



# Tax Policy Bulletin

## Update on OECD tax projects

September 2011

*Welcome to our September 2011 bulletin which provides an update on the key tax projects currently being undertaken by the Organisation for Economic Cooperation and Development (OECD). We've included details on the progress of this work as well as commentary on the potential impact of these new developments on the business community. If you'd like further advice or information in relation to any of the issues covered, please refer to the contact list at the end of the document.*

### **Transfer pricing and intangibles**

**Scope:** The OECD has recently indicated that Working Party 6 (WP6), composed of delegates focused on transfer pricing matters, will begin a project examining issues relating to intangible property later this year. Recent developments in the United States and other countries in relation to transfer pricing for intangible property transfers and cost-sharing agreements also provide some impetus for further OECD consideration in this area. While the precise scope of this project is still under development, it seems likely that it will be broad in scope and address several important issues relating to transfer pricing or transfers of intangible property. Potential topics to be addressed by this project are:

- defining intangibles,
- distinguishing intangibles from services,
- identifying whether an intangible has been transferred,
- harmonising the concepts of ownership in Articles 7 and 9 of the OECD Model Convention,
- intangibles in the context of cost contribution arrangements, and
- intangibles and transfer pricing and valuation methods.

The project is likely to take several years to conclude, and may ultimately result in a substantial rewrite of Chapters VI and VIII of the OECD Transfer Pricing Guidelines (the Guidelines), after the final draft of the changes to Chapters I-III of the report on business restructurings is released.

**Current status:** Following an intensive consultation process throughout 2010, the OECD has now released a scoping document for this project. In response to the rapidly changing world, the updated guidance is intended to be principles-based, to ensure flexibility, rather than being a set of prescriptive rules. A draft discussion paper is intended to be published by the end of 2013 which is likely to cover the topics identified above. WP6 is currently pursuing the approach to suitable valuation methods for transfer pricing purposes with private sector representatives. Discussions with the business community are expected to continue in relation to the other areas within the scope of this project. This matter was discussed with the private sector at WP6's special session on the transfer pricing aspects of intangibles in March 2011.

**PwC observations:** It's not possible, at this time, to judge the approach that the OECD is likely to take on any of these topics. What is clear is that the discussion of intangible-related topics at the OECD will provide an opportunity for tax administrations around the world to further educate themselves on transfer pricing issues relating to intangible property and, in many cases, to seek to have standards adopted consistent with local country interpretations. They might also wish to consider some of the wider implications arising from the increased focus on intangibles in the revised Chapters I-III and the new Chapter IX on business restructuring. Overall, therefore, this is a natural progression from earlier projects. It can be hoped that the discussion will be productive and lead to consensus views and clearer international rules on a number of important transfer pricing topics.

**Contacts:** Andrew Casley, Horacio Pena or Adam Katz

### **International cooperation amongst tax authorities: joint audits**

**Scope:** At the OECD's International Tax Conference held in Washington in early June, IRS Commissioner and Chair of the OECD's Forum on Tax Administration (FTA), Douglas Shulman, highlighted the shift from cooperation among tax authorities to coordinated joint action via joint audits, offshore compliance efforts for high net worth individuals, and other avenues of information sharing.

For example, two or more countries might participate in a joint risk assessment, which could result in a multinational group making one presentation to the various tax authorities involved. The tax authorities could then decide which risks they wished to audit, either together as a joint team, or separately. The process will therefore differ from a simultaneous audit where two or more tax authorities would conduct their own audits and then exchange information. The competent authorities will clearly be an integral part of the process of any joint working of risk assessments and any subsequent joint audits.

The objective is to reduce the burden of audits on multinational companies (MNCs) and also to involve the competent authorities from the start of the joint audit process, rather than waiting for the two audits to be finalised before double taxation can be relieved in the context of the mutual agreement procedure (MAP). The focus of the FTA's work will continue to be on creating a framework for tax authorities to work together; on improving the relationship between large corporate taxpayers, revenue bodies and tax intermediaries; and on enhancing compliance with the spirit of the law.

**Current status:** The OECD has worked with a number of tax authorities to develop a protocol for the development of a joint audit process which may take a number of forms. Its report, together with a practical guide for tax authorities wanting to engage in joint audits, was published at the end of the last OECD FTA meeting in Istanbul. A few projects are already underway which are being badged as joint audits. We understand that these include two joint audits involving the US Internal Revenue Service (IRS) and the Australian Taxation Office (ATO); a

joint audit of a high net worth individual by the UK's HM Revenue & Customs (HMRC) and the South African Revenue Service (SARS); and an IRS and HMRC 'fast-track' advance pricing agreement (APA) renewal which is targeted for completion within six months.

**PwC observations:** Involving the competent authorities at an early stage, rather than after an audit has taken place, is a welcome development and one to be encouraged. We would want to see, however, that the competent authorities are properly resourced for this new role and that joint audits do not result in longer MAP and APA turnaround times. The tax authorities have made a brisk start to this programme and those leading this project say that a number of MNCs have already expressed an interest in taking part. It's likely that the concept will appeal most to those MNCs that have adopted a more transparent and open approach towards disclosure. Whether these are the MNCs which are of most interest to the tax administrations remains to be seen.

**Contacts:** Diane Hay or David Swenson

### **Beneficial ownership**

**Scope:** The intention of this project, undertaken by the OECD's Working Party 1 (WP1), is to add greater clarity to the 'beneficial ownership' concept in the Commentary to the OECD Model Treaty. (The concept is used in the Model Treaty in the dividends, interest and royalties articles.)

**Current status:** On 29 April 2011, the OECD released a public discussion draft containing proposed new guidance on the interpretation of the term, 'beneficial owner'. The OECD received comment letters from 38 organisations, including PwC, prior to the comment deadline closing on 22 July 2011. The next step in the process is for WP1 to examine and discuss the comment letters at their September 2011 meeting. The comment letters are posted on the OECD website ([click here to access](#)).

**PwC observations:** Given the nature of the beneficial ownership concept and the wide variety of situations covered by the dividends, interest and royalties articles of double tax treaties, any attempt to further clarify this concept in a manner which assists in the

interpretation of these treaty articles (without causing major new difficulties in the access to and application of the treaties) would be welcome. But, this is clearly providing difficult.

Given the array of approaches taken by tax authorities to the interpretation of the term, coupled with an increasing amount of litigation, it's understandable that the OECD wishes to instil some degree of greater clarity around the concept. However, we believe that the proposed wording in the public discussion draft will not improve the current position and runs the risk of making interpretation even more difficult – particularly given the rather vague comments in the OECD's discussion draft about "passing on" income. We envisage that this project will have significant implications. Our main concern is whether it will be possible to arrive at a meaningful consensus on the interpretation of the term without sacrificing its intended meaning as set out in the existing Commentary.

**Contact:** Mike Gaffney or Richard Collier

### **PE threshold issues (Threshold PE)**

**Scope:** The OECD is seeking to provide further clarification in the Commentary of the Model Tax Convention on a variety of issues and interpretations related to the PE concept as it applies to the creation of a PE through a fixed place of business or through the 'dependent agent' rule. The work is being carried out by a separate subgroup of Working Party 1 (WP1) (which has an ongoing brief in relation to the provisions of the OECD's Model Tax Treaty). This subgroup is comprised of 25 of the 30 OECD member countries, reflecting a strong interest in this topic from various tax authorities.

**Current status:** The working group is addressing a long list of issues relating to terms in the current Article 5 and in the Commentary. It will clearly take some time to work through the various points under discussion. Little has been made public regarding the work in progress or the direction of thought. However, it does seem that the OECD remains of the view that, while the Commentary to Article 5 is likely to be amended materially, the wording of Article 5 itself should not be changed.

It's understood that progress reports are intended to be released in the future and that WP1's final report is scheduled for release in February 2012.

**PwC observations:** The OECD work on examining PE threshold issues (i.e. dealing with the circumstances in which a PE is created) has attracted considerable interest from the tax authorities. This is not surprising given the OECD's earlier forays into this area during the comprehensive work on the attribution of profits to permanent establishments (see separate update on Attribution PE on page 11) and the relevance of the issue to the business restructuring project (again, see separate update on page 11). Like the beneficial ownership project, this work is likely to prove of great importance going forward. The major concern here is that 'clarification' of the PE threshold tests will, in practice, lead to a widening of the tests and thus to greater dispute. It's hoped that any greater clarity in the concepts and terms of Article 5 is not achieved at the expense of the parameters surrounding what does and does not crystallise a PE under Article 5.

**Contacts:** Mike Gaffney,  
Peter Skewes-Cox or Richard Collier

### ***Tax havens and international financial centres: transparency and exchange of information***

**Scope:** The OECD's work on this topic is being conducted through its Global Forum. This body assembles the most senior tax enforcement officers (e.g. US IRS Commissioner and counterparts) and includes both OECD member and non-member countries. The Global Forum has conducted significant work in setting out standards of transparency and exchange of information principles. It's actively encouraging states to introduce exchange of information arrangements in bilateral tax treaties based on the OECD's Model Tax Information Exchange Agreement. So far, more than 500 such treaties have been signed following the impetus set by the G20 meeting of April 2009.

**Current status:** The G20 meeting in September 2009 encouraged the expansion of the OECD's work to include the participation of developing countries, and to initiate a peer review programme of Global Forum members by February 2010. This programme is

now well underway with many peer reviews in progress and a number already completed. Peer reviews comprise two phases of reviews. 'Phase 1' reviews cover the legal and regulatory frameworks for transparency and the exchange of information. Phase 2 reviews cover the practical aspects of exchange of information. By the time of the next G20 summit in Cannes in November 2011, it's expected that close to 60 reviews will have been completed. Significant progress has also been made in relation to the 'black' and 'grey' listing of countries by reference to tax transparency standards. Currently, no jurisdictions remain on what has been referred to as the 'black list' (i.e. jurisdictions that have not committed to the internationally agreed standard of transparency and exchange of information). Only five remain on the 'grey list' (i.e. jurisdictions that have committed to the agreed standard, but have not yet substantially implemented it by reference to the OECD's test of whether 12 exchange of information agreements have been signed).

**PwC observations:** There seems little doubt that pressure on territories to conform to the transparency and exchange of information agenda will remain high, particularly as measures to address uncooperative territories are being developed. There are also some indications that there may be renewed focus by the G20/OECD on themes stemming from the 1998 report on harmful tax competition that may result in the examination of specific tax measures or regimes based on what goes beyond fair tax competition. It's also perhaps worrying that some of the themes from the work on transparency and exchange of information, largely addressing tax evasion, seem to be given a wider voice by the OECD outside of the tax evasion arena. See, for example, the recent OECD report, 'Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure' (discussed further below) which is presented by the OECD on the basis that tax planning by large corporations, which complies with the letter of the law but not its spirit, is costing 'honest' taxpayers a lot of money.

**Contacts:** Richard Collier or  
Yoshiyasu Okada

**Tax and Development**

**Scope:** The OECD Task Force on Tax and Development is a joint initiative of the Committee on Fiscal Affairs (CFA) and the Development Assistance Committee (DAC). The Task Force was set up last year to look at the role that taxes play in a development context and how developing countries can build their own tax revenues to be less reliant on debt and aid. The Task Force is a multi-stakeholder group. Its members include governments (from both OECD and non-OECD countries), aid donors, civil society organisations, and business.

**Current status:** At its first meeting in May 2010, the Task Force established a work programme covering four areas which were identified as key for developing country efforts to mobilise their domestic resources and tax revenues. They are:

1. Building the capacity and accountability of tax systems and tax administration in developing countries;
2. Implementing more effective transfer pricing regimes in developing countries;
3. Increasing transparency in the reporting of financial data by MNCs; and
4. Countering international tax evasion/avoidance and improving transparency and exchange of information.

Subgroups of the Tax Force were set up to work on the first three areas and the fourth is covered by the Global Forum on Transparency and Exchange of Information. The second meeting of the Tax Force in April 2011 reviewed progress and prioritised potential areas of work and outputs by the subgroups, which are to be continued as an integrated package of work in this area.

**PwC observations:** This is an important OECD initiative which brings together both tax and development expertise, as well as organisations with different experience and perspectives, to focus on the important question of how tax could help break the cycle of aid dependency in some developing countries. A challenge for the OECD is how to involve more developing country governments in active membership of the Task Force. PwC is a member of

the Tax Force and is closely involved in the work of the subgroup looking at transparency in the reporting of financial data by MNCs.

**Contacts:** Susan Symons, Peter Merrill, Gilles De Vignemont

**Country-by-country (CbyC) reporting**

**Scope:** CbyC reporting is a proposed system of corporate financial reporting that would require MNCs to report on their financial performance and their tax payments in each of the countries where they operate. CbyC reporting is being put forward by campaigners and civil society organisations as part of their aim to build tax revenues in developing countries, by combating corruption and increasing transparency over tax avoidance.

**Status:** The proponents of CbyC reporting are lobbying governments, international organisations, and standard setters looking to bring in regulation to require CbyC reporting. The campaign has attracted some political attention and the G8 countries requested the OECD to evaluate CbyC reporting. This work is being progressed by the subgroup of the OECD Tax Force on Tax and Development, which is looking at transparency in the reporting of financial data by MNCs. The subgroup produced a discussion paper which was reviewed by the Task Force at its April 2011 meeting. The paper looks at a number of issues including:

- What would be the objectives of greater transparency in financial reporting; what would the proponents hope to achieve?
- Are there increased or better forms of disclosure than those that exist currently which could reasonably be expected to meet these objectives?
- What would be the costs, both financial and otherwise, of such disclosure?
- How could greater transparency be achieved? For example, should it be voluntary or compulsory? Could it be best achieved through changes to accounting standards, by amendments to the OECD Guidelines for MNCs, or by some other route?

The paper also recommends a number of areas for further work.

**PwC observations:** The campaign for CbyC reporting has gained momentum. Last year, the US enacted requirements in the Dodd Frank Wall Street Reform Act that SEC registered companies in the extractive industries (mining, oil and gas) must disclose their payments to governments for natural resources, both by country and by project. The SEC is currently consulting on the design of these new rules. The European Commission is also evaluating CbyC and has committed to issuing a communication on it later this year. The OECD work on the topic is important because it brings together a multi-stakeholder group, including some civil society organisations advocating new regulation, to discuss the objectives of greater transparency and how they could best be achieved. This includes discussion over the balance between costs and benefits of different possible disclosure options. PwC is a member of and closely involved in the work of the OECD subgroup.

**Contacts:** Susan Symons and John Preston

#### **Value added taxes (VAT): guidelines on neutrality**

**Scope:** The guidelines on neutrality were released for public consultation following approval by Working Party 9 (WP9) and the Committee on Fiscal Affairs (CFA) at the end of 2010. The guidelines address the principles that VAT/GST should be neutral to business and should not influence business decisions. They also address the issue that foreign and domestic business should be treated in the same way. As a next step, the Technical Advisory Group (TAG) has undertaken work on the approaches for achieving neutrality in practice in the context of international trade. The interim report, 'Achieving Neutrality in Practice', includes suggestions made by the TAG at its meeting held on 16-17 February 2011. The guidelines on neutrality were reviewed and approved by WP9 during its meeting on 12-13 April 2011.

**Current status:** The outcomes of the public consultation were published by the OECD in July 2011 ([click here to access](#)). In this document, the OECD states, "All contributions support the OECD work on VAT/GST Guidelines and express broad agreement with the neutrality principles set out in the Guidelines. They "are in full

support"; "agree with the analysis of the basic principles of neutrality" or consider that the Guidelines "do not contain any statement [we] would object to, nor do they leave out [important] aspects". The Guidelines are also "welcome and sensible"; "essential to make sure that VAT stays neutral for businesses as tax collectors"; "represent a significant and important contribution to global tax policy" and "are in line with an effective and fair VAT/ GST system and totally in accordance with our clients' best practices".

On the basis of the interim report and any WP9 guidance, the TAG will work on the guidelines and/or Consumption Tax Guidance Series papers on achieving neutrality in practice, with a view to submitting a completed draft outline to WP9 in November 2011.

**PwC observations:** The approval of guidelines on neutrality represents a very important development. The guidelines confirm that VAT/GST should not be a cost of doing business for taxable businesses, and that VAT should be neutral on similar business structures. These principles have a global influence and impact. They set a principle to adhere to for OECD and European countries, future members of the OECD, and non-OECD countries that are currently implementing or reforming their VAT/GST systems.

**Contacts:** Ine Lejeune and Stephen Dale

#### **Value added taxes (VAT): place of taxation rules for international trade in services and intangibles.**

**Scope:** WP9 has reviewed a report from the TAG on specific place of taxation rules for international trade in services and intangibles, to be included in Chapter II of the OECD International VAT/GST Guidelines. The report stated that the circumstances where specific place of taxation rules may be applied should be clearly defined and limited in scope. Furthermore, the rules should meet the following four criteria of: (i) certainty and simplicity; (ii) practicality and efficiency; (iii) competitive neutrality; and (iv) effectiveness and fairness. The report was considered and approved by WP9 during its meeting on 12-13 April 2011.

**Current status:** There was general agreement with the TAG's views within

WP9. Considering that the above criteria were derived from analysis of practical examples by the TAG, the group was asked to continue working on developing further business examples. The treatment of services related to immovable property is scheduled for a later date.

**PwC observations:** The approval of the principle to limit the scope of application for specific place of taxation rules is important in bringing clarity to the place of taxation and avoiding double or non-taxation issues. Using clear benchmarks to define the need and to assess the impact of a specific rule is important to create efficient VAT/GST systems globally. One of the difficult areas that is being addressed is that of Head-office to branch transactions, and whether these should be treated as 'normal' VAT supplies.

**Contacts:** Ine Lejeune and Stephen Dale

### **TAX e-audit group**

**Scope:** The aim of this group is to develop a standard audit file for tax audits covering payroll taxes, corporate income taxes, customs duties and VAT/GST. The developed guidance and tools should also facilitate voluntary compliance and should enhance the relationship between business and tax authorities.

The aim is to reduce costs of audits for both taxpayers and governments by using e-auditing techniques and tax control frameworks.

**Current status:** Five new draft Guidance Notes were adopted at the last plenary meeting held on 5-6 November 2009 in Paris:

1. Guidance and specifications for tax compliance of business and accounting software (GASBAS);
2. Guidance on test procedures for tax audit assurance;
3. Guidance note on Standard Audit File for Tax (v 2.0);
4. Guidance note on Standard Audit File for Payroll (v 1.0);
5. Information note on tax compliance and tax accounting systems.

These notes were published on the OECD website in April 2010 (click here to access).

**PwC observations:** Since their publication, the e-audit guidance notes have been evaluated by OECD countries and have also been used to help shape initiatives in non-OECD countries such as Singapore. PwC conducted a study for the European Commission on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries. In this study, the implementation of a standard audit file for tax was referred to as one of the solutions for reducing the VAT gap in the EU. (Click here to access a copy of the study).

Further work on this area is expected in the EU in the coming months and years.

**Contact:** Ine Lejeune and Jean-Paul Mondon

### **Taxation of tradable emissions permits**

**Scope:** In December 2009, the OECD announced that it would initiate a project to examine the taxation of tradable emissions permits and determine whether it would be appropriate to develop a statement of best practices in this area. The OECD seeks to catalogue existing tax practices with respect to tradable permits and, where possible, to discern emerging best practices. Various economic models for taxing these assets include treatment as intangibles, commodities, financial instruments, or some other approach. These economic models drive the application of domestic tax principles and national views as to how tax treaties and transfer pricing concepts apply to income from emissions trading.

One of the goals of the OECD project is to determine whether differences in national choice of economic model present a risk of double taxation of cross-border trading and, if so, how that risk should be addressed. The OECD's Business and Industry Advisory Committee (BIAC) has been an active participant in this project from the outset. It's been included in joint discussions with government representatives on the key corporate and international tax issues stemming from

the emergence of environmental trading systems for carbon dioxide and other greenhouse gases.

**Current status:** In May 2011, the OECD released its preliminary analysis of the tax treaty issues related to the trading of emission permits. The discussion draft was prepared for the purpose of inviting comments from interested parties and will be reviewed in light of the comments received. A report on the broader subject of the tax treatment of Emissions Trading Scheme allowances was also prepared for the EU tax commission (DG TAXUD) and published in October 2010.

**PwC observations:** Since our last update, the OECD's efforts appear to have been focussed on the higher level Green Growth Strategy development. Although having an overarching vision is important, the OECD will need to renew its attention to the broader question of tax and carbon emissions trading, which is already up and running. The OECD has stated that environmental taxes and charges, including revenues from auction-based emissions trading systems, could reach 2.5% of GDP. This is more than the total current US corporate income tax bill. Receipts from emissions permit sales will be a core component of this tax base in a market that analysts Point Carbon predict could be worth \$2 trillion globally by 2020.

The global motor industry will always rue the missed opportunity to agree that everyone around the world should drive on the same side of the road. There's a short window of opportunity to make sure the carbon markets don't make the same mistake with the accounting and tax treatment of permits. The emergence of an efficient global emissions trading market is by no means certain. But it can be given a helpful boost if the financial language of emissions trading can be standardised from the start, and unhelpful distortions avoided by having the common treatment of allowances under different tax regimes. Ensuring that sufficient EU/OECD dialogue is taking place to harmonise their two projects will be crucial to developing a global standard.

**Contacts:** Mark Schofield or Matt Haskins

### **Collective investment vehicles (CIVs)**

**Scope:** Initiated in 2006 and completed in 2010, this project examined both substantive and practical administrative issues related to the application of tax treaties to large cross-border portfolio investments held through CIVs or other custodians/nominees. To that end, an informal consultative group (ICG), consisting of governments and industry representatives, explored the legal and policy issues related to treaty benefit entitlements of CIVs, or their investors, as well as the procedural aspects of treaty benefit claims.

**Current status:** The report on treaty access has been adopted and now forms part of the OECD Treaty Commentary. The implementation package has been released for public comment and is now the subject of a new OECD workstream known as TRACE (see below for further information).

**PwC observations:** The reports represent a major step in clarifying entitlements to treaty benefits. Governments are already applying some of the principles in treaty negotiations.

**Contacts:** Pat Wall and Rebecca Maher

### **Treaty Relief and Compliance Enhancement (TRACE)**

**Scope:** In January 2010, the Committee on Fiscal Affairs (CFA) created the new 'Treaty Relief and Compliance Enhancement' (TRACE) group. This group was created to progress the work begun by the 'Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors' and continued through the 'Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors'. The objectives of this work are two-fold: (i) to develop treaty relief systems that are as efficient as possible, in order to minimise administrative costs and allocate the costs to the appropriate parties; and (ii) to identify solutions that enhance countries' abilities to ensure proper compliance with tax obligations, from the perspective of both source and residence countries.

**Current status:** The draft implementation package has been completed and the public consultation is now closed. Governments have been

meeting to consider how to take forward the TRACE project's work and to explore the establishment of a pilot programme among a number of OECD member countries to run 'proof of concept' tests for the TRACE project – i.e. to ensure that the TRACE approach is able to fulfil the objectives set for the project. A business advisory group has been established to assist in the consultation process with industry.

**PwC observations:** The TRACE proposal would greatly simplify withholding tax procedures and clarify custodian and paying agent responsibilities. However, this would come at a price, with more burdensome reporting requirements on intermediaries who would be required to report beneficial ownership information to source countries (and possibly to resident countries). This feature of the system would, in part, resemble the US FATCA system. The EU has established a working group to examine the OECD TRACE proposal and to make recommendations for the implementation of an EU-wide system along the lines described in the Commission's recommendations published in November 2009. Given the post-crisis global political climate, it seems probable that governments will sign up. It's vital that industry players play an active role in the design of new systems to minimise duplication and streamline processes.

**Contact:** Pat Wall

### **Study of intermediaries**

**Scope:** In its 2008 'Study into the Role of Tax Intermediaries', the OECD's Forum on Tax Administration (FTA) set out its conclusions on the role that tax intermediaries (i.e. law and accounting firms, other tax advisers and financial institutions) play in the operation of tax systems (specifically in relation to unacceptable tax minimisation arrangements). The study also presents the FTA's recommendations on strategies for strengthening the relationship between tax intermediaries and revenue bodies.

**Current status:** Following this study, the OECD endorsed two further related studies in May 2009: 'Engaging with High Net Worth Individuals on Tax Compliance' (the HNWI study) and 'Building Transparent Tax Compliance

by Banks' (the Bank study). The OECD concluded that HNWIs pose significant challenges to the integrity of tax administrations and require additional attention in order to improve compliance. The Bank study examined the role of banks in providing aggressive tax planning arrangements and governance around complex structured financing transactions. It identified best practices for consideration by banks and made a number of recommendations for revenue bodies to improve compliance. This work was extended to commission a report to address tax risks involving bank losses, which was issued in September 2010, as well as a February 2011 report on aggressive tax planning – both of which are described below in more detail.

**PwC observations:** The HNWI and Bank studies both seek to improve international cooperation between revenue bodies and taxpayers. The HNWI study recommends the use of regular meetings between heads of HNWI units and other specialists within tax administrations. The Bank study goes further with proposals for revenue bodies to pursue an advanced engagement process with taxpayers, in addition to the development of an OECD Aggressive Tax Planning Directory to share experiences (presumably just among revenue bodies). The Bank study also calls on banks to ensure that tax risk management is considered as part of overall corporate governance at a board level. An evaluation of the impact of both studies was presented at the FTA meeting on 15-16 September 2010 in the Republic of Turkey. Given the more recent work mentioned above, it seems likely that tax authorities globally will be increasingly interested in the status and use of bank losses and cross-border structure trades via 'aggressive' tax planning.

**Contacts:** Mike Gaffney

### **Addressing tax risks involving bank losses**

**Scope:** On 15 September 2010, the OECD released the 'Bank Loss' report. This report provides an overview of the tax treatment of banks' tax losses in 17 OECD countries which took part in the study team. The report estimates the size of the commercial losses at approximately US\$ 400 billion for 2008, and outlines how these losses impact the

capital base of the regulated banking sector. A number of chapters provide a summary of several jurisdictional rules for utilising losses; the concern that tax administrators share regarding the use of cross-border structured transactions to utilise losses; and the tools that they can use to address compliance risks relating to the use of bank tax losses. The tax administrators' ultimate concern is that aggressive tax planning involving losses will further reduce already depleted tax revenues as a result of the financial crisis.

**Current status:** The report's recommendations for revenue bodies to engage in a more enhanced, real-time and commercially aware audit process is quite aspirational, though it is already helping tax administrators to focus examinations on critical issues. The OECD and the Forum on Tax Administration (FTA) will continue to coordinate on the issue of bank losses as they continue the analysis of how to deal with, what they call, 'aggressive tax planning'. The OECD has also signalled an interest in the wider (i.e. non-financial sector) aspects of tax losses with the launch of a new publication on 27 August 2011, 'Corporate Loss Utilisation through Aggressive Tax Planning'. The publication identifies three key risk areas in relation to the use of losses for tax purposes, namely corporate reorganisations, financial instruments and non-arm's length transfer pricing.

**PwC observations:** The report is well-documented and contains several helpful appendices detailing the 17 study team member's jurisdictional rules relating to the use of losses, including what happens to cross-border losses and the impact to losses when ownership shifts and bank mergers occur. The report also explains the importance of maintaining the value of deferred tax assets (DTAs) created by losses as part of the bank's regulatory capital. It makes the useful observation that the existence of the DTA for IFRS / GAAP purposes, as well as for regulatory purposes, will generally reduce the incentives for the bank to enter into structured transactions. The report also observes that tax planning may occur around accelerating income or deferring deductions in order to protect the value of the DTA for accounting and regulatory purposes. These comments can be helpful to the banks' tax departments in explaining to the tax

authorities that the tax loss is essentially the tail on a much larger commercial loss dog.

Chapter 5 of the Bank Loss report highlights compliance/tax risk issues for tax authorities to be aware of as they audit banks with losses. This chapter can also act as a helpful reminder for bank tax departments of what to be ready for on examination. The issues discussed include non-arm's length transfer pricing, corporate restructuring involving loss shifting, use of financial instruments and structured transactions, and possible circumvention of loss recognition and group relief or consolidation regimes. The report helpfully states that, "at present there is no evidence of significant manipulation" of tax losses. This is largely due to the accounting and regulatory benefits associated with the DTA. It should be noted that, as the Basel III rules tighten recognition of the DTA, this may put more pressure on banks extracting value through tax planning to utilise losses. As that occurs, the Bank Loss report will be a helpful guide as to what may be expected upon an ultimate examination.

**Contacts:** Mike Gaffney or Richard Collier

### **Tackling aggressive tax planning through improved transparency and disclosure**

**Scope:** The 'Aggressive Tax Planning' (ATP) report was approved by all 33 OECD members and issued on 1 February 2011. It provides a summary of existing mandatory disclosure regimes and other techniques that tax administrators can use to combat ATP. The report builds upon the creation of an enhanced relationship between the tax authority and the taxpayers, and the desire to work in 'real-time'. The ATP report makes a fairly strong statement that new strategies are needed to combat ATP, "which traditional audits alone can no longer deliver". The ATP report was prepared by the 'Aggressive Tax Planning Steering Group of Working Party No 10 on Exchange of Information and Tax Compliance of the Committee on Fiscal Affairs'.

**Current status:** This report is a continuation of the focus on ATP that started with the 'Study into the Role of Tax Intermediaries' in 2008. This focus

continued in the reports on ‘Engaging with High Net Worth Individuals on Tax Compliance’ (HNWI report) and ‘Building Transparent Tax Compliance by Banks’ in May 2009, and also in the Bank Loss report released in 2010. One of the recommendations of the ATP report is that members should continue to share experiences, so this is likely to be the case going forward. The report can currently be used as a toolkit for tax administrators requiring taxpayers to respond to more focused document requests relating to ATP.

**PwC observations:** The ATP report builds upon the prior work of the FTA and the OECD in the area of aggressive tax planning. The disappointing part of the report is that it seems to be premised on political support, rather than strictly tax policy concerns or analysis. The first paragraph refers to the political support of the G20, and then conflates the exchange of information/HNWI report, “where much of the concerned activity was fraudulent tax evasion”, with tax avoidance.

**Contacts:** Mike Gaffney

### **Business restructurings**

**Scope:** This OECD project relates to the transfer pricing aspects of business restructurings. Among the issues concerned are the allocation and transfer of risk among related parties; the question of whether and when internal business restructuring transactions require arm’s length compensation and/or indemnification; the question of how transfer pricing rules should be applied to the parties of a business restructuring transaction following the restructuring; and the question of whether and when governments have the ability to disregard a taxpayer’s restructuring for the purposes of applying transfer pricing rules. These issues were addressed in four issues notes in a Discussion Draft on the Transfer Pricing Aspects of Business Restructurings, released in September 2008 (the Discussion Draft).

**Current status:** On 22 July 2010, the OECD Council approved and released final guidance, which now combines the four issues notes of the Discussion Draft into a single, four-part chapter (chapter IX) of the OECD Transfer Pricing Guidelines (the Guidelines). This guidance was issued following

a public consultation period to the initial Discussion Draft, including a consultation meeting with business representatives in June 2009.

**PwC observations:** The final guidance addresses the main concerns raised by business commentators at the June 2009 consultation meeting. The main area of debate was the potentially broad scope of government powers to disregard restructuring transactions. However, even though the OECD is to be applauded for the fairly balanced approach demonstrated in the final guidance, some areas for significant disagreement remain. In line with the Discussion Draft, it’s good to see that the OECD recognises that associated enterprises are not expected to behave in the same way as independent enterprises in negotiating and concluding the terms of a particular agreement. The final guidance seeks to strike a fair balance between the unique features of multinational enterprises and the need to safeguard consistency with what independent enterprises in similar circumstances would do.

The revised Guidelines do not state when the new rules will come into effect. It can be expected that many countries will begin to apply the new rules as an interpretation of existing OECD transfer pricing guidance and potentially use them to aid the resolution of controversy matters from previous years.

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### **Attribution of profits to permanent establishment (Attribution PE)**

**Scope:** This extremely long-running project was started in the late 1990s in response to the OECD’s view that there has been considerable variation in the domestic laws of OECD member countries regarding the taxation of PEs, especially with the development of global trading of financial products and electronic commerce. The OECD has been examining the international tax principles for attributing profits to a PE, provided in Article 7 of the OECD Model Tax Convention on Income and on Capital, with the intention of formulating the preferred approach to attributing profits to a PE given modern-day multinational operations and trade.

**Current status:** On 22 July 2010, a completely new version of Article 7 and accompanying Commentary were approved for inclusion in the 2010 version of the OECD's Model Tax Convention. A 2010 version of the 2008 report on the 'Attribution of Profits to Permanent Establishments' was also approved. This concludes the OECD's work on this project.

**PwC observations:** Given the OECD's starting point for this project, it's somewhat ironic that it may now be several years before any kind of international consistency is achieved

in this area. It's likely to take some time before the new Article 7 and commentary are reflected in double tax treaties, especially as some developing countries may not accept the new Article 7 approach due to their concerns over the impact of this new approach on the balance between source and residence taxing rights. As a practical matter, this new relatively complex approach to attribution issues is proving hard for many taxpayers and tax authorities to follow.

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