



ANNUAL PRACTICAL ETHICS FORUM 2021

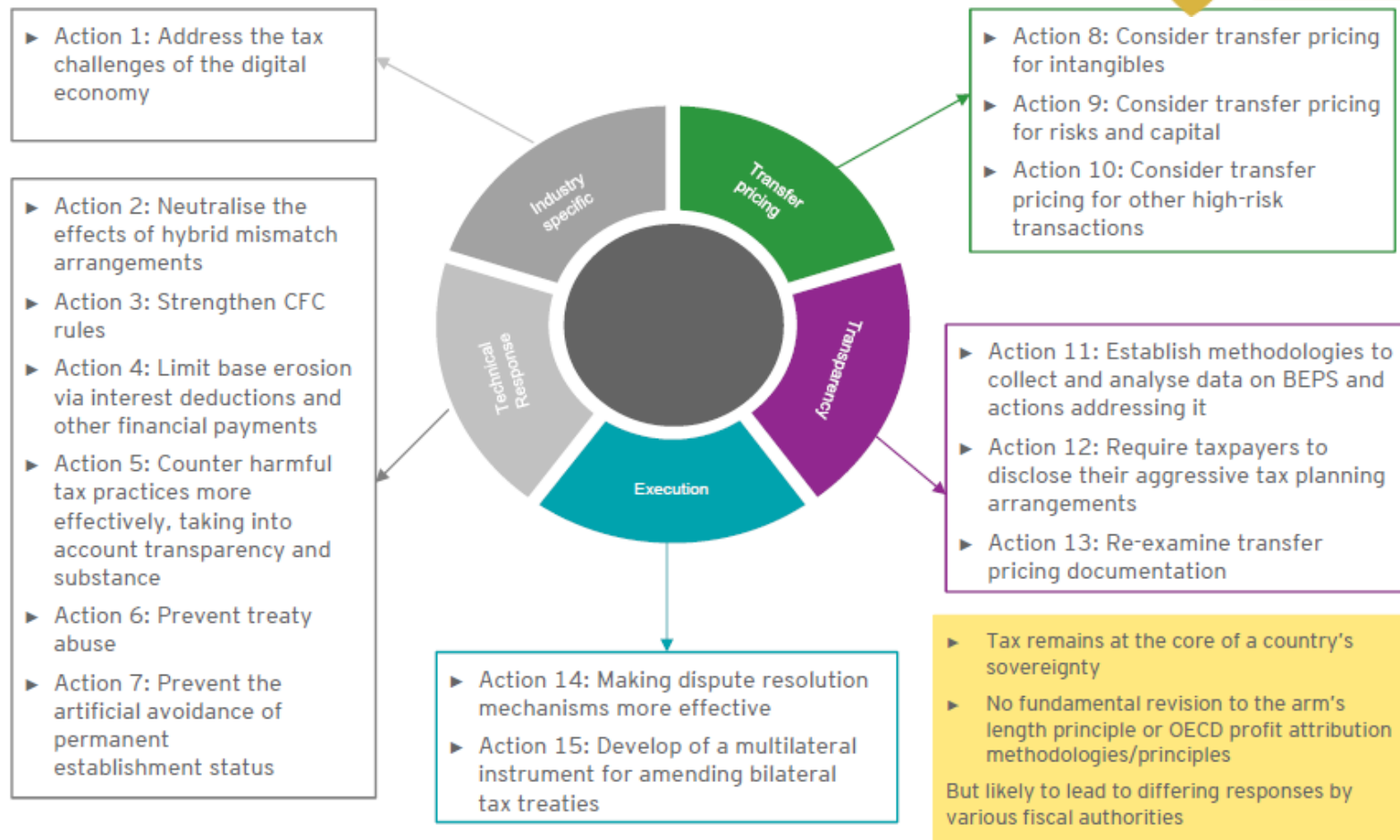
24TH-25TH FEBRUARY 2021

Why BEPS



- Tax rates on foreign income often very low/issues of double non taxation
- Separation of place of economic activity and place where profits are reported for tax purposes.
- Increasing importance of intangible assets.
- Increasing mobility of capital and financing
- Outdated principles of international taxation- globalisation of value chains, digitisation
- Harmful tax competition –tax havens, tax rulings, preferential regimes

15 BEPS Actions



15 BEPS Actions



Coherence

Hybrid Mismatch Arrangements (2)

CFC Rules (3)

Interest Deductions (4)

Harmful Tax Practices (5)

Substance

Preventing Tax Treaty Abuse (6)

Avoidance of PE Status (7)

TP Aspects of Intangibles (8)

TP/Risk and Capital (9)

TP/High Risk Transactions (10)

Transparency and Certainty

Measuring BEPS (11)

Disclosure Rules (12)

TP Documentation (13)

Dispute Resolution (14)

Digital Economy (1)

Multilateral Instrument (15)

BEPS 1.0 Package



- **Minimum standards**
- **Reinforced international standards** on tax treaties and transfer pricing
- **Common approaches** and **best practices** for domestic law measures
- **Analytical reports** with recommendations (digital economy and multilateral instrument)
- Detailed **report on measuring BEPS**

BEPS – Overview of Actions



Action Plan	BEPS Action	Key BEPS proposal
1	Tax challenges in the digital economy	<ul style="list-style-type: none"> ▶ Increasing scope of PE by limiting exemption for preparatory/auxiliary activities. ▶ May include domestic warehouse for delivery of goods sold online to customers if proximity is key to the business model, and domestic entities principally involved in concluding contracts which the foreign company routinely accepts without modification.
2	Neutralizing effects of hybrid mismatch arrangements	<ul style="list-style-type: none"> ▶ Guidelines to counter multiple deductions or double non taxation by using certain hybrid instruments and hybrid entities
3	Designing effective Controlled Foreign Company (“CFC”) Rules	<ul style="list-style-type: none"> ▶ Outlines essential “building blocks” for effective CFC legislation that will limit opportunities for tax deferral through blocker entities in low tax countries.
4	Limiting base erosion through interest deductions	<ul style="list-style-type: none"> ▶ Proposes certain fixed ratio rules based on net interest/EBITDA to limit an entity’s deductions for interest payouts.

BEPS – Overview of Actions



Action Plan	Particulars	Key BEPS proposal
5	Addressing harmful tax competition and special tax regimes	<ul style="list-style-type: none"> ▶ Requirement of substantial activities in a country to avail preferential tax regimes. ▶ Monitoring preferential tax regimes and ensuring a framework of transparency including sharing of tax rulings, advance pricing agreements, etc. between countries.
6	Preventing treaty abuse	<p>Countering treaty shopping through:</p> <ul style="list-style-type: none"> ▶ Clear statements in treaties that the treaty does not seek to provide opportunities for tax evasion or avoidance ▶ Inclusion of a Principal Purposes Test ('PPT') that denies treaty relief if one of the principal purposes of the transaction or arrangement is to obtain relief not consistent with the treaty's objectives ▶ Limitation of Benefits ('LOB') rules that limit the availability of treaty relief to entities that meet certain criteria based on their legal nature, ownership, and general activities. ▶ Countries may adopt PPT or LOB or both into the existing as well as future tax treaties ▶ Various steps have been taken by Indian government to address treaty abuse. India has amended various treaties, most notably Mauritius, Singapore, and Cyprus wherein the taxpayer needs to satisfy minimum criteria failing which the tax benefits under the treaty shall be denied.

BEPS – Overview of Actions



Action Plan	Particulars	Key BEPS proposal
7	Preventing the artificial avoidance of PE Status	<ul style="list-style-type: none"> ▶ Expanding scope of PE by covering commissionaire arrangements or similar strategies where a domestic enterprise substantially carries out all negotiations while the foreign enterprise concludes the contract only as a matter of formality. ▶ Addressing fragmentation of activities to avoid PE status
8-10	Aligning transfer pricing outcomes with value creation	<p>Key changes to the OECD transfer pricing guidelines including</p> <ul style="list-style-type: none"> ▶ Guidance on transactions involving valuable intangibles to prevent misallocation of profits, ▶ Allocation of risk based on actual activities rather than contracts or level of funding, and ▶ Re-characterizing transactions that are not commercially rational.
11	Data collection	<ul style="list-style-type: none"> ▶ Implementing better data collection and sharing tools for monitoring the scale of BEPS and determining counter-measures.
12	Disclosure rules	<ul style="list-style-type: none"> ▶ Recommendations for mandatory disclosure of specific 'reportable schemes' in order for countries to be able to identify potentially aggressive and abusive tax planning arrangements, along with enhanced information sharing between countries. ▶ UK, USA, Canada and South Africa already have disclosure rules

BEPS – Overview of Actions



Action Plan	Particulars	Key BEPS proposal
13	Transfer pricing documentation and country-by-country reporting	<p>Widening transfer pricing documentation and reporting obligations to include</p> <ul style="list-style-type: none"> ▶ A master file providing an overview of the groups global business and global transfer pricing policy; ▶ A local file containing more detailed information relating to intercompany transactions; ▶ Country-by-country report (where annual consolidated group revenue equal to or exceeding EUR 750 million) with details of allocation, taxes paid and activities in each jurisdiction.
14	Making dispute resolution mechanisms more effective	<ul style="list-style-type: none"> ▶ Minimum standards and best practices for resolution of disputes through Mutual Agreement Procedure ("MAP") in a timely and transparent manner;
15	Developing a multilateral instrument	<ul style="list-style-type: none"> ▶ Developing a Multilateral Treaty framework which will amend all bilateral tax treaties between signatories for expediting implementation of BEPS action points

Treaty Abuse- the problem

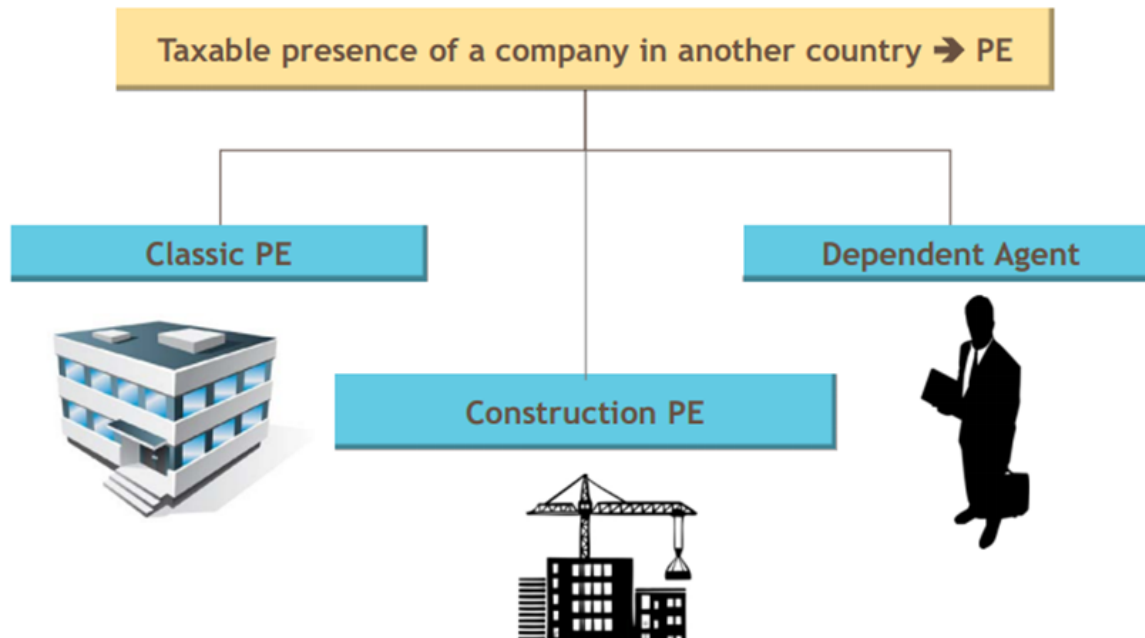


- Principal role of bilateral tax agreements, concluded by nearly every jurisdiction in the world, is to **prevent harmful double taxation** and **remove obstacles to cross-border trade in goods and services**, and **movements of capital, technology and persons**.
- This extensive network of tax agreements has, however, also given rise to treaty abuse and so-called “treaty-shopping” arrangements where a person who is not a resident of a jurisdiction that is a party to a tax agreement may attempt to obtain benefits that a tax agreement grants to a resident of that jurisdiction.
- [What is treaty shopping and how can we eliminate it \(watch 2 mins video\)](#)

Action 7: Preventing Artificial avoidance of PE



Actual situation “before BEPS”

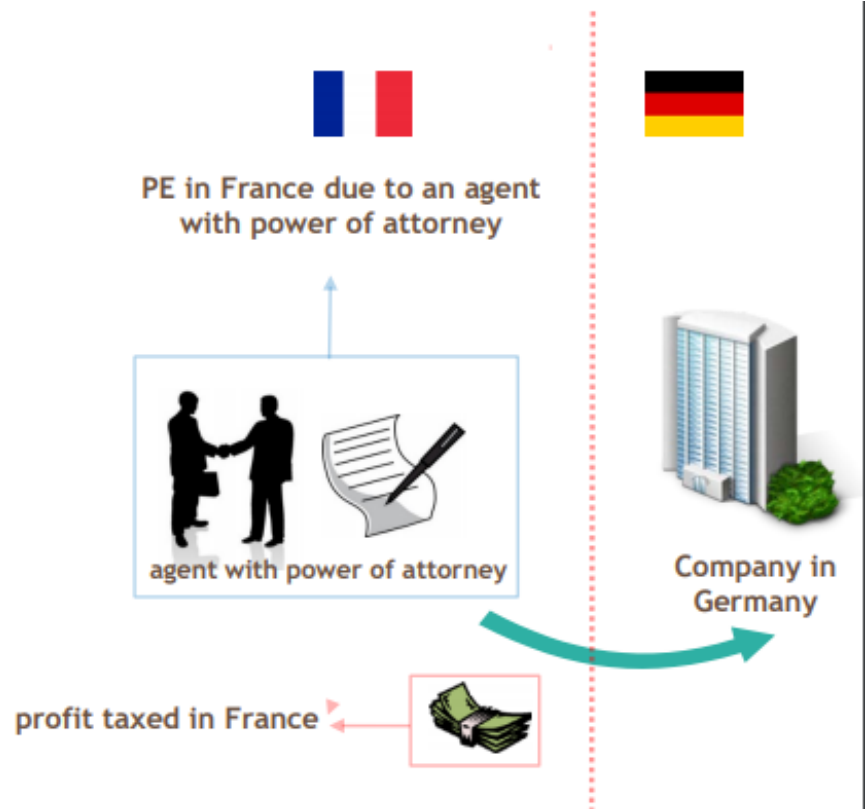


Classic Permanent Establishment

Commissionaire arrangements and similar strategies - Civil law countries

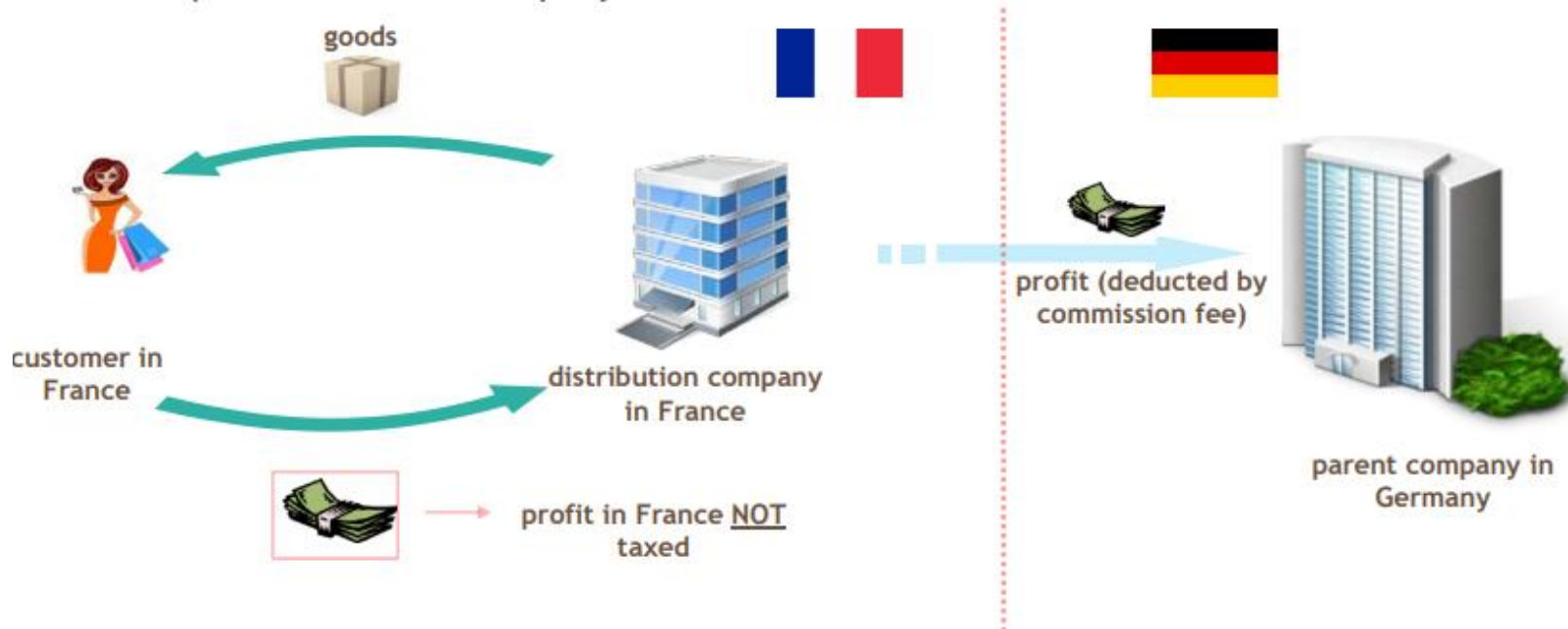
Agent PE:

- A company has an agent PE in another country if a person (*commission agent*) is empowered to conclude contracts on behalf and in the name of this company, or otherwise bind this company and carries out this power of attorney habitually.



Commissionaire arrangements and similar strategies

► Example: distribution company

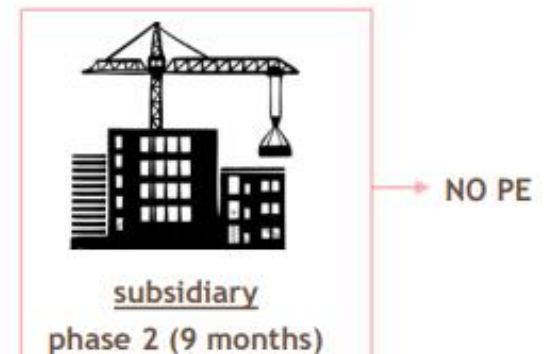
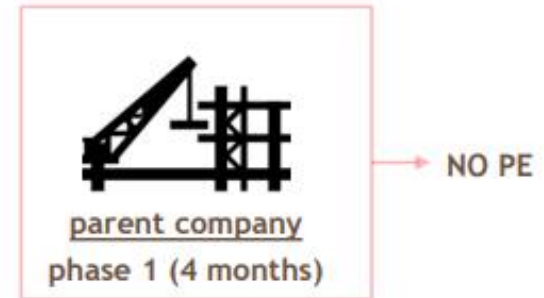


Construction PEs

Splitting up contracts

Problem

- Today
→ A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months (see art. 5 (3) OECD MTC).
- Strategy of many companies
→ splitting-up of a single construction process into several parts or phases, each with own contracts lasting less than 12 months.



- ▶ Current rules - a PE is deemed not to exist when a place of business is used solely for storage, maintenance of stocks of goods for storage, display, delivery or processing, purchasing or the collection of information
- ▶ New rules - the activities referred to above must be of a preparatory or auxiliary nature
- ▶ Preparatory - emphasizing the short-term duration of the relevant activity
- ▶ Auxiliary - being an activity “to support, without being part of, the essential and significant part of the activity of the enterprise as a whole”

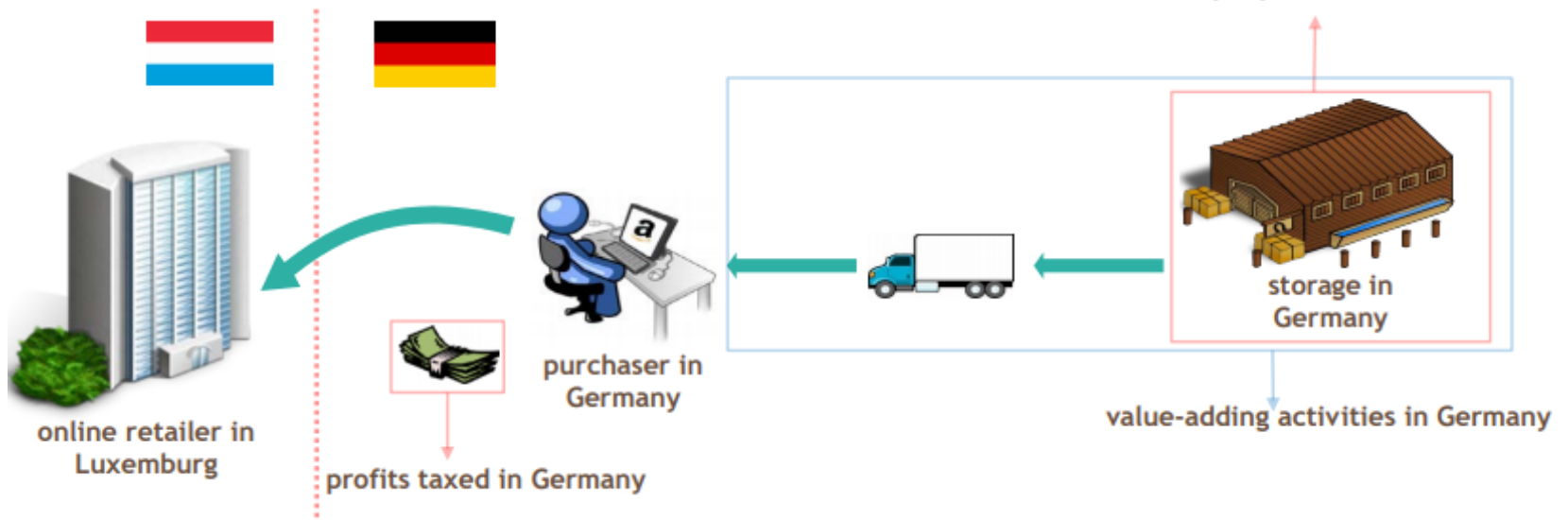
Specific activity exemptions

Example auxiliary activities:

- Is the large warehouse of a Luxembourg company with a significant number of employees, which is located in Germany and serves as a storage and for a timely delivery of online sold products to German customers (still) an auxiliary activity?
- **NO**, according to BEPS action point 7: Storage and delivery are an essential part of the company's sales activities!



. Specific activity exemptions - Results after BEPS project:



REVISED TP GUIDANCE (ACTIONS 8-10)



- The Report, Aligning Transfer Pricing Outcomes with Value Creation, contains 6 interlinked sections
- Guidance for Applying the Arm's Length Principle
- Guidance on Commodity Transactions
- Further work on Transactional Profit Split is scoped
- Guidance on Intangibles
- Guidance on Low Value-adding Intra-group Services
- Guidance on Cost Contribution Arrangements

REVISED TP GUIDANCE

KEY THEMES



Accurate delineation of the actual transaction is fundamental: contracts are reviewed against conduct

Legal ownership alone does not create entitlement to profits

Provision of funding alone: no more than a risk-free financial return

Differences between anticipated and actual profits are allocated depending on assumption of risk / functions that warrant a profit share

Information asymmetry and lack of transparency are addressed (hard-to-value-intangibles, commodities and services)

Analysing TP Risks



• Identify risk

• How is the risk contractually assumed?

• Functional analysis

• Contractual assumption risk aligned with conduct and other facts?

• Control over risk and financial capacity to assume the risk?

TP Documentation



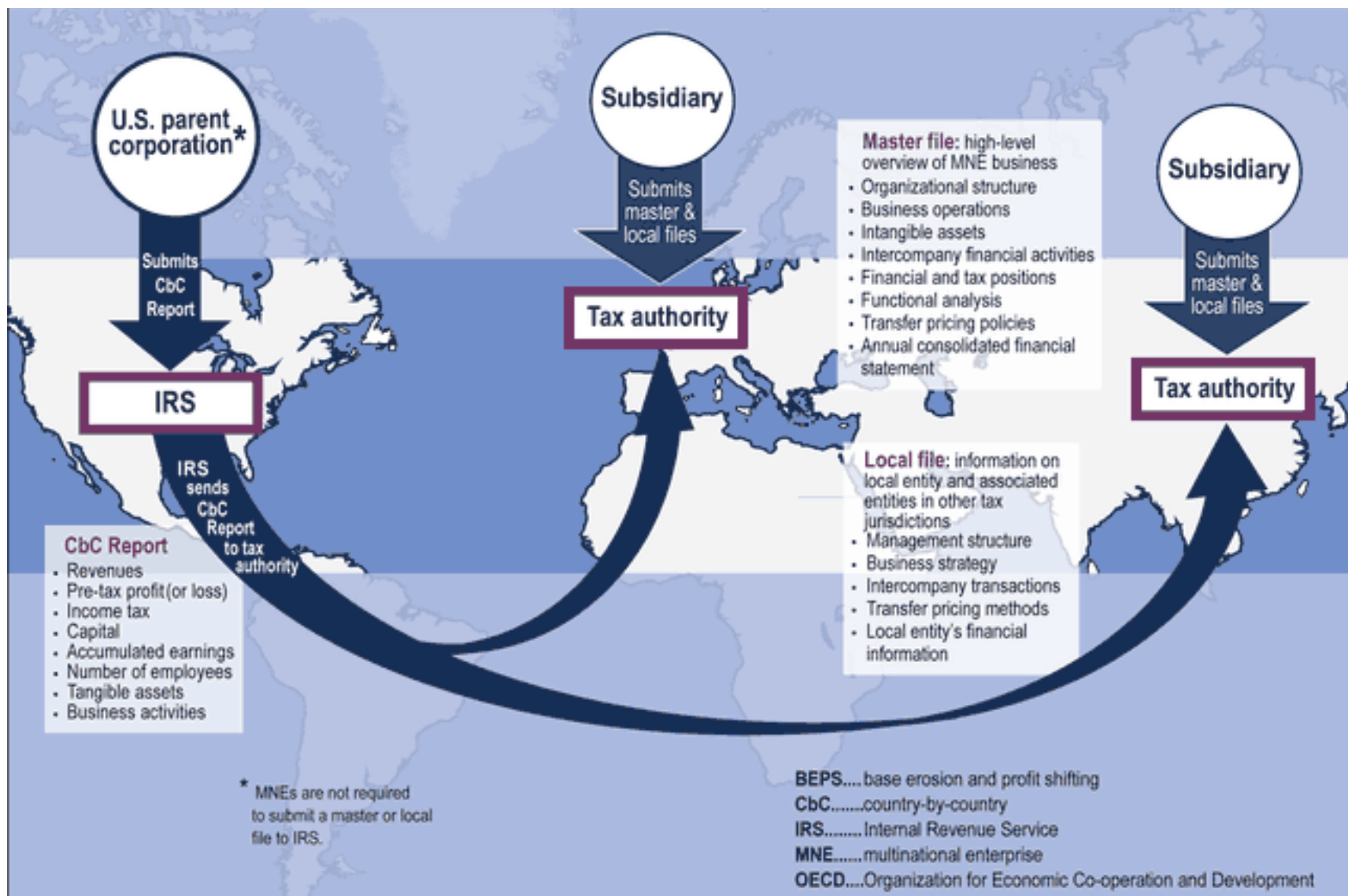
As part of an effort to ensure transparency of Transfer Pricing practices by taxpayers, BEPS addresses the following changes:

Pre BEPS

- Limited transparency into how company operates globally
- Individual reports for each country focused on local rules
- One sided analysis focused solely on results of single entity

Post BEPS

- CbC Report / Master File
- Local File provided along with CbC / Master File allows visibility to multiple jurisdictions into whole value chain
- Value chain analysis / profit split



Kenya

Position on BEPS



- Rules on remuneration of 'cash box' entities
- Rules on exploitation of intangible property
- Reference point for commodity pricing
- Maintaining contemporaneous documentation
- Requirement of filing Country by Country reports
- Formalisation of Inter-quartile Range- median
- Intra-group services- stricter rules on justification
- Expanded definition of Permanent Establishment



THANK YOU

