will have that tax refunded when they provide the transparency over their arrangements and prove their transfer pricing.

Thirdly, there are taxpayers for whom the arrangements are currently avoiding tax, due to PE avoidance. For those taxpayers, they will be able to avoid the DPT charge at 25% by restructuring their arrangements to come within the corporate income tax charge (by then at 20%). Then there's a final class of taxpayers who fall within the DPT charge and don't restructure their arrangement and actually pay the penalty rate of tax.

Thomas: Let's go back to the PE avoidance case. Can you give us an overview of the potential mechanics of the rules?

Atherton: Basically, this focuses on a non-UK company providing goods or services to customers in the UK, where somebody is carrying on an activity in the UK in connection with those supplies. You then have to look at whether it's reasonable to assume that the activity has been designed to ensure that there isn't a PE in the UK. Importantly, you have to make that assumption ignoring any commercial objectives that may have driven how activities may have been designed. That is quite a wide entry into the charge. We then have two tests that have to be met, although both can be met at the same time. First, you have the mismatch condition, or you have the tax avoidance condition. The mismatch

> "The key wording here is "reasonable to assume." It is currently unclear what is reasonable to assume and in what scenario you may or may not have been able to or decided not to pay the UK tax."

condition is basically that in between the foreign company, there is a tax-effective arbitrage (80%) via a transaction or a series of transactions. In addition, the mismatch condition requires that there is insufficient economic substance, which I'll come to shortly.

Tax avoidance condition

The tax avoidance condition is very simple. It basically says "in connection with the supplying of goods and services, is it possible that one of the main purposes, or the main purpose itself, was to avoid the charge of corporation tax in the UK?" The only guidance is that this definition of tax avoidance is to be as per common language in UK tax law, so again that is potentially quite broad.

This is satisfied if there is an insufficient financial benefit referable to the transaction (that is, in comparison to the tax arbitrage), or where in a series of transactions a person or an entity that is part of those transactions and has economic value less than the value of the arbitrage.

Interestingly, the UK has so far said that the economic value is to be measured solely by the function performed by the staff of that entity. That can include directors and external staff where activities are outsourced, provided they are under the company's direction. In each case, depending on which part of the insufficient economic substance condition is met, you have to ask if it is reasonable to assume that transaction is designed to secure the tax deduction. Basically, if you have more than 80% tax-effective arbitrage and you have insufficient economic substance somewhere along the line, then you meet the mismatch condition in total, and once again the DPT will apply.

Under the tax avoidance route, the DPT basically seeks to tax the profits of the avoided PE on an ongoing basis, so you would likely have some kind of distribution return allocated to the PE in the UK. This is also likely under the mismatch route, but importantly, the mismatch condition also allows for the recharacterization, so where there is a provision somewhere along the route that wouldn't have been made or imposed without the tax advantage, HMRC can propose a replacement that is on a just and reasonable basis. That is very broad and is the first time that we've seen something as broad, and we are unclear at the moment exactly how that is going to be applied. Clearly that has been put in place because there is a feeling that the existing recharacterization of business in the OECD guidelines has not been providing HMRC with the ability to attack some of the transactions they dislike. However, the recent OECD BEPS discussion draft on actions 8-10 (risk and recharacterization) seems to introduce more stringent recharacterization provisions than is currently the case in the OECD guidelines, and there are similarities with the DPT proposals in this regard.

Thomas: So section 2 is actually probably the more basic of the provisions despite what that might sound like, having run through it. Why don't you take us through section 3, Jenny?

Coletta: Section 3 is a separate charging provision that is completely separate from section 2 and applies when you've got a PE or a subsidiary in the UK. Essentially, section 3 looks to apply a DPT charge where there are transactions between connected parties by means of a series of transactions or a single transaction where one of the parties is resident in the UK. So this could be any type of transaction, other than loan relationships. The provision applies in similar circumstances to section 2, but the precise criteria are slightly different. There is still an effective tax mismatch condition, but it is a different test. Again there is an insufficient economic substance condition, and this is essentially the same test as section 2.

The mismatch provision is related to a tax paid test. The test looks at the extent to which the overseas company is paying tax on the transaction upon which the UK entity has essentially not paid tax. The test here really relates to a percentage of the UK rate, and the safe harbor is set at 80%, so where you've got overseas companies that have an effective tax rate of less than 16%, then you are potentially in these rules. Whilst the rules relate to the tax paid, it does allow the use of losses — there are references to allowing offset of losses in the overseas companies but the refund of tax (by means of a tax credit) can potentially add to the tax paid mismatch.

This test is interesting and unusual compared to what we are used to seeing in other parts of UK legislation.

Once you've gone through that analysis, you then need to look at the insufficient economic substance test. The first pillar is: "Do you have a financial benefit that is in line with the tax benefit?" So, for example, if your tax benefit is greater than any other type of financial benefit, then you are potentially into this test. If you meet that test, then you have effectively breached the insufficient economic substance condition, even if you then have sufficient economic substance.

If you are into the charging provision, the rules can adjust the transaction to an arm's-length transfer pricing amount. If your transfer pricing is all in line, then you have to go through the recharacterization test and look at the extent to which it is reasonable to assume that the transaction would have taken place were it not for the tax benefit and as compared to alternative arrangements. The key wording here is "reasonable to assume." It is currently unclear what is reasonable to assume and in what scenario you may or may not have been able to or decided not to pay the UK tax. Again there are some similarities with the proposed changes to the OECD guidelines outlined in the BEPS risk and recharacterization discussion draft, which talks about "reasonable expectation."

Thomas: So let's just pause for a moment. What do you see as the high-level messages so far?

"Although the charge is on the deemed PE in the low-tax jurisdiction, and therefore the low-tax jurisdiction is always initially assessed, the tax can be collected from the UK company in default, and that's common throughout all of the DPT rules."

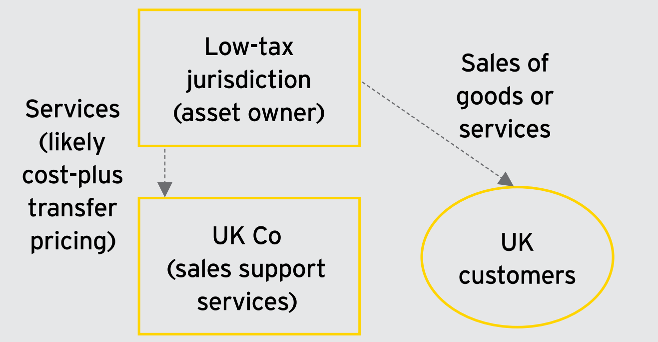
Mealey: I think that taxpayers with a DPT exposure will most likely respond by altering their corporate structure, because the DPT is at a higher rate than the UK main CIT rate and it's a broader base than the UK base. I could visualize that a very small number of taxpayers might not want to do that because in so restructuring, you might have to recalibrate your transfer pricing into the UK. And if you are using the same methodology in 60 countries, you might not want to adjust your transfer pricing in the UK because of the lack of consistency with other countries.

A second point is that, in the vast majority of cases, transparent transfer pricing approved by HMRC is likely to switch off the DPT and avoid the risk of punitive or upfront assessment. Structures at risk of a DPT charge are not going to be that difficult to identify – there will be UK-source profits, UK–source customers, and lots of profits arising in an entity with low substance and low tax.

A third and very controversial point: Foreign-to-foreign transfer pricing with low-substance entities is going to have to be at arm's length where it leads, in HMRC's view, to UK tax base erosion. Companies will need to have regard to HMRC's interpretation of the foreign transactions.

Thomas: Simon, could you bring this alive with an example?

Figure 1. PE avoidance cases: direct example



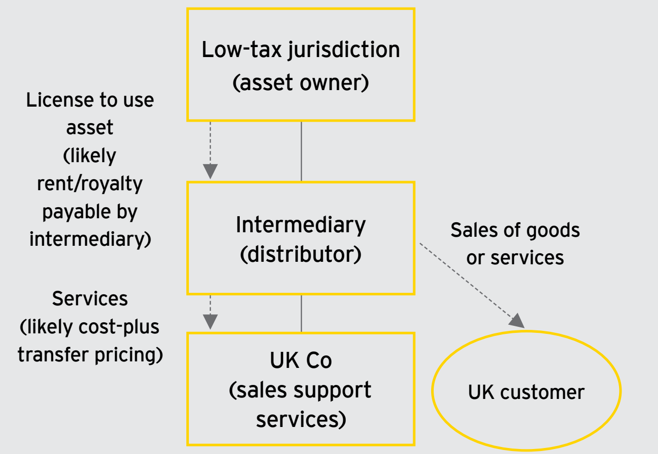
Atherton: Consider a foreign company in a place that is viewed as a low-tax jurisdiction, which is providing goods or services to UK customers. It has someone in the UK undertaking activity in association with the provision of those goods or services, such as a UK company operating as a sales support vehicle, on cost-plus return.

So first HMRC will ask whether, ignoring commercial imperatives, it is reasonable to assume that activity has been designed to avoid a PE. In this case, we are not looking at the mismatch provisions, since it requires another entity, or series of entities, on top of this transaction. Therefore, we look at the tax avoidance condition, which is the other route into section 2, asking when tax avoidance is the main purpose or one of the main purposes in establishing the activities.

So how would such an assessment apply in practice? In this case, the offshore entity would have to notify that it is potentially liable to the charge. The assessment would be what HMRC believes is the best estimate of the profit that would be in the PE, which most likely would be some form of distribution return. As there is no mismatch, you don't recalculate the tax base upon which the profit is charged, and also the recharacterization provision does not apply.

Although the charge is on the deemed PE in the low-tax jurisdiction, and therefore the low-tax jurisdiction is always initially assessed, the tax can be collected from the UK company in default, and that's common throughout all of the DPT rules.

Figure 2. PE avoidance cases: indirect example with mismatch



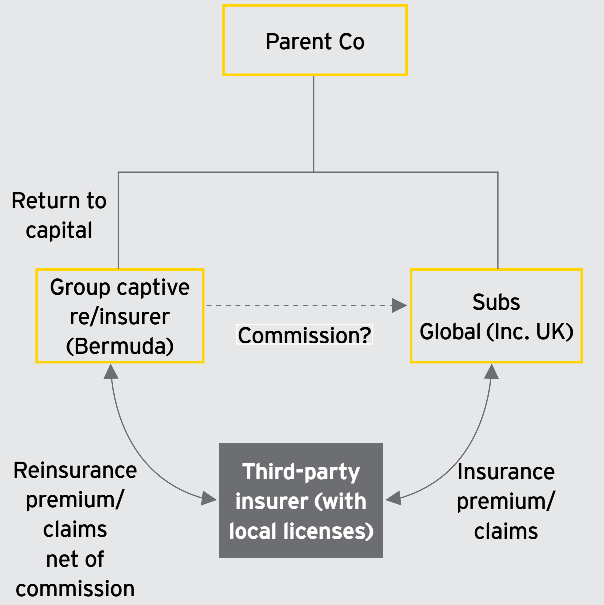
Mealey: This next example illustrates an indirect structure, where the territory that is avoiding the UK PE is itself base eroded to somewhere else. Consider a low-tax asset owner who licenses the right to use the asset to an intermediary distributor, based in a treaty-qualified territory with a 10% effective tax rate. The intermediary distributor has a UK sales support function that provides services to the distributor but doesn't conclude contracts, and hence there is no PE. The intermediary sells the goods or services to the UK customers. Under the rules, is it reasonable to assume that the activity of the intermediary distributors (that is, the 10% tax rate country) is designed to avoid a UK PE? Yes, it is – in this case, we don't test the tax-avoidance motive, because we already have a tax mismatch and a material provision (being the license from the low-tax jurisdiction to the intermediary) that is base eroding the intermediary from 10% down to a rate of less than 80% of 10%.

If the mismatch condition is triggered, the insufficient substance condition must also be tested. The transaction that gives rise to the mismatch is that royalty or license from the low-tax jurisdiction to the intermediary, so it's a single transaction. We have to test whether the financial benefit of the tax reduction is less than the financial benefit of the transaction. If this threshold is met, there is another test: Was the contribution of the low-tax jurisdiction staff or the intermediary staff less than the tax benefit of the transaction? That will have to be evaluated on a case-by-case basis.

The mechanics here are interesting because in the first case, where there was direct avoidance of the PE, we just had a deemed PE, but here we have a deemed PE of the intermediary in the UK and we have to look at the base eroding payment to the low-tax jurisdiction. If HMRC is not satisfied that that payment is at arm's length, then the assessment mechanics disallow 30% of the royalty. You then have to pay that tax, but if you prove that the transfer pricing was right, the tax will be paid back to you, with interest. So by interposing the intermediary, you get a worse outcome: a worse assessment protocol and the risk of recharacterization.

Thomas: Hopefully, that has illustrated some of the mechanics and the consequences of the section 2 PE avoidance cases. Jenny, why don't you walk us through a section 3 case involving a low-substance transaction or a low-substance entity?

Figure 3. Section 3 Case involving a low-substance transaction or low-substance entity



Coletta: Let's consider captive insurance, by which I mean an insurance transaction within a group that is not an insurance group. This diagram represents captive insurance with a third-party insurer, which many non-insurance companies might have within their group. The captive will be licensed and regulated in the territory in which it is located, but it will essentially transact business with the rest of the group, often through a third-party insurer that essentially provides the licenses in all the locations in which the group carries out business. So the subsidiaries of the group will enter into insurance arrangements with the third-party insurer, but the third-party insurer is merely providing a license and a balance sheet, and then that risk is essentially reinsured back into the captive.

"The UK generally does not believe you need large numbers of people to create value, but you do need the people who control the development, enhancement, maintenance, and/or protection functions."

This enables the group to retain the risk within its own corporate structure, and to essentially aggregate the risk, which from an insurance capital perspective gives you diversification and aggregation benefits. This DPT provision could potentially apply here due to the need to assess whether there is a tax mismatch as a result of the arrangement and, in this case, the UK subsidiary would be claiming a tax deduction for the payment of the insurance premium. In many cases, the premium may ultimately end up in a low-tax jurisdiction, and therefore the 80% test might be met. Given this, we need to look at whether there is insufficient substance.

In thinking about the two aspects of the insufficient substance test, we need to consider whether the financial benefit of the arrangement effectively outweighs its tax benefit. That, in the context of insurance, is a difficult test. Often, the aim of a captive insurer will be to aggregate risk for the business as a whole to achieve better return on capital and to diversify that capital. That isn't something we can measure through GAAP accounts or financial reporting; it's something that we typically measure through economic capital modeling, involving actuarial assessment of the risk. Furthermore, given insurance contracts may often be multiyear, this tends to be measured at the outset of the contract (without the benefit of knowing the outcome of the insured event) and considered over the life of the contract. Whereas the DPT rules seem to suggest a test based on the outcome for a particular year in isolation. This test could therefore be onerous for taxpayers.

Then, you have to look at the more traditional substance test — are there enough staff in the captive to effectively generate this level of return in it, for example. Captive structures can often be run in conjunction with captive managers on an outsourced model, with relatively low cost base, helping to optimize the capital base. However, we can expect that this will come under greater scrutiny of the result of the DPT (and also the OECD BEPS actions 8-10 proposals). The assessment mechanics are the same as those outlined in the previous example, so there is a need to notify HMRC if you think that you are in these rules, and you may have to make a payment pending the assessment. This example will be of interest to both groups with a captive, and also to insurance groups who may reinsure risk intragroup in order to optimize capital efficiency. Also for insurers whose customers are the captives, because they may get questions from the captive asking them to prove that the transaction and the premiums are at arm's length. Clearly that is not the responsibility of the insurer — it's the responsibility of the captive — but it may need support in coming to that conclusion.

Pre-filing agreements

Thomas: So given all that we have covered so far, what about prefiling agreements? Should companies do some kind of protective filing?

Mealey: The safest situation to be in is if your arrangements are fully transparent to HMRC, so they understand all of the flows and they've given an advance pricing agreement. At a workshop on January 8, HMRC confirmed that there will be no clearance procedure for DPT as the rules are fact dependent. The safest approach for taxpayers to take is to provide HMRC with full value chain transparency and agree to an APA for high-risk cases. An existing APA switches off the 30% disallowance (as the transfer pricing will be assumed to be right) but not necessarily recharacterization of the actual provision or PE avoidance. An APA struck after April 1, 2015, will switch off the DPT.

Thomas: We keep on talking about 80% of the headline corporate tax rate (which will be 20% by April 1, 2015), but the UK itself has a much lower rate due to its patent box. How does that affect this?

Mealey: What you have to do is identify the material provision that gives rise to the tax mismatch. So consider a royalty payment: You have to look at the cash tax rate of the royalty deduction. If you are getting 10% in the UK, because you are in the patent box, then it's 10%. Then you have to look at the other side of it and say, "Is it 80% or more of that?" Indeed, the other side of it can be in the UK, so if you had an arrangement where a 20% UK company was turned into a 10% UK company without substance, you would be within the DPT because you would fail the tax rate mismatch.

Sanger: Will companies convert the UK sales support services to distribution companies, so that the intermediary distributor simply sells goods directly to the UK distribution company, and the UK distribution company buys the goods from the intermediary, generating profit in the UK that is consistent with arm's-length transfer pricing, presumably based on some percentage of revenue? Will that address the PE avoidance issue in this case?

Mealey: It would switch off the PE avoidance case completely, but it would also put you into the low-substance mismatch case. If the intermediary distributor is in a location with a tax rate of, say, 15%, then the payment would be from 20% to 15%, being below the 80% threshold. Therefore, you would have a tax mismatch, and would have to ask the question of whether there is sufficient substance in the intermediary distributor to defend the payment. If there was, you wouldn't be in the DPT. But if the intermediary distributor itself paid a royalty to a low-tax jurisdiction, then you would have to test the substance by reference to that low-tax jurisdiction, not by reference to the intermediary distributor.

IP ownership

Control over the IP ownership functions in the low-tax jurisdiction would switch off the mismatch, because you would have sufficient substance. In the alternative, if you moved the IP to the intermediary distributor, but you didn't have control over the IP ownership functions and you just had distribution functions in the intermediary distributor, I don't think it would switch off the mismatch. So I don't think there is a generic solution; onshoring to the intermediary distributor

"You wouldn't need this tax if you rewrite the PE article. I think the UK must perceive there to be a risk that consensus around PE and transfer pricing changes might take quite some time to win."

and paying tax of 15 percent is still a mismatch. To protect yourself from the rules, you would need to also move the IP ownership function into the intermediary distributor; if you couldn't do that, then you would still have a risk of the DPT applying.

Thomas: What substance do you need for the IP ownership?

Mealey: There are a few points we can say about that. One is that the UK generally does not believe you need large numbers of people to create value, but you do need the people who control the development, enhancement, maintenance, and/or protection functions. You don't necessarily need them to be there permanently; you just need them to be employed, and you need to exercise the function in the entity. Outsourcing and specialization of function and control of specialized functions by head office is a normal part of what HMRC expects to see in multinational groups.

What precisely is needed depends on the facts and circumstances, and you can secure APAs with HMRC. However, these are APAs that are generally quite difficult to obtain, and you really have to describe the functions in the low-substance IP owner and dig into who does what. Also, this is so subjective and fluid that it can be difficult to conclude without making sure HMRC agrees. If you are a low-substance entity, you may want to make sure that HMRC understands the level of substance and confirms its agreement. This is the real game changer from the DPT: HMRC's agreement on the transfer pricing becomes even more important to obtain.

My current expectation is that without an APA there is a risk that you will suffer a 30% disallowance on the royalty or service fee or product price paid to the intermediary distributor and may have to pay DPT on that at 25%, with the possibility of getting that back, with interest, if and when you prove the transfer pricing. I think that is exactly what HMRC wants to achieve — to drive and force transparency. It wants to make sure that transactions are at arm's length and to test that by reference to its own interpretation of OECD standards.

Thomas: Does HMRC have enough people to actually react to what looks like what will be a real uptick in APA applications?

Mealey: Extra resource was made available to build HMRC's transfer pricing team in last year's UK budget, but it's not clear that they have enough resource to deal with the DPT. It depends mostly on how many groups are going to be in the regime. There are lots of transactions that are in the boundaries as currently drafted, but if the provisions are refined and ultimately lots of companies fall outside of it so that it's just a narrow class of company, then maybe the resource is there. If it ends up being very wide ranging, then there is a real danger. In that case, there will be lots of companies, I think, who will be at risk of an upfront charge (which in some cases may be very substantial) and will have to fight to get the money back.

Personally, I would be very surprised if that is the outcome, as HMRC tends to draw the boundaries quite narrowly, but it is a real risk, and we shouldn't assume that it isn't a risk until we definitively know that it's not.

Thomas: If the DPT is not actually a corporation tax, does this mean that other jurisdictions will not accept it as such? What I'm thinking here is mutual agreement procedures — are companies going to be able to get relief?

Atherton: It's deliberately a penalty tax in order for it not to be corporation tax and therefore not subject to treaty overrides, so the UK can collect it. It doesn't look creditable in some cases, but obviously that will be a question for the overseas territory.

Coletta: There is also an accounting question as well, which groups will need to discuss with their auditors. If the DPT is not tax on the profits of the company, is there a potential risk that it is an above-the-line tax for financial reporting purposes?

Thomas: How might other countries respond? Do you expect anyone else to adopt a DPT? And what about the interaction with BEPS action 7 on PE?

Sanger: I don't think we know yet. The issues that this tax is tackling are very high-profile issues for several countries, including Australia, France, Italy, Spain, and maybe to a lesser extent, Germany. It seems to me that the DPT is also highly relevant for US corporations, because it seems to be highly likely that it will impose a greater tax burden on the foreign profits of some US corporations, so a rather more negative outlook from the US might be expected.

On the point you make about action 7 on PE, I think you wouldn't need this tax if you rewrite the PE article. I think the UK must perceive there to be a risk that consensus around PE and transfer pricing changes might take quite some time to win.

In terms of the wider BEPS initiative, Pascal Saint- Amans [director of the Centre for Tax Policy and Administration at the OECD] has already commented that "it's a bit bizarre that in the middle of the project, you have a country acting unilaterally because that's what we're trying to avoid. But on the other hand, it shows that there is a real big political issue, which is not about politicians speaking but politicians taking action."[1]

It's clear that the development of the DPT is something for all international tax practitioners to keep a very close eye on, whether or not you have an interest in the UK.

[1] Tax Policy Fire Side Chat at Vienna University of Economics and Business, Dec. 16, 2014, available at http://www.wu.ac.at/wutv/clips/20141216-firesidechat. An abbreviated transcript of this interview is forthcoming in TNI.

Legislative update: Finance Bill 2015 delivers DPT legislative language

The DPT legislation included in the UK's 2015 Finance Bill clearly shows that HMRC have responded to the representations received on the draft clauses released on 10 December 2014. A key concern expressed was the breadth of the notification requirements.

These have been narrowed from the original draft, focusing on situations where the financial benefit of the tax reduction is significant relative to the non-tax benefits of the material provision. Furthermore, there is an opportunity for groups to proactively discharge their DPT notification obligations by providing HMRC with, and ensuring HMRC has examined, sufficient information to able it to determine whether a DPT assessment notice should be issued. This will be welcomed by many taxpayers.

Despite the narrowing of the notification provisions, it is clear that HMRC continues to intend DPT to have a very wide scope. In fact, the scope of the avoided permanent establishments rule has been expanded to include sales to non-UK customers that relate to UK business activity and to sales of land and property. It has also been put beyond doubt that UK headed-groups that have suffered a UK controlled foreign corporation (CFC) charge, could still be subject to a DPT charge. Credit will, however, be available where a company has paid a CFC charge.

As expected, it has been confirmed that DPT will not apply where there has been a wholesale transfer to a lower tax jurisdiction of the economic activity needed to generate the associated income. Specific details of how this will be applied are yet to be received but the briefing note published on 20 March suggests that merely the holding, maintenance or legal protection of intellectual property will not be considered sufficient to avoid a DPT charge.

More information is available at **www.ey.com/taxalerts**.

US

US Treasury Department proposes revisions to US model tax treaty to address US tax base erosion

On 20 May 2015, the US Treasury Department released proposed revisions to the US Model Income Tax Convention (the US Model), which was last updated in 2006, to address certain concerns with the erosion of the US tax base in light of changes in the international tax environment. The revisions include provisions that would:

- Deny treaty benefits for dividends and certain deductible payments made by a domestic corporation, treated as an expatriated entity under Section 7874, during the 10 years following the completion of the inversion transaction
- Deny treaty benefits to certain income items benefiting from a "special tax regime" in the beneficial owner's country of residence
- Tighten the "triangular provision" that would deny treaty benefits when certain income is attributable to a permanent establishment outside the beneficial owner's country of residence (e.g., deny treaty benefits for income attributable to a US branch that does not give rise to a permanent establishment under the relevant tax treaty)
- Make certain modifications to the limitation-on-benefits article, including adding a "derivative benefits test" and a base erosion prong to the "subsidiary of a publicly traded company" test

Additionally, guidance from Treasury indicated that while not among the draft treaty provisions that are were released, it is intended to include in the next U.S. Model a new Article to resolve disputes between tax authorities through mandatory binding arbitration.

The Treasury Department issued technical explanations for the proposed revisions, except for those to the limitation-on-benefits article, and has requested comments on the proposed revisions.

Read EY's full analysis at
bit.ly/1GgBxyh

US and India

Tax authorities agree on a framework for resolving certain double tax cases

David Canale

Americas Transfer Pricing Controversy Services Leader – EY
T: +1 202 327 7653
E: david.canale@ey.com

E. Miller Williams, Jr.

Partner/Principal Transfer Pricing Controversy Services Washington, DC – National Tax
T: +1 202 495 9809
E: miller.williams@ey.com

US and India tax officials met on 15-16 January 2015 in Delhi and have agreed on a framework for the resolution of pending double tax cases involving information technology enabled services (ITeS) and software development, according to news reports. This is the third formal meeting of the two governments in the past 16 months; however, there have also been on-going discussions and exchanges of information and analysis during that time.

Douglas O'Donnell, US competent authority and Deputy Commissioner (International) in the Internal Revenue Service (IRS) Large Business & International (LB&I) Division, said he met with Indian competent authority and Bilateral Advance Pricing Agreement (APA) Commissioner, Akhilesh Ranjan.

In that meeting, they agreed on a broad framework for resolving the backlog of pending US-India double tax cases. Specifically, the agreed-upon framework is aimed at resolving those cases involving ITeS and software development services. O'Donnell noted there are more than 250 pending Mutual Agreement Procedure (MAP) cases between the two countries, and next steps involve reviewing that inventory to identify those cases that can be resolved under the framework.

Separately, in the Indian press, Mr. Ranjan stated "After two days of fruitful and intense discussions (on 15-16 January), both sides have arrived at a broad agreement on a framework to be applied for resolving disputes in cases of IT Software Services & ITeS. The details of each case are now being worked out. The US has also agreed to accept Bilateral APAs with India. This will mark a breakthrough in a long pending matter. Disputes as old as AY 2006 will now be resolved within this financial year." (i.e., by 31 March 2015).

Bilateral APAs

The meeting achieved a resolution that provides a framework that will be used to settle as many as 100 competent authority cases and that the IRS will allow for the filing of bilateral APAs with India and US tax authorities. This is consistent with the IRS' past comments that until there was a framework to settle a significant amount of the outstanding competent authority cases, the IRS would not allow for bilateral APA cases with India.

EY is already starting to see the IRS reach out to US taxpayers for information. The typical request is asking for the applicable India affiliate's audited financial statements for assessment years (prepared in accordance with Indian GAAP) and (a) the total services cost (or equivalent, which may be designated "operating cost" or some other variation) for the services that were the subject of the adjustments; and (b) the amounts of any adjustments to the total services cost as reported by the taxpayer on its tax return for such assessment years.

Accordingly, US taxpayers with filed competent authority cases should begin to assemble this information in anticipation of the IRS contacting them.

Transfer pricing adjustments on the rise

This resolution is significant since Indian transfer pricing adjustments are on the rise. In the most recent audit cycle, transfer pricing adjustments were made in over half of the audits resulting in approximately US$12.5 billion of tax assessments (vs. US$7.4 billion in the previous cycle). The Indian Tax authority continues to audit most foreign-owned companies in India on an annual basis and statistics show that over half of all India transfer pricing audits result in adjustments. US and European-based taxpayers operating in India are at the receiving end of many of these adjustments.

The agreement to allow for bilateral APAs will re-open an option for US-owned companies to manage their transfer pricing risk in India. It is designed to avoid the confrontation inherent in an examination and foster more effective communication between taxpayers and the Indian tax authorities and IRS. Once signed, a bilateral APA will provide taxpayers certainty on the APA covered transactions for five consecutive years along with up to four years of roll back. The roll back provision combined with a bilateral APA and Competent Authority filings should allow for as many as 14 years of transfer pricing issues to be resolved.

The filing date in India to cover the tax year starting 1 April 2015 is 31 March 2015. The APA request must be filed prior to the start of the financial year in India. This short deadline may mean that companies will need to file for a unilateral APA in India and later convert it to a bilateral APA to give them more time to obtain requisite information.

India's APA program

After the India APA program started, close to 150 APA applications were filed in the first year and an additional 232 APA applications were filed by 31 March 2014. Based on EY India's estimates, approximately 80% of the applications are for unilateral APAs and the balance is for bilateral APAs. The Government is pleased with taxpayers' interest and has promised to process these applications as rapidly as possible. The Indian APA Program agreed to and signed five unilateral APAs in March 2014 and has many others in advanced stages of the process. Also, the Japanese Tax Authority and the Indian Tax Authority have concluded one bilateral APA and are discussing several others. In a couple of cases, the results through the APA process have been more favorable to taxpayers than typical results seen in tax audits or in the Safe Harbor provisions (the typical mark-up under the safe harbor of 22% to 28%).

Corporate income tax (CIT) rates

Table 1. Global CIT rates — largest 50 "economies" or "jurisdictions" by GDP, sorted by tax rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

Jurisdiction	GDP 2015 (US$ billions)[1]	2015 CIT rate (national statutory rate only)	2015 CIT rate (national and subnational, average)	Worldwide vs. territorial taxation	Notes
United States	15,653	35.00%	39.00%	Worldwide	
France	2,580		38.00%	Territorial	The initially proposed 1% tax on EBITDA (earnings before interest, taxes, depreciation and amortization) is replaced by an increase of the temporary additional contribution to CIT from 5% to 10.7%, that applies to companies (or tax consolidated groups) with an annual turnover exceeding €250 million. The increase would apply to fiscal years (FYs) ending between 31 December 2013 and 30 December 2015. The maximum CIT rate would thus amount to circa 38% instead of the current 36.1%.
Argentina	475		35.00%	Worldwide	
Pakistan	231		35.00%	Worldwide	
Brazil	2,425		34.00%	Worldwide	
Venezuela	338		34.00%	Worldwide	
India	1,947		33.99%	Worldwide	Rate illustrated is applied to domestic companies, including surcharge and education CESS. Foreign companies pay tax of 43.26% including surcharge and education CESS.
Belgium	477		33.99%	Territorial	
Japan	5,984		33.10%	Territorial	The Government has a policy to cut the effective corporate tax rate from the current 35% to below 30% over several years starting in the fiscal year starting on or after 1 April 2015. Under the 2015 tax reform plan announced on 30 December 2014, the effective corporate tax rate (Tokyo area) will be reduced by 2.54 percent point in the fiscal year starting on or after 1 April 2015.
Germany	3,367	Top federal (national) corporate tax rate: 15% (plus solidarity surcharge of 5.5%)	33.00%	Territorial	Top federal (national) corporate tax rate: 15% (plus solidarity surcharge of 5.5%). Local trade taxes range between 7% and 17.5%
Italy	1,980		31.40%	Territorial	
Australia	1,542		30.00%	Territorial	The CIT rate is to be cut by 1.5 percentage points to 28.5% from 1 July 2015.
Mexico	1,163		30.00%	Worldwide	An additional 10% CIT will be imposed on certain profits and dividends from 2014 onwards. Because the tax on dividends would be on the distributing company, there would be no tax treaty protection.
Nigeria	273		30.00%	Worldwide	
Philippines	241		30.00%	Worldwide	
Spain	1,340		28.00%	Territorial	
South Africa	391		28.00%	Territorial	
Dominican Republic	Data not available		28.00%		

1. IMF World Economic Outlook Database — September 2012.

Jurisdiction	GDP 2015 (US$ billions)[1]	2015 CIT rate (national statutory rate only)	2015 CIT rate (national and subnational, average)	Worldwide vs. territorial taxation	Notes
Guatemala	Data not available		28.00%		
Norway	500		27.00%	Territorial	
Egypt	255		26.50%	Worldwide	
Israel	247		26.50%	Territorial	
Canada	1,770	15.00%	26.23%	Territorial	
Greece	255		26.00%	Territorial	
China	8,250		25.00%	Worldwide	
Indonesia	895		25.00%	Worldwide	
Netherlands	770		25.00%	Territorial	Rate for the first €200,000 taxable basis is 20%.
Islamic Republic of Iran	484		25.00%	Worldwide	
Austria	391		25.00%	Territorial	
Colombia	365		25.00%	Worldwide	
Malaysia	307		25.00%	Territorial	
Algeria	207		25.00%	Worldwide	
Denmark	309		24.50%	Territorial	
Korea	1,151		24.20%	Worldwide	24.2% top tax rate includes a 10% surcharge applicable to taxable income in excess of KRW20 billion (US$18 million).
Portugal	211		23.00%	Territorial	
Chile	268		22.50%	Worldwide	
Switzerland	623	7.80%	22.00%	Territorial	Municipal rates vary widely.
Sweden	520		22.00%	Territorial	
Vietnam	Data not available		22.00%		
Slovak Republic	Data not available		22.00%		
United Kingdom	2,434		20.00%	Territorial	Mainstream rate of corporation tax will be 20% from April 2015.
Russia	1,954		20.00%	Territorial	
Turkey	783		20.00%	Territorial	
Saudi Arabia	657		20.00%	Worldwide	
Thailand	377		20.00%	Territorial	
Finland	247		20.00%	Territorial	Finland cut the rate by 4.5 percentage points as of 2014
Poland	470		19.00%	Worldwide	
Czech Republic	194		19.00%	Territorial	
Taiwan	466		17.00%	Worldwide	
Singapore	268		17.00%	Territorial	
Hong Kong SAR	258		16.50%	Territorial	
Romania	171		16.00%	Worldwide	
Ireland	205		12.50%	Worldwide	
United Arab Emirates	362		0.00%	N/A	

2015 CIT rate

Note: Where applicable, rates include an average subnational (state/provincial) tax rate in addition to the national/federal rate.

Figure 1. 2012 Headline CIT rates — largest 50 "economies" or "jurisdictions" by 2011 GDP

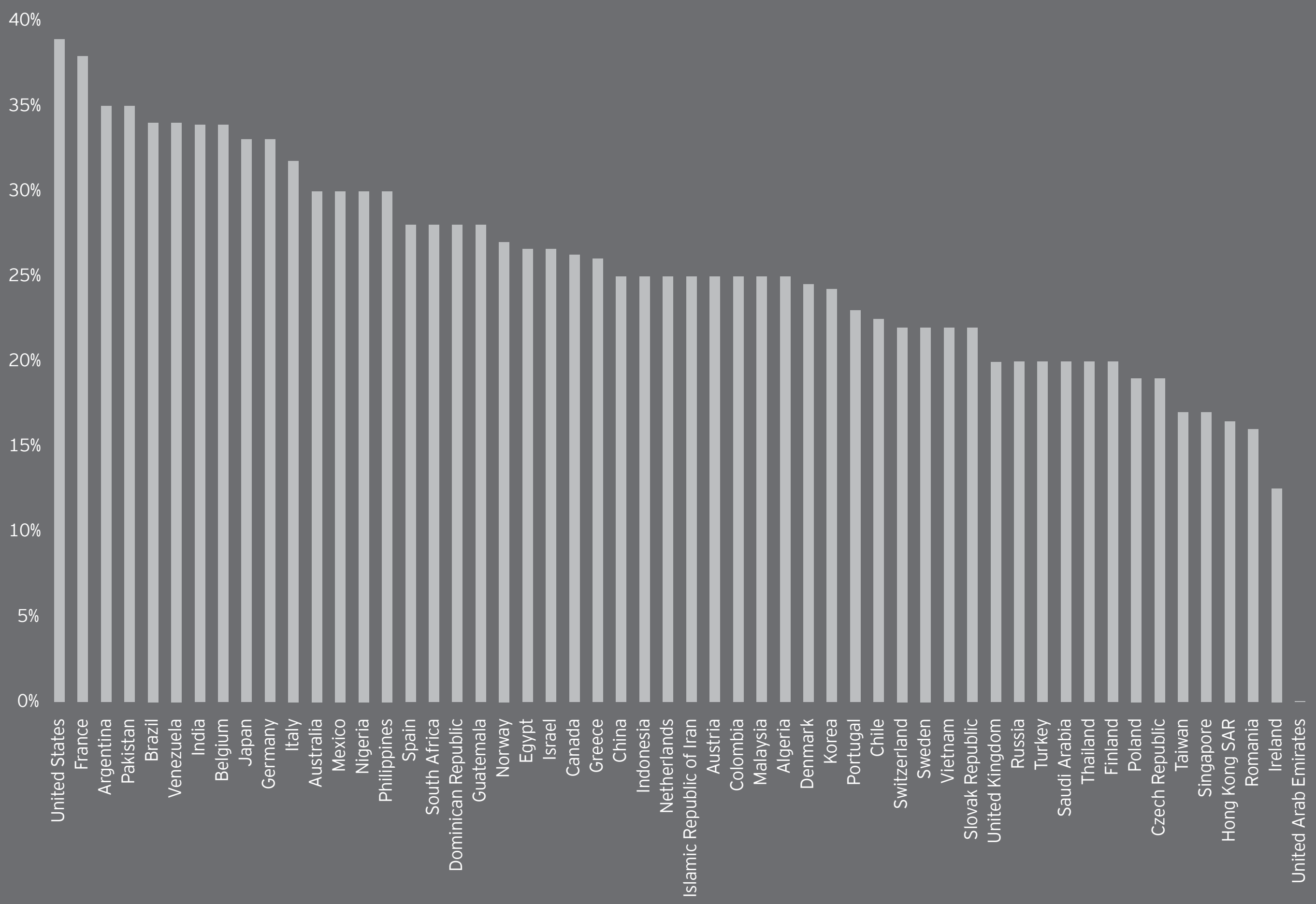


Figure 2. "Economies" or "jurisdictions" taxing worldwide income

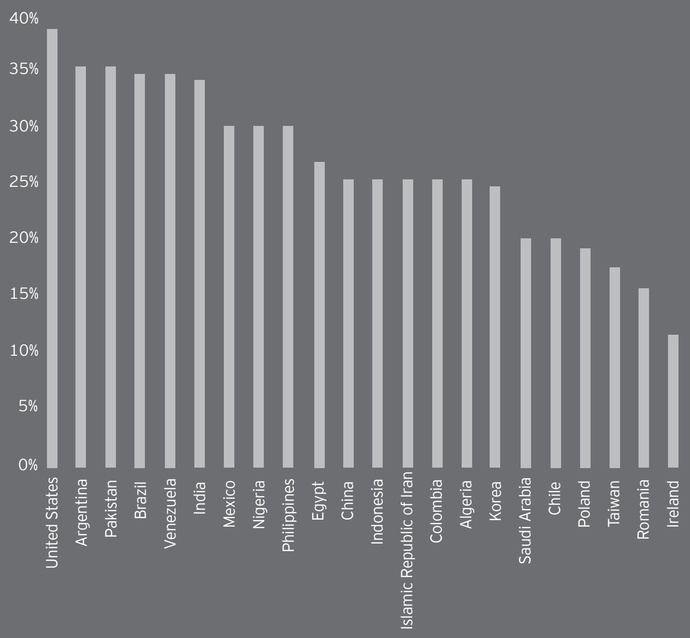
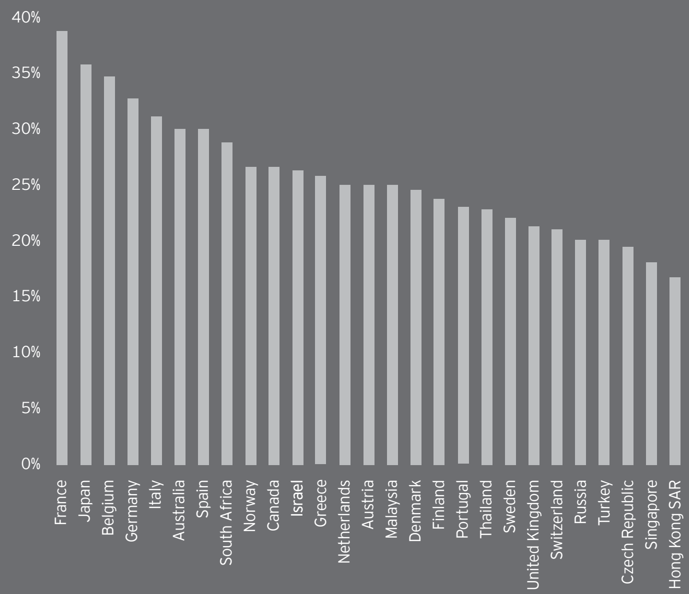


Figure 3. "Economies" or "jurisdictions" taxing territorially



Insights

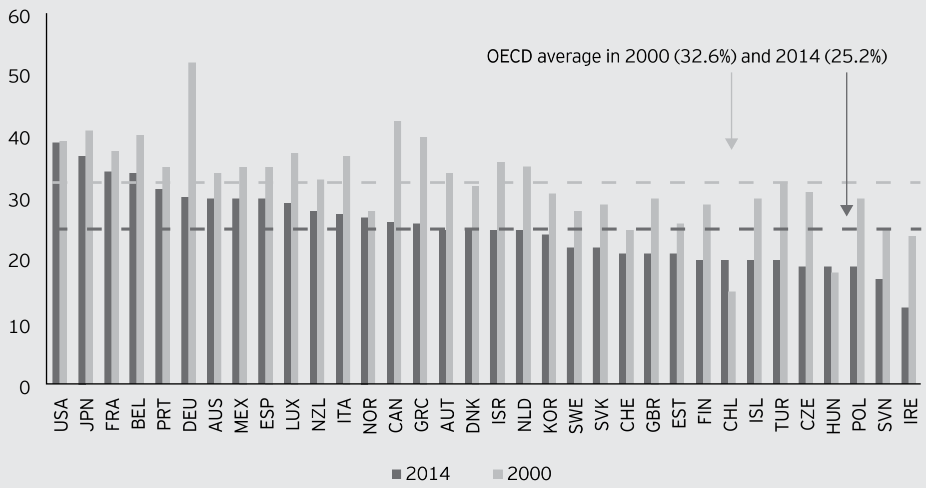
Statutory corporate income tax rates, 2000-2014

The trend toward a reduction of statutory CIT rates started with the tax reforms in the United Kingdom and the United States in the mid-1980s, which broadened the tax base (for example, by making depreciation allowances for tax purposes less generous) and cut statutory rates. CIT rates have continued to be cut in recent years, accompanied by various base broadening measures, including limitations in interest (and other business expenses) deductibility, more limited utilization of losses and continuing to restrict depreciation allowances.

The table below shows that statutory CIT rates in OECD member countries dropped on average by more than 7 percentage points between 2000 and 2014, from 32.6% to 25.2% (a further 0.3% decrease from 2012). This trend seems to be widespread, as rates have been reduced in more than 90 countries globally. Within the OECD area, the rate has stayed constant in the United States, as well as in non-OECD countries such as Brazil. Almost 95% of OECD countries have reduced their CIT rates since 2000; only Chile and Hungary have 2014 rates that are higher than their 2000 rate.

A number of countries around the world (Denmark, Dominican Republic, Japan, Finland, Portugal, Slovak Republic, United Kingdom and Vietnam for example) continue to reduce rates in 2014, while other countries (Australia, The Netherlands, among others) seem to have now stretched their tax bases as far as they believe to be competitively and/or politically prudent. In a recent EY study of 61 countries, the number of countries reducing their statutory CIT rates outpaced those increasing it by a factor of more than 3 to 1.

Figure 1. Statutory corporate income tax rates, 2000 and 2014



EY contacts

Global Leaders

Chris Sanger

Global Tax Policy Leader
csanger@uk.ey.com
+44 20 7951 0150

Rob Hanson

Global Tax Controversy Leader
rob.hanson@ey.com
+1 202 327 5696

Americas

Jurisdiction	Tax policy	Tax controversy
Tax policy and controversy leaders	**Cathy Koch** **cathy.koch@ey.com** **+1 202 327 7483**	**Rob Hanson** **rob.hanson@ey.com** **+1 202 327 5696**
Argentina	Ariel Becher ariel.becher@ar.ey.com +54 11 4318 1686	Ariel Becher ariel.becher@ar.ey.com +54 11 4318 1686
Brazil	Gil Mendes gil.f.mendes@br.ey.com +55 11 2573 3466	Julio Assis julio.assis@br.ey.com +55 11 2573 3309
Canada	Greg Boehmer greg.c.boehmer@ca.ey.com +1 416 943 3463	Gary Zed gary.zed@ca.ey.com +1 403 206 5052
Chile	Carlos Martinez carlos.martinez@cl.ey.com +56 2 267 61261	Carlos Martinez carlos.martinez@cl.ey.com +56 2 267 61261
Colombia	Margarita Salas margarita.salas@co.ey.com +57 1 484 7110	Margarita Salas margarita.salas@co.ey.com +57 1 484 7110
Costa Rica	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880
Dominican Republic	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880
Ecuador	Fernanda Checa fernanda.checa@ec.ey.com +593 2 255 3109	Fernanda Checa fernanda.checa@ec.ey.com +593 2 255 3109
El Salvador	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880

Americas

Jurisdiction	Tax policy	Tax controversy
Guatemala	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880
Honduras	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880
Israel	Arie Pundak arie.pundak@il.ey.com +972 3 568 7115	Gilad Shoval gilad.shoval@il.ey.com +972 3 623 2796
Mexico	Jorge Libreros jorge.libreros@mx.ey.com +52 55 5283 1439	Enrique Ramirez enrique.ramirez@mx.ey.com +52 55 5283 1367
Nicaragua	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880	Rafael Sayagués rafael.sayagués@cr.ey.com +506 2208 9880
Panama	Luis Ocando luis.ocando@pa.ey.com +507 208 0144	Luis Ocando luis.ocando@pa.ey.com +507 208 0144
Peru	David de la Torre david.de.la.torre@pe.ey.com +51 1 411 4471	David de la Torre david.de.la.torre@pe.ey.com +51 1 411 4471
Puerto Rico	Teresita Fuentes teresita.fuentes@ey.com +1 787 772 7066	Teresita Fuentes teresita.fuentes@ey.com +1 787 772 7066
United States	Nick Giordano nick.giordano@wc.ey.com +1 202 467 4316	Rob Hanson rob.hanson@ey.com +1 202 327 5696
Venezuela	Alaska Moscato alaska.moscato@ve.ey.com +58 212 905 6672	Alaska Moscato alaska.moscato@ve.ey.com +58 212 905 6672

Asia-Pacific

Jurisdiction	Tax policy	Tax controversy
Tax policy and controversy leaders	**Alf Capito** **alf.capito@au.ey.com** **+61 2 8295 6473**	**Howard Adams** **howard.adams@au.ey.com** **+61 2 9248 5601**
Australia	Alf Capito alf.capito@au.ey.com +61 2 8295 6473	Howard Adams howard.adams@au.ey.com +61 2 9248 5601
China	Becky Lai becky.lai@hk.ey.com +852 2629 3188	Henry Chan henry.chan@cn.ey.com +86 10 5815 3397
Hong Kong SAR	Becky Lai becky.lai@hk.ey.com +852 2629 3188	Joe Chan joe-ch.chan@cn.ey.com +852 2629 3092
Indonesia	Rachmanto Surahmat rachmanto.surahmat@id.ey.com +62 21 5289 5587	Rachmanto Surahmat rachmanto.surahmat@id.ey.com +62 21 5289 5587
Malaysia	Kah Fan Lim kah-fan.lim@my.ey.com +60 3 7495 8218	Kah Fan Lim kah-fan.lim@my.ey.com +60 3 7495 8218
New Zealand	Aaron Quintal aaron.quintal@nz.ey.com +64 9 300 7059	Kirsty Keating kirsty.keating@nz.ey.com +64 9 300 7073
Philippines	Emmanuel Castillo Alcantara emmanuel.c.alcantara@ph.ey.com +63 2 894 8143	Wilfredo U. Villanueva wilfredo.u.villanueva@ph.ey.com +63 2 894 8180
Singapore	Russell Aubrey russell.aubrey@sg.ey.com +65 6309 8690	Lee Khoon Tan lee-khoon.tan@sg.ey.com +65 63098679
South Korea	Min Yong Kwon min-yong.kwon@kr.ey.com +82 2 3770 0934	Min Yong Kwon min-yong.kwon@kr.ey.com +82 2 3770 0934
Taiwan	Sophie Chou sophie.chou@tw.ey.com +886 2 2757 8888	Sophie Chou sophie.chou@tw.ey.com +886 2 2757 8888
Thailand	Yupa Wichitkraisorn yupa.wichitkraisorn@th.ey.com +66 2 264 0777	Yupa Wichitkraisorn yupa.wichitkraisorn@th.ey.com +66 2 264 0777
Vietnam	Huong Vu huong.vu@vn.ey.com +84 903432791	Huong Vu huong.vu@vn.ey.com +84 903432791

EMEIA

Jurisdiction	Tax policy	Tax controversy
Tax policy and controversy leaders	**Jean-Pierre Lieb** **jean.pierre.lieb@ey-avocats.com** **+33 1 55 61 16 10**	**Jean-Pierre Lieb** **jean.pierre.lieb@ey-avocats.com** **+33 1 55 61 16 10**
Austria	Andreas Stefaner andreas.stefaner@at.ey.com +43 1 21170 1040	Andreas Stefaner andreas.stefaner@at.ey.com +43 1 21170 1040
Belgium	Herwig Joosten herwig.joosten@be.ey.com +32 2 774 9349	Philippe Renier philippe.renier@be.ey.com +32 2 774 93 85
Bulgaria	Milen Raikov milen.raikov@bg.ey.com +359 2 8177 100	Milen Raikov milen.raikov@bg.ey.com +359 2 8177 100
Croatia	Denes Szabo denes.szabo@hr.ey.com +385 2480 540	Denes Szabo denes.szabo@hr.ey.com +385 2480 540
Cyprus	Philippos Raptopoulos philippos.raptopoulos@cy.ey.com +357 25 209 999	Philippos Raptopoulos philippos.raptopoulos@cy.ey.com +357 25 209 999
Czech Republic	Lucie Rihova lucie.rihova@cz.ey.com +420 225 335 504	Lucie Rihova lucie.rihova@cz.ey.com +420 225 335 504
Denmark	Jens Wittendorf jens.wittendorff@dk.ey.com +45 51 58 2820 Bjarne Gimsing bjarne.gimsing@dk.ey.com +45 25 29 3699	Johannes Larsen johannes.r.larsen@dk.ey.com +45 73 23 3414
Estonia	Ranno Tingas ranno.tingas@ee.ey.com +372 611 4578	Ranno Tingas ranno.tingas@ee.ey.com +372 611 4578
European Union	Marnix Van Rij marnix.van.rij@nl.ey.com +31 70 328 6742	Klaus Von Brocke klaus.von.brocke@de.ey.com +49 89 14331 12287
Finland	Tomi Johannes Viitala tomi.viitala@fi.ey.com +358 207 280 190	Jukka Lyijynen jukka.lyijynen@fi.ey.com +358 207 280 190
France	Charles Menard charles.menard@ey-avocats.com +33 1 55 61 15 57	Charles Menard charles.menard@ey-avocats.com +33 1 55 61 15 57
Germany	Ute Witt ute.witt@de.ey.com +49 30 25471 21660	Jürgen Schimmele juergen.schimmele@de.ey.com +49 211 9352 21937

EMEIA

Jurisdiction	Tax policy	Tax controversy
Greece	Stefanos Mitsios stefanos.mitsios@gr.ey.com +302 102 886 365	Tassos Anastassiadis tassos.anastassiadis@gr.ey.com +302 102 886 592
Hungary	Botond Rencz botond.rencz@hu.ey.com +36 145 18602	Botond Rencz botond.rencz@hu.ey.com +36 145 18602
India	Ganesh Raj ganesh.raj@in.ey.com +91 120 6717110	Rajan Vora rajan.vora@in.ey.com +91 22 619 20440
Ireland	Kevin McLoughlin kevin.mcloughlin@ie.ey.com +353 1221 2478	David Smyth david.smyth@ie.ey.com +353 1 2212 439
Italy	Giacomo Albano glacomo.albano@it.ey.com +39 0685567338	Maria Antonietta Biscozzi maria-antonietta.biscozzi@it.ey.com +39 02 8514312
Kazakhstan	Konstantin Yurchenko konstantin.yurchenko@kz.ey.com +7 495 641 2958	Konstantin Yurchenko konstantin.yurchenko@kz.ey.com +7 495 641 2958
Latvia	Ilona Butane ilona.butane@lv.ey.com +371 6704 3836	Ilona Butane ilona.butane@lv.ey.com +371 6704 3836
Lithuania	Kestutis Lisauskas kestutis.lisauskas@lt.ey.com +370 5 274 2252	Kestutis Lisauskas kestutis.lisauskas@lt.ey.com +370 5 274 2252
Luxembourg	Marc Schmitz marc.schmitz@lu.ey.com +352 42 124 7352	John Hames john.hames@lu.ey.com +352 42 124 7256
Malta	Robert Attard robert.attard@mt.ey.com +356 2134 2134	Robert Attard robert.attard@mt.ey.com +356 2134 2134
Middle East	Balaji Ganesh balaji.ganesh@kw.ey.com +202 27260260	Balaji Ganesh balaji.ganesh@kw.ey.com +202 27260260
The Netherlands	Arjo van Eijsden arjo.van.eijsden@nl.ey.com +31 10 406 8506	Arjo van Eijsden arjo.van.eijsden@nl.ey.com +31 10 406 8506
Norway	Arild Vestengen arild.vestengen@n0.ey.com +47 24 002 592	Arild Vestengen arild.vestengen@n0.ey.com +47 24 002 592
Poland	Zbigniew Liptak zbigniew.liptak@pl.ey.com +48 22 557 7025	Agnieszka Talasiewicz agnieszka.talasiewicz@pl.ey.com +48 22 557 72 80
Portugal	Carlos Manuel Baptista Lobo carlos.lobo@pt.ey.com +351 217 912 000	Paulo Mendonca paulo.mendonca@pt.ey.com +351 21 791 2045

EMEIA

Jurisdiction	Tax policy	Tax controversy
Romania	Alexander Milcev alexander.milcev@ro.ey.com +40 21 402 4000	Jean-Marc Cambien marc.cambien@ro.ey.com +40 21 402 4191
Russia	Alexandra Lobova alexandra.lobova@ru.ey.com +7 495 705 9730	Alexandra Lobova alexandra.lobova@ru.ey.com +7 495 705 9730
Slovak Republic	Richard Panek richard.panek@sk.ey.com +421 2 333 39109	Peter Feiler peter.feiler@sk.ey.com +421 2 333 3915
Slovenia	Lucijan Klemencic lucijan.klemencic@si.ey.com +386 1 58 31721	Lucijan Klemencic lucijan.klemencic@si.ey.com +386 1 58 31721
South Africa	James Deiotte james.deiotte@za.ey.com +27 11 772 3307	Christel Brits christel.brits@za.ey.com +27 11 502 0100
Spain	Eduardo Verdun Fraile eduardo.verdunfraile@es.ey.com +34 915 727 419	Maximino Linares maximino.linaresgil@es.ey.com +34 91 572 71 23
Sweden	Erik Hultman erik.hultman@se.ey.com +46 8 520 594 68	Erik Hultman erik.hultman@se.ey.com +46 8 520 594 68
Switzerland	Claudio Fischer claudio.fischer@ch.ey.com +41 58 286 3433	Walo Staehlin walo.staehlin@ch.ey.com +41 58 286 6491
Turkey	Yusuf Gokhan Penezoğlu yusuf.penezoglu@tr.ey.com +90 212 368 55 47	Yusuf Gokhan Penezoğlu yusuf.penezoglu@tr.ey.com +90 212 368 55 47
Ukraine	Jorge Intriago jorge.intriago@ua.ey.com +380 44 490 3003	Vladimir Kotenko vladimir.kotemko@ua.ey.com +380 44 490 3006
United Kingdom	Chris Sanger csanger@uk.ey.com +44 20 7951 0150	James Wilson jwilson8@uk.ey.com +44 20 7951 5912

Japan

Jurisdiction	Tax policy	Tax controversy
Tax policy and controversy leaders	**Alf Capito** **alf.capito@au.ey.com** **+61 2 8295 6473**	**Howard Adams** **howard.adams@au.ey.com** **+61 2 9248 5601**
Japan	Koichi Sekiya koichi.sekiya@jp.ey.com +81 3 3506 2447	Koichi Sekiya koichi.sekiya@jp.ey.com +81 3 3506 2447

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