

כנס סוף שנת המס 2013

Base Erosion and Profit Shifting

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BEPS Overview

Timing and Process of Action Plan

- ארגון ה-OECD פרסם ב-19 ליולי, 2013 תוכנית פעולה בת 40 עמודים בנושא *Base Erosion and Profit Shifting* ("BEPS"). תוכנית הפעולה מציעה מפת דרכים הכוללת 15 תחומים
- שרי האוצר של המדינות הנמנות עם ה-G-20 פרסמו ב-20 ליולי, 2013 הצהרה ממקום כינוסם במוסקבה בה הכריזו, כי הם מאמצים את התוכנית השאפתנית של ה-OECD
- תוכנית הפעולה אושרה גם בפגישה של מנהיגי המדינות הנמנות עם ה-G-20 בספטמבר האחרון בסנט פטרסבורג
- יישום תוכנית הפעולה יעשה על ידי ה-OECD באמצעות צוותי פעולה וכח משימה שיעסוק בנושא מיסוי מסחר אלקטרוני
 - צוותי הפעולה יורכבו מנציגי המדינות הנמנות עם ה-G-20 בייצוג שווה (לרבות, מדינות שאינן חברות ב-OECD)
 - היעד להשלמת תוכנית הפעולה הינו 12-27 חודשים

Main Themes

- עקרונות המיסוי הבינלאומי לא עמדו בקצב השינויים של הכלכלה המודרנית
 - שרשרות אספקה בינלאומיות
 - עליית החשיבות של נכסים אינטלקטואליים (IP) ושירותים
 - מסחר אלקטרוני (E-commerce)
- האמור לעיל אפשר לתאגידים בינלאומיים (MNEs) להפחית את נטל המס המוטל עליהם
 - היעדר מיסוי (או מיסוי בשיעור מופחת) של פעילויות מלאכותיות שהובילו להחרגת הכנסה חייבת מהפעילות שיצרה אותה
 - פערים וחוסר קורלציה בין שיטות מס שונות
 - ניצול לרעה של אמנות מס
- חוסר הלימה כאמור מונע ממדינות הכנסות, מסיט נטלי מס, יוצר חוסר שיוויון בין תאגידים מקומיים לבין תאגידים בינלאומיים וחותר תחת ערך ההגינות
- פעולות מהירות נדרשות על מנת למנוע פעולות חד צדדיות שעשויות להוביל לכאוס
- ניתן ליישם את עקרונות ה-BEPS תוך שימוש בעקרונות מס בינלאומיים
 - תמחור של עסקאות בין-חברתיות על פי שווי שוק ובהתאם למחירי העברה (Arm's Length)
 - שימוש בעקרונות מיסוי קיימים על מנת לקבוע זכות מיסוי בכל הקשור להכנסה חוצת גבולות (Cross Border Income)
 - שקיפות היא אבן יסוד אך מוסכם שהקפדה על סודיות הנישום היא הכרח

Action Plan: 15 workstreams

I. Digital economy

1. Address the challenges of the digital economy

II. Establishing international coherence of corporate income taxation (“gaps”)

2. Neutralize impact of hybrid mismatch arrangements
3. Strengthen CFC rules
4. Limit base erosion through financial payments
5. Counter harmful tax practices more effectively

III. Restoring the full effects and benefits of international standards (“frictions”)

6. Preventing treaty abuse
7. Prevent artificial avoidance of PE status
8. Assure transfer pricing outcomes are in line with value creation: Intangibles
9. Assure transfer pricing outcomes are in line with value creation: Risks and capital
10. Assure transfer pricing outcomes are in line with value creation: Other high-risk areas

IV. Ensuring transparency; Promoting increased certainty, predictability (“transparency”)

11. Establish methodologies to collect and analyze BEPS data
12. Require taxpayers to disclose their aggressive tax planning arrangements
13. Re-examine transfer pricing documentation
14. Make dispute resolution mechanisms more effective

V. Swift implementation of the measures

15. Develop a multilateral instrument

I. Digital economy

1. Addressing the challenges of the digital economy

- Task-force will be set up to review business models and identify issues and options
- Scope: PE, attribution of profits, character of income, and source rules
- Includes review of indirect taxation
- One issue is value derived from domestic customer information

Observation

- The OECD's decision to limit this workstream to a study means that companies with significant digital business will likely not see major OECD policy changes in this area in the near term

Note: Similar scope to 1997-2002 OECD e-commerce project.

II. Establishing international coherence of corporate income taxation (“gaps”)

- Neutralize impact of hybrid mismatch arrangements
- Strengthen CFC rules
- Limit base erosion through financial payments
- Counter harmful tax practices more effectively

Establishing international coherence of corporate income taxation (“gaps”)

2. Neutralize impact of hybrid mismatch arrangements

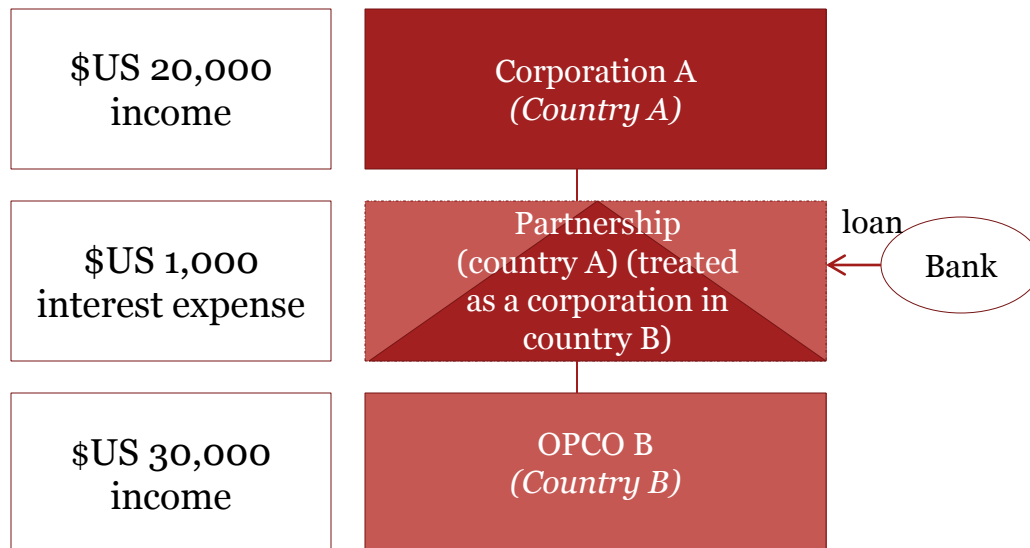
- Model treaty provisions to prevent use of hybrid entities and hybrid instruments to obtain undue treaty benefits (e.g., denial of withholding tax relief)
- Domestic law changes to
 - Prevent exemption or nonrecognition of deductible payments
 - Deny deductions for payments not includible in income
 - Prevent double deductions
 - Provide tie-breaker rules

Observation

- Because many multinationals use hybrid instruments or hybrid entities in global tax planning, changes resulting from this workstream could have a significant impact

Hybrid entity – example (“Double Interest Deduction”)

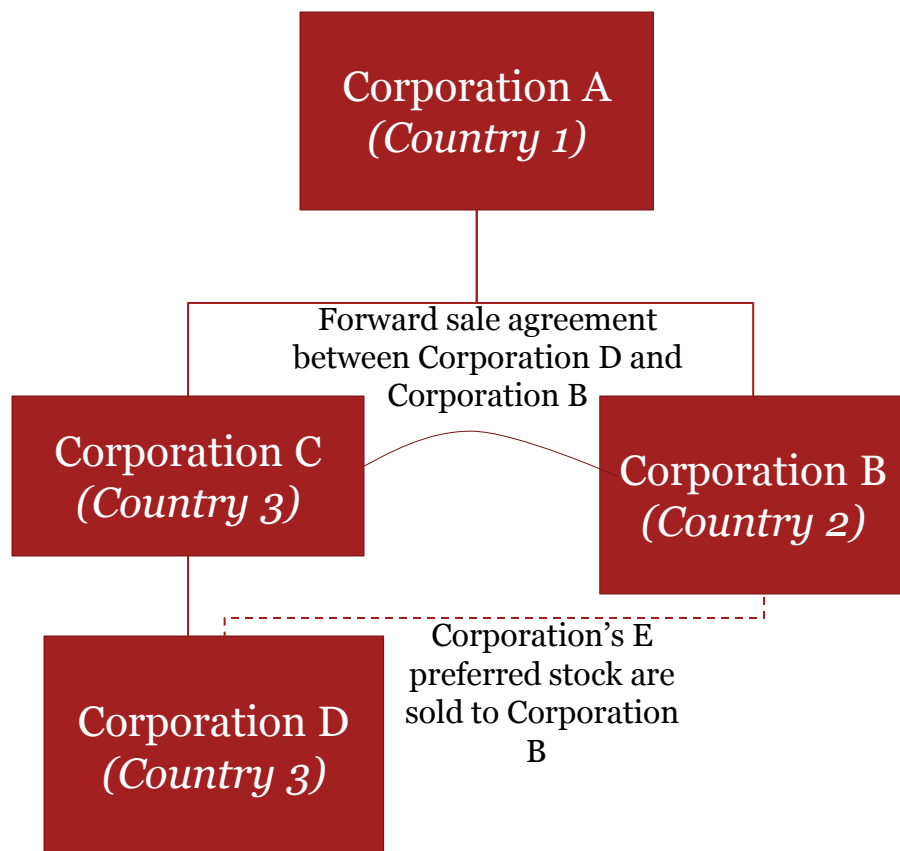
Description:



- Under the laws of jurisdiction A the Partnership is treated as flow through entity for country A tax purposes
- Under the laws of jurisdiction B the Partnership is treated as a corporation for country B tax purposes
- Partnership and OPCO B file a consolidated tax return in country B, and deduct the interest from OPCO B's business income
- Under the law of country A, the income/expense of the Partnership flows through to corporation A and therefore the interest is taken as a deduction against Corporation A's profits
- **The result:** same interest deducted twice in different jurisdictions

Hybrid instrument – example

Description:



- There is a forward sale agreement according to which Corporation C sells to Corporation B the preferred shares of Corporation D, which will be sold back within 5 years for a higher price. In the meanwhile, coupons are paid on the preferred shares by Corporation D to Corporation B
- In country 3, a high tax jurisdiction, the forward sale agreement is treated as an interest-bearing loan and Corporation C records an interest expense, which is exempt from WHT under the tax treaty between country 3 and 2
- In country 2, the transaction is treated as a “true sale”, and coupons paid to Corporation B are treated as dividend which are 95% exempt under the “participation exemption” regime of country 2
- **The result:** interest deduction in country 3 and minimum tax in country 2

Establishing international coherence of corporate income taxation (“gaps”) (cont’d)

3. Strengthen CFC Legislation

- Develop model CFC legislation

Observation

- The Plan does not acknowledge the European Court of Justice decisions setting limitations on CFC rules
- The workstream likely targets United States, given other OECD countries’ concerns about subpart F exceptions and the impact of the check-the-box rules

Establishing international coherence of corporate income taxation (“gaps”) (cont’d)

4. Limit base erosion through financial payments

- Develop TP guidelines for valuing financial transactions including guarantees, derivatives, and captive and other insurance arrangements
- Recommendations regarding domestic law limitations on related and unrelated interest expense and economically equivalent payments, for both inbound and outbound investors

Observation

- The application of this workstream to the financial services sector should be closely monitored, as a bank’s interest expense is essentially equivalent to a manufacture's cost of goods sold

See, OECD report on Thin Capitalisation, 1987.

Establishing international coherence of corporate income taxation (“gaps”) (cont’d)

5. Counter harmful tax practices more effectively

- Concerns actions of governments, not taxpayers
- Review member country regimes
- Develop strategy to expand participation to non-OECD countries
- Modify criteria to require substantial activity for preferential regime
- Mandatory, spontaneous exchange on preferential regime rulings

Observation

- The results associated with both reviewing regimes of member country as well as developing strategy, may not be excessively controversial
- The revised criteria may generate some resistance from certain OECD members, meaning that consensus could be difficult to reach

III. Restoring the full effects and benefits of international standards (“frictions”)

- Preventing treaty abuse
- Prevent artificial avoidance of PE status
- Assure transfer pricing outcomes are in line with valuecreation: Intangibles
- Assure transfer pricing outcomes are in line with value creation: Risks and capital
- Assure transfer pricing outcomes are in line with value creation: Other high-risk areas

Restoring the full effects and benefits of international standards (“frictions”)

6. Preventing treaty abuse

- Clarify policy behind tax treaties and criteria for entering
- Develop limitation of benefit provisions
- Develop recommendations for domestic rules to prevent inappropriate treaty benefits.

Observation

- This workstream seeks first to clarify the policy behind bilateral tax treaties and the criteria for entering into them
- In addition, it aims to develop best practice anti-abuse clauses for use within bilateral treaties and best practice anti-avoidance rules for domestic tax systems to prevent inappropriate treaty benefits.

Restoring the full effects and benefits of international standards (“frictions”) (cont’d)

7. Preventing artificial avoidance of PE status

- Prevent avoidance of PE status through use of commissionaire arrangements
- Review specific activity exemptions (e.g., preparatory and auxiliary)
- Address related profit attribution issues

Observation

- The workstream will seek to redefine PEs so as to prevent PE status avoidance through using commissionaires (as dependent agents) or specific activity exemptions
- This effort will also address related profit attribution efforts

Restoring the full effects and benefits of international standards (“frictions”) (cont’d)

8. Transfer pricing: intangibles

- Adopt a broad definition of intangibles (phase 1)
- Allocate profits based on value creation (phase 1)
- Develop TP rules for hard-to-value intangibles (phase 2)
- Update cost contribution arrangement guidance (phase 2)

Observation

- Note that the OECD has released a report specifically on intangibles since issuing the BEPS CAP

Restoring the full effects and benefits of international standards (“frictions”) (cont’d)

9. Transfer Pricing: Risks and Capital

- Align profits with value creation
- Prevent inappropriate returns from accruing to an entity solely because it has assumed contractual risk or provided capital.

Observation

- Although this way seem to be a drastic departure from traditional contractual risk allocation, it is not an entirely new approach
- In 2008, the OECD “KERT” approach to profit attribution relied heavily on “people” functions. Some observers felt that this approach, which primarily affected the financial services industry, overly diminished the value capital plays

Effective control of risk within a group-OECD's view

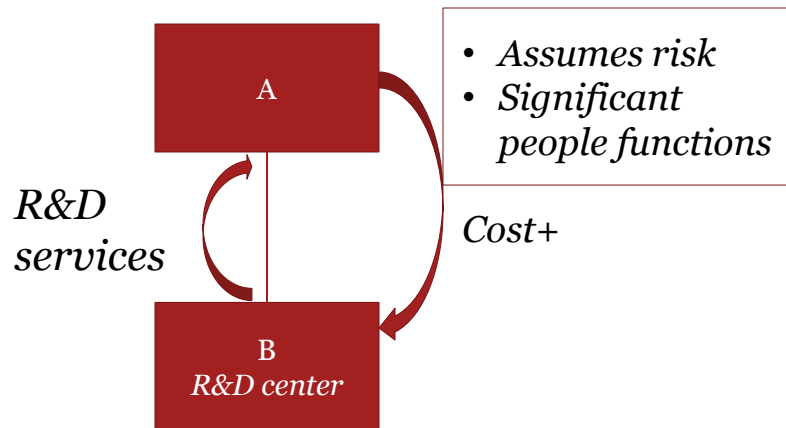
Step 1 –A functional and factual analysis, leading to:

- The attribution to the PE as appropriate of the rights and obligations arising out of transactions between the enterprise of which the PE is a part and separate enterprises;
- The identification of significant people functions relevant to the attribution of economic ownership of assets, and the attribution of economic ownership of assets to the PE;
- The identification of significant people functions relevant to the assumption of risks, and the attribution of risks to the PE;
- The identification of other functions of the PE;
- The recognition and determination of the nature of those dealings between the PE and other parts of the same enterprise that can appropriately be recognized, having passed the threshold test; and
- The attribution of capital based on the assets and risks attributed to the PE.

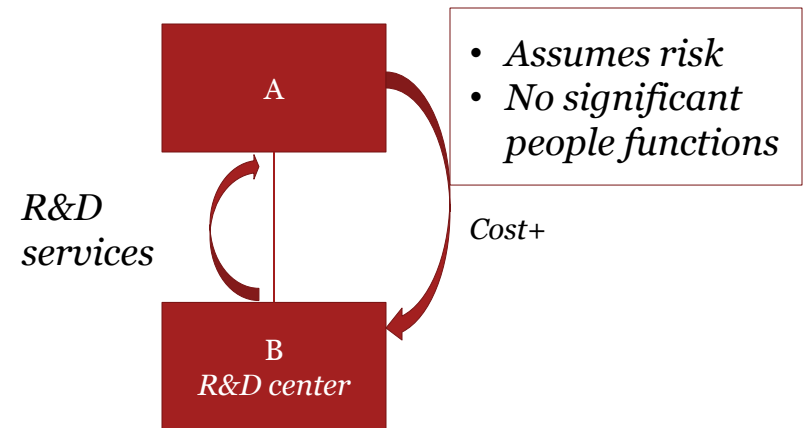
Step 2 –The pricing on an arm's length basis of recognized dealings through:

- The determination of comparability between the dealings and uncontrolled transactions, established by applying the Guidelines' comparability factors directly (characteristics of property or services, economic circumstances and business strategies) or by analogy (functional analysis, contractual terms) in light of the particular factual circumstances of the PE; and
- Selecting and applying by analogy to the guidance in the Guidelines the most appropriate method to the circumstances of the case to arrive at an arm's length compensation for the dealings between the PE and the rest of the enterprise, taking into account the functions performed by and the assets and risks attributed to the PE.

Illustrative example – significant people functions



- Given a significant people functions and the assumption of risk the IP ownership is attributed to corporation A



- Due to the lack of substance the IP ownership is attributed to corporation B

Restoring the full effects and benefits of international standards (“frictions”) (cont’d)

10. Transfer Pricing: Other high-risk transactions

- Address related-party transactions that rarely occur between 3rd parties
- Provide rules when transactions can be recharacterized
- Clarify application of TP methods, especially profit splits, to global value chains
- Protect against base eroding payments, such as management fees and head office expenses.

Observation

- Some of the approaches demonstrate an apparent misunderstanding of TP principles
- Arm’s length standard does not require related parties to mimic transaction between unrelated parties it only requires them to reach the price that unrelated parties would have reached in similar transactions.

IV. Ensuring transparency; Promoting increased certainty, predictability (“transparency”)

- Establish methodologies to collect and analyze BEPS data
- Require taxpayers to disclose their aggressive tax planning arrangements
- Re-examine transfer pricing documentation
- Make dispute resolution mechanisms more effective

Ensuring transparency; Promoting increased certainty, predictability (“transparency”)

11. Establish methods to collect and analyze BEPS data

- Develop recommendations for data to gather and methodologies to analyze BEPS
- Consider taxpayer confidentiality and administrative costs
- Analyze the scale and impact of BEPS, including spillover effects.

Ensuring transparency; Promoting increased certainty, predictability (“transparency”) (cont’d)

12. Require taxpayers to disclose aggressive tax planning

- New working party to be formed to develop recommendations for design of domestic mandatory disclosure rules for aggressive or abusive transactions using a wide definition of “tax benefit”
- Consider administrative costs
- Maximize consistent reporting; design models for info sharing
- Use a modular approach allowing countries to keep existing measures.

Observation

- There will be a particular focus on international tax structures and information-sharing, using models such as the Joint International Tax Shelter Information Centre (JITSIC) which now includes the US, UK, Japan and China
- Existing US rules related to disclosure, e.g., Schedule UTP, are also likely to provide models for domestic disclosure recommendations

Ensuring transparency; Promoting increased certainty, predictability (“transparency”) (cont’d)

13. Re-examine transfer pricing documentation

- Require reporting to all relevant governments of global allocation of profits, economic activity, and taxes paid using a common template

Observation

- The work on a global documentation package could be useful if there is a consensus and if countries would change domestic rules, but that result may be unlikely
- Edging closer to a new set of transfer pricing rules that relay more on the use of formulas to allocate profits globally, and could result in more pressure on taxpayers to align profits and taxes paid with location of employees, assets or sales

Ensuring transparency; Promoting increased certainty, predictability (“transparency”) (cont’d)

14. Make dispute resolution procedures more effective

- Improve efficiency of mutual agreement procedure (“MAP”)
- Increase access to MAP
- Increase access to arbitration
- See OECD *Manual on Effective Mutual Agreement Procedures*

Observation

- This workstream reflects comments by the Business and Industry Advisory Committee to the OECD and various tax authorities on dispute resolution difficulties
- Note that current US treaty policy is to include binding arbitration as part of the MAP process

V. Swift implementation of the measures

15. Develop a multilateral instrument

- Review legal issues related to development of a multilateral instrument
- Develop a multilateral instrument allowing signatories to make modifications to OECD tax conventions immediately effective without renegotiating bilateral treaties.

Observation

- The idea of a multilateral income tax treaty is very ambitious in light of strong national sovereignty issues. Even within the European Union, it has not yet been possible to begin harmonizing income tax systems.

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