

OECD developments on taxation

In a rapidly-changing globalised economy, the role of the OECD has progressively broadened from its historical mission. The challenges brought on by the global economic crisis have bolstered international support for long-standing OECD projects, specifically those focused on tackling tax evasion and transparency. Recently, and in particular following the G20 meeting of 2 April 2009, the OECD has been called upon to enhance its participation in discussions with governments and other international organisations to deliver effective exchanges of information between states on a global basis.

OECD/G20 Related Focus on Transparency & Tax Havens

The G20 communiqué following the London summit meeting in April 2009 included the following statement:

"We agree to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information."

Although there are various interpretations of what is meant by a tax haven, the OECD's criteria for identifying tax havens include four key factors: (1) no or nominal tax effective tax rate; (2) lack of effective exchange of information; (3) lack of transparency; and (4) no requirement for substantial presence in the jurisdiction. Of these, the OECD appears to rank the absence of an effective exchange of information with foreign tax authorities and lack of transparency as the key factors in determining whether a territory is a tax haven. However, the recent work of the OECD on transparency and exchange of information has seen the OECD move away from an agenda focused just on "tax havens" to a wider perspective including a number of established financial centres.

As a practical matter, the OECD's work in relation to harmful tax practices on both OECD non-members and tax havens now concentrates on ensuring the OECD's standards of transparency and the exchange of information are met. Indeed, the OECD standards, which revolve around themes relevant to the exchange of information

mechanisms, appropriate access to information and availability of information, have effectively become the new "international standard" for tax cooperation.

The key principles of transparency and effective exchange of information for tax purposes have been articulated and refined through the work of the OECD's Global Forum on Taxation (endorsed by the UN and the G20), and can be summarised as follows:

- Exchange of information on request where it is "foreseeably relevant" to the administration and enforcement of the domestic laws of the treaty partner.
- No restrictions on exchange caused by bank secrecy or domestic tax interest requirements.
- Availability of reliable information and powers to obtain it, including in particular:
 - Bank information: access by tax authorities to bank and other financial information relating to customers and transactions held by financial intermediaries;
 - Ownership and identity information: access to information relating to the beneficial ownership of all types of entities such as companies, partnerships, other entities and of managers and beneficiaries of collective investment funds and of those setting up and benefitting from trusts; and
 - Accounting information: access to information relating to reliable accounting records, audited accounts, etc.
- Respect of taxpayers' rights.
- Strict confidentiality of information exchanged.

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Currently the standards for exchange of information, which are set out in Article 26 of the OECD Model Convention and the 2002 Model Agreement on Exchange of Information, have been adopted by all OECD countries and have served as a basis for most bilateral tax treaties.

At the conclusion of the G20 London Summit, the OECD issued a progress report on the implementation of the internationally agreed tax standard for 84 jurisdictions that participate in the Global Forum's annual assessment of the legal and administrative framework for transparency and exchange of information. The Global Forum's 2009 assessment is expected to be published later this year and should highlight more clearly the distinction between those jurisdictions that are and are not making progress by providing a factual summary of the legal and administrative framework for transparency and exchange of information in each country.

In its *Declaration on Strengthening the Financial System*, the G20 agreed to take action against those jurisdictions which do not meet international standards in relation to tax transparency and agreed to develop a toolbox of effective counter measures for countries to consider, such as:

- Increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions;
- Withholding taxes in respect of a wide variety of payments;
- Denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction;
- Reviewing tax treaty policy;
- Asking international institutions and regional development banks to review their investment policies; and
- Giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programs.

In response to this pressure, many previously reluctant countries have recently agreed to adopt the OECD "international standards" after they were threatened with blacklisting. Austria, Andorra, Belgium, Luxembourg and Switzerland withdrew their reservations while Hong Kong, China,

Monaco, and Singapore all agreed to adopt the standard this year.

OECD Actions Post G-20

Commitment to and Effective Implementation of Standard: The OECD has stated it is ready to assist in the negotiations of specific bilateral Tax Information Exchange Agreements (TIEAs) and will monitor domestic legislative changes as they arise. This initiative will require an exploration of the use of multi-lateral TIEAs to accommodate small tax havens that lack the resources to enter into negotiations with a large number of countries.

Review of Membership of OECD's Global Forum: This forum's membership includes more than 80 jurisdictions which carry out self reviews to assess progress in implementation of standard. More robust reviews will be undertaken that will re-evaluate membership, the architecture and the role of the Global Forum.

Other OECD Initiatives in Progress

There are a number of other OECD projects of relevance to the financial sector tax community.

Intermediaries Project: Subsequent to a meeting held in Cape Town, South Africa in January 2008, the OECD's Forum on Tax Administration (FTA) endorsed the conclusions and recommendations of the *Study into the Role of Intermediaries* and agreed to further examine the role of tax intermediaries (e.g., law and accounting firms, other tax advisors and financial institutions) specifically in relation to unacceptable tax minimisation schemes. The objectives of the project assume mutual benefit in identifying strategies for strengthening the relationship between tax intermediaries and revenue bodies. Several follow-up studies have been commissioned including a study on the banking sector that was published in May 2009. The report focuses on understanding how the banking sector currently operates with particular emphasis on structured financing and covers:

- Building transparent tax compliance by banks;

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- Focus on transparency and risk based approach; and
- Recommendations for both banks and revenue bodies.

Transfer Pricing Aspects of Business Restructurings: The OECD's Committee on Fiscal Affairs (CFA) has undertaken a project that examines the nature of business restructurings by multinational enterprises that involve cross border redeployment of functions, assets and/or risks, with consequent effects on the profit and loss potential in countries. The issues involve primarily the application of transfer pricing (TP) rules upon and/or after the conversion, the attribution of profits to permanent establishments (PEs), and the recognition or non-recognition of transactions. The separate study on PE threshold issues (i.e., Article 5 of the Model Treaty) is expected to be commenced as part of the 2009-2010 programme of work. The PE attribution project is further discussed below.

The project's objective in examining TP aspects of business restructurings is to provide a clearer theoretical framework on how to apply the arm's-length principle and treaty rules. Public comments to the discussion draft published on 12 September 2008 were released on 6 March 2009. The discussion draft contained four "Issue Notes":

- Special consideration for risks between related parties;
- Arm's-length comparison for the restructuring itself;
- Remuneration of post-restructuring controlled transactions; and
- Recognition of actual transactions undertaken.

The discussion draft seems to widen the scope in which it is acceptable for tax authorities to re-characterise transactions for TP purposes. For example, its interpretation of TP Guidelines 1.26 to 1.29 (contractual terms respected only if they have economic substance) appears to allow for piecemeal re-characterisation of individual contract terms. In particular circumstances, at the same time, the discussion draft interestingly recognises that associated enterprises may engage in transactions that independent enterprises would not undertake.

Moreover, the discussion draft also takes a broad view of what constitutes an intangible asset for the purposes of applying an exit tax. There is also strong emphasis on high standards of comparability which infers that unique functions are unlikely to be capable of being benchmarked.

The OECD recognises that this is a long-term project which will require input from the business community. In particular, because changes to the Model Treaty and TP guidelines will likely require unanimous agreement, the widely diverging interests of its own membership will make this a challenge.

Wider Transfer Pricing Project: This OECD project has been on-going for sometime and involves a review of and potential revisions to the 1995 TP Guidelines specific to comparability issues encountered when applying the transfer pricing methods and the application of transactional profit methods.

In the published discussion draft of 25 January 2008, the OECD suggested that in any situation a selection of TP methodology should aim to find the most appropriate method with an emphasis on the relative strengths/weaknesses of each method and on the importance of comparability analysis. In other words, the profit-based methods should no longer be regarded as a method of last resort, but rather there should be a broad alignment with the US "best method" rule of IRC Section 482. The OECD concluded transactional profit splits are usually most reliable where there are: (1) significant non-benchmarkable contributions and/or; (2) highly integrated transactions.

PE Attribution: The OECD released its final version of the *Report on the Attribution of Profits to Permanent Establishments* which provides guidance on the principles for attributing profits to a PE under Article 7 of the OECD Model Tax Convention on Income and Capital. The report is organised in four parts, in which Part I sets out the general considerations for attributing profits to PEs, regardless of the business sector in which they operate.

More specifically, Part I of the report describes a two step approach in which the PE is first hypothesised as a "functionally

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separate entity” from the rest of the enterprise of which it is a part, including attribution of assets/risks/capital as well as recognition of dealings. The second step is to determine profits by applying by analogy the TP Guidelines’ arm’s-length principle, including its comparability analysis, to dealings between the PE and the rest of the enterprise. This requires pricing in accordance with the TP Guidelines any transactions between PE and Head Office (or other PEs). The latter Parts of the report elaborate upon the application of this approach to enterprises carrying on a banking business through a PE, enterprises carrying on global trading in financial instruments and enterprises carrying on insurance activities.

Future Developments

Political pressures and budget deficits leading to a determinedly anti-tax avoidance agenda seem to have increased support for the OECD agenda and have placed its projects at the forefront of strategic tax responses to the global financial crisis.

It will be interesting to monitor the changing relationship of the OECD with its member as well as non-member countries. It seems likely there will be a continuing focus on widening its sphere of influence across the globe and in pushing through its efforts focused on combating tax evasion and aggressive international tax avoidance.

Further, recent work started by the OECD on the separate topics of beneficial ownership (i.e., effectively dealing with the ownership of most forms of income for treaty purposes) and PE threshold issues (i.e., clarifying the rule relating to the circumstances in which a PE is created) will be of special relevance to the financial sector and will need to be closely monitored going forward.

How can PwC help?

PwC has an internal network of tax specialists who have relationships at different levels of the OECD and can provide insights and guidance on how these projects affect the financial services sector.

Contacts

If you would like further advice in relation to the issues outline above, please call your local PwC contact or alternatively any of the people listed below:

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