Recent Developments in International Tax & Transfer Pricing:
Major Trends and Impact

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Concerns in International Tax

- Tax avoidance- use legal methods to pay less tax by utilizing loop holes in tax systems.
- Can only be controlled by amending the law and prohibiting the practice.
- Recent developments centered on efforts to deal with Tax avoidance by Multinationals
- Globalisation of businesses and the ease of movement of capital and assets lead to Base erosion of the Tax base and shifting of profits

International Tax cont:

- Business leaders argue they have a duty to shareholders to legally reduce taxes and deem governments responsible for incoherent tax policies, complain about double taxation
- Issue reached a political level- on the agenda of several OECD and non-OECD countries.
- The G20 leaders meeting in Mexico on 18-19 June 2012 explicitly referred to "the need to prevent base erosion and profit shifting" in their final Declaration.
- This message was reiterated at the G20 finance ministers meeting of 5-6 November 2012.
- calls for coordinated action to strengthen international tax standards and urging their counterparts to back efforts by the OECD to identify possible gaps in tax laws.

BEPs Progress:

- 2013- Action plan on Base Erosion and Profit Shifting
- International Consensus achieved in 2015
- 15 Action Items

Action Items

Coherence	Substance	Transparency
Hybrid Mismatch Arrangements (2)	Preventing Tax Treaty Abuse (6)	Methodologies and Data Analysis (11)
Harmful Tax Practices (5)	Avoidance of PE Status (7)	DisclosureRules (12)
Interest Deductions (4)	TP Aspects of Intangibles (8)	TP Documentation (13)
CFC Rules (3)	TP/Risk and Capital (9)	Dispute Resolution (14)
	TP/High Risk Transactions (10)	
	Digital Economy (1)	
	Multilateral Instrument (15)	

Overview of the Action Points and Impact

BEPS Minimum standards:

Action 5

- **Jurisdictions to make changes to domestic legislation or structures to abolish Harmful Tax Practices**

Action 6

- **Changes in Treaty provisions to Prevent Tax Treaty Abuse -** ***LOB or PPT or LOB and anti-conduit rule.***

Minimum standards Cont':

TP Documentation

- CBC Reporting
- Ist Reports shared in year 2018 – Automatic exchange of information

Multilateral Instrument

Key impact –

- changes in treaty provisions
- Exchange of information – enhancing Transparency

Transparency cont':

Tax transparency standards:

- Availability of information
- Appropriate access to the information
- Existence of exchange of information mechanisms

Information required:

- Bank
- Ownership
- Identity
- Accounting

Non-minimum standards

On Dealing with Aggressive Tax Planning:

- **Hybrid Mismatch Rules**
- **Interest Deductions Rules**
- **CFC Rules**
- **Mandatory Disclosure Rules**

Transfer Pricing:

On Transfer Pricing – Actions 7-10

Key Outcome: Aligning taxation with value creation

Careful delineation of the actual transaction between associated enterprises

1. Identify risk
2. Determine how risk are contractually assumed
3. Functional analysis
4. Determine whether contractual assumption of risk is consistent with the conduct of the associated enterprises and other facts of the case

TP Cont':

Changes to Guidelines:

- **Further guidance on Risk allocation**

  Apply guidance for allocation of the risk - Allocation to party that exercises control and has the financial capacity to assume the risk

Scenarios:

- *Does not exercise control over the risk?; or*

- *Does not have the financial capacity to assume the risk*

TP changes cont…

- ***Further Guidance on Intangibles - Framework Chapter 1***

Guidance on Hard-to-Value Intangibles

- ✓ Allows taxpayer to demonstrate proper transfer pricing analysis (Development, Exploitation, Maintenance, Protection and Enhancement)
- ✓ Addressing information asymmetries

Scenarios

- ➢ Funder without performing important functions related to intangible and without assuming the risks related to the intangible: **risk-adjusted financial return if control over financial risk**
- ➢ Funder without control over financial risk: **no more than risk free financial return**

TP Changes Cont:

- ***Artificial Avoidance of PE Status – changes to OECD Model Convention***

Article 5(5)

- Departure of formal approach:
- Regular conclusion of contracts may lead to taxable presence in other Contracting State (*habitually plays the principal role to conclusion of contracts)*

Article 5(4)

- Each of exceptions is restricted to activities that are otherwise of a "preparatory or auxiliary" character
- Introduction of anti-fragmentation rule

- + Interaction with PPT

Digital Economy – Action 1

- 2019 Update
- Draft proposals on Pillar 1 and Pillar 2

Pillar 1

- change the profit allocation and nexus rules.

- Not intended to apply only to a subset of highly digitalised businesses but have a wider scope in an effort to respond to the broader impact of the digitalisation on the economy.
- Addresses a situation where an MNE can essentially "reach into" a jurisdiction, either remotely or through a limited local presence, to develop a user/customer base and other marketing intangibles.
- It sees an intrinsic functional link between marketing intangibles and the market jurisdiction.

Pillar 1 Cont':..

- Based on the rationale that this intrinsic functional link is manifested in two different ways.

  - First, some marketing intangibles, such as brand and trade name, are reflected in the favourable attitudes in the minds of customers

  - Secondly, other marketing intangibles, such as customer data, customer relationships and customer lists are derived from activities targeted at customers and users in the market jurisdiction

- This supports the treatment of such intangibles as being created in the market jurisdiction

Pillar 1 cont':

Intended impact/ outcome:

- The approach would modify current transfer pricing and treaty rules

- It would require marketing intangibles and risks associated with such intangibles to be allocated to the market jurisdiction.

- The market jurisdiction would be entitled to tax the income properly associated with such intangibles and the risks relating to those intangibles.

- Gives the market jurisdictions a right to tax highly digitalised businesses even in the absence of a taxable presence given the importance of market intangibles for such business models.

Digital Economy – Pillar 2

- To deal with all other issues that cause BEPS and may not be captured under the existing rules or Pillar 1
- Meant to be a back stop on BEPS issues
- Proposal has 4 rules
  1. Income Inclusion Rule
  2. Subject to Tax Rule
  3. Undertaxed Payments Rule
  4. Switch over Rule

<u>Intended outcome/impact:</u>

All income of an entity be subjected to tax at least at the minimum effective tax rate

Outcome

- New and Revised Rules (2017 Guidelines)
- Increased Transparency
- Increased Monitoring
- Legal certainty and Dispute Resolution
- Address challenges of taxing the digital economy (by 2020)

Current status:

- Implementation stage through Forums/ working parties
- Peer reviews for BEPS Minimum standards
- Digital Economy – under Discussion

The End