

### TAX PRACTITIONERS' TOOL KIT

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International tax landscape changes:

# Agenda



- Introduction
- Current Tax landscape and challenges.
- BEPS project
- Rat



• Tax opportunities from BEPS.

## A classic Case...



- The BVI is an archipelago of about 60 Caribbean islands with fewer than 23,000 inhabitants. It is a British Overseas Territory, substantially controlled and supported by Britain, but with a fair degree of political autonomy.
- The secrecy here comes most importantly from the BVI's lax, flexible, ask-no-questions, see-no-evil company incorporation regime with very low set-up cost. In 2017, there were 417,000 active companies: 18 for each inhabitant.
- The IMF in 2010 estimated,9 very conservatively, that BVI companies held over \$600 billion in assets.
- On paper, the BVI was the ninth largest recipient of Foreign Direct Investment (FDI) in 2015 more than India and the world's seventh largest source of outbound FDI.
- The BVI has no effective income tax, no capital gains tax, no inheritance taxes, no gift taxes, sales taxes or even value added taxes. It raises income

### Current Tax Landscape



- International taxation involves individual country tax laws and bi- and multilateral trade agreements between nations.
- Modernization is needed to better reflect the realities of today's global business economy.
- The global landscape of Base Erosion & Profit Shifting, unilateral action by countries, and increased international tax audits is resulting in a Global Tax Reset

## Current Tax Landscape

- 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 Project



From 2013, the core of the G20/OECD's project is:

- Eliminating tax mismatches such that all income is taxed.
- Aligning profits with value creation.
- Increasing consistent levels of transparency with tax authorities.
- Implementing change in a coordinated fashion.

### BEPs Project



#### The Hierarchy of commitment

Minimum standards

- Action 5: Harmful tax practices
- Action 6: Prevent treaty abuse
- Action 13: Country by Country (CbC) reporting only
- · Action 14: Dispute resolution

Strengthening existing international standards

- Action 7: Permanent Establishment (PE)
- Actions 8 10: Transfer Pricing
- Action 13: Master file and local file

Common approach

- Action 1: Digital economy
- Action 2: Hybrid mismatch arrangements
- Action 4: Interest deductions

**Best practices** 

- Action 3: Controlled foreign company (CFC) rules
- Action 12: Aggressive tax planning arrangements

Action 15: Multilateral instrument

### BEPS Minimum Standards

#### Action 5



Jurisdictions to make changes to domestic legislation in order to Counter Harmful Tax Practices More Effectively by;

- -Requiring substance for all preferential regimes
- »Link core income generating activities to the business income;
- »IP core income generating activities-performance of R&D activities
- -Improve transparency, including compulsory spontaneous exchange of certain rulings
- »Compulsory exchange of information between tax authorities on taxpayer specific rulings.
- -Ongoing review of preferential regimes-IP regimes reviews such as structures to abolish Harmful Tax Practices- EPZs, SEZs etc.

#### Action 6

#### Changes in Treaty provisions to Prevent Tax Treaty Abuse –

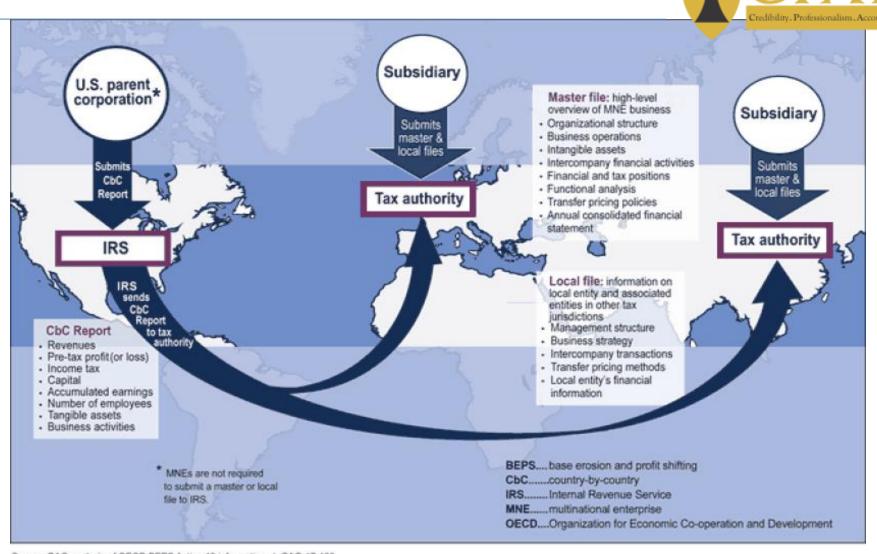
- Recommends that DTAs structured to prevent double taxation as well as double non-taxation (preamble clause).
- Limitation of Benefits Rule or Principal Purpose Test. Define a qualified person(Section 41 (5) ITA similarity).

# Action 13;TP Documentation



- CBC Reporting- 3-tier reporting.
- 1st Reports shared in year 2018 Automatic exchange of information.
- Also in line with The <u>Convention on Mutual</u> Administrative Assistance in Tax Matters.

# Action 13;TP Documentation



# Action 15; Multilateral Instrument



#### Key impact –

- Changes in treaty provisions.
- Exchange of information enhancing Transparency
- Kenya has given indications on being party to the MLI though the document is pending signature and Ratification.

# Other Action Plans and current TP Issues



**Action 7**; Preventing artificial avoidance of PE status and PE threshold.

- Commissionaire arrangements:
- Auxiliary or preparatory activities/character
- Fragmentation/splitting of activities.

All these in light of definition of a PE in section 2 of the Income Tax Act.

# Action 8-10 Transfer pricing CPAK Credibility. Professionalism. Accountability

#### Aligning taxation with value creation

Careful delineation of the actual transaction between associated enterprises

- 1. Contractual allocation of risk vs actual risk bearing.
- 2. Capital contribution versus risk bearing
- 3. Intangibles and Transfer Pricing (DEMPE activities)
- 4. The use of 6<sup>th</sup> Method and commodities.



# 2019 Update draft proposals on Pillar I and Pillar II Pillar 1; (ring Fence)

- Change the profit allocation and nexus rules. Through user/customer base and other marketing intangibles as connecting factors to beat remote presence or limited local presence.
- It sees an intrinsic functional link between marketing intangibles and the market jurisdiction.



#### Pillar II

- The Members of the Inclusive Framework have agreed to explore an approach that leaves jurisdictions free to determine their own tax system,
- Provided that the above does not result in taxation where there is no economic profit not result in double taxation and simple to administer.
- inclusion rule, Tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;



- A switch over rule, This would allow the state of residence to apply the credit method instead of the exemption method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to tax at an effective rate below the minimum rate
- An undertaxed payment rule; deny a deduction or impose source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at a minimum rate and
- A subject to tax rule in tax treaties that would only grant certain treaty benefits if the item of income was subject to tax at a minimum rate.



- The above mentioned will require Treaty changes and through local laws.
- Kenya has attempted to introduce the same in Finance Bill 2019.
- Some jurisdictions have adopted a kind of "non-direct "taxation for the same such as;
- "equalization" levies on internet advertising in India (6%).
- digital services taxes in France at 3% on all services above a threshold..
- UK and Australian Diverted Profit Taxes
- US Base Erosion Anti-Abuse Tax and TCJA

# Action 14-Dispute Resolution



- ✓ Competent authority / Mutual agreement procedure (MAP) also known as government-to-government dispute resolution process.
- ✓ Useful in secondary adjustments and
- ✓ in cases where taxation has not been done according to treaty provisions.
- ✓ The Use of courts and the ADR Framework in Kenya.

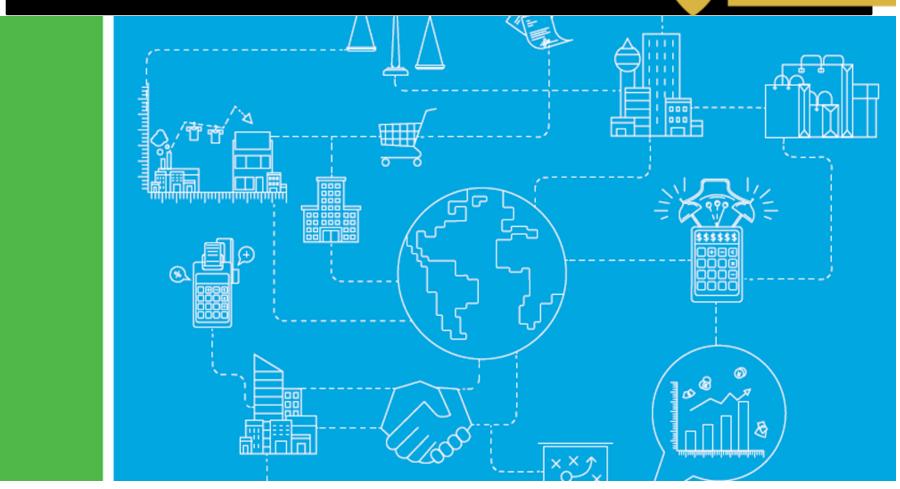
#### Tax Practitioners



- Tax agents, tax preparers, tax accountants and tax lawyers(tax Practitioner), play multiple roles in our tax systems.
- They are gatekeepers to the tax system.
- Tax practitioners function as enforcers, trying to dissuade clients from tax non-compliance.
- Tax practitioners also adopt the role of enablers (or exploiters), identifying financial planning arrangements that minimize tax or avoid it altogether.
- In recent decades their role has become more complicated with recognition that they, not taxpayers hold the special knowledge required to facilitate tax avoidance, or sophisticated as opposed to simple tax evasion

# Group Work

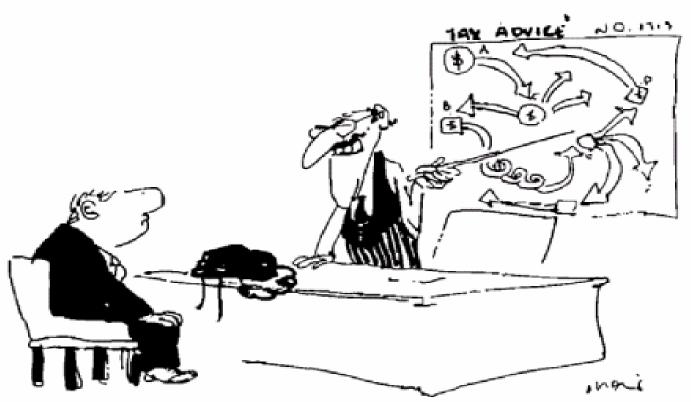




### Opportunities

- Training opportunities for peers and clients consultants.
- Web based alerts on BEPS changes and local laws touching on the changes.
- Affiliation with international brands to obtain locally affiliated international clients.
- Cross-border tax practice given the level of competence with ICPAK members, Kenya and the region.
- Review of existing Policies and contractual arrangements to align with international best practice and laws.





Believe me, it's all perfectly simple