

Base Erosion and Profit Shifting

Impacts on Jersey

10 September 2013

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OECD BEPS action plan

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Timeline

10 AD	1799	1930's	1979	2011
Income tax introduced in China by Emperor Wang Mang of the Xin Dynasty	Income tax introduced in the UK by William Pitt the Younger to pay for the Napoleonic Wars	League of Nations developed model of tax conventions including transfer pricing principles	OECD introduced practical guidance on the arms length principle	OECD work began on transfer pricing simplification and treatment of intangibles

OECD BEPS action plan

Overview

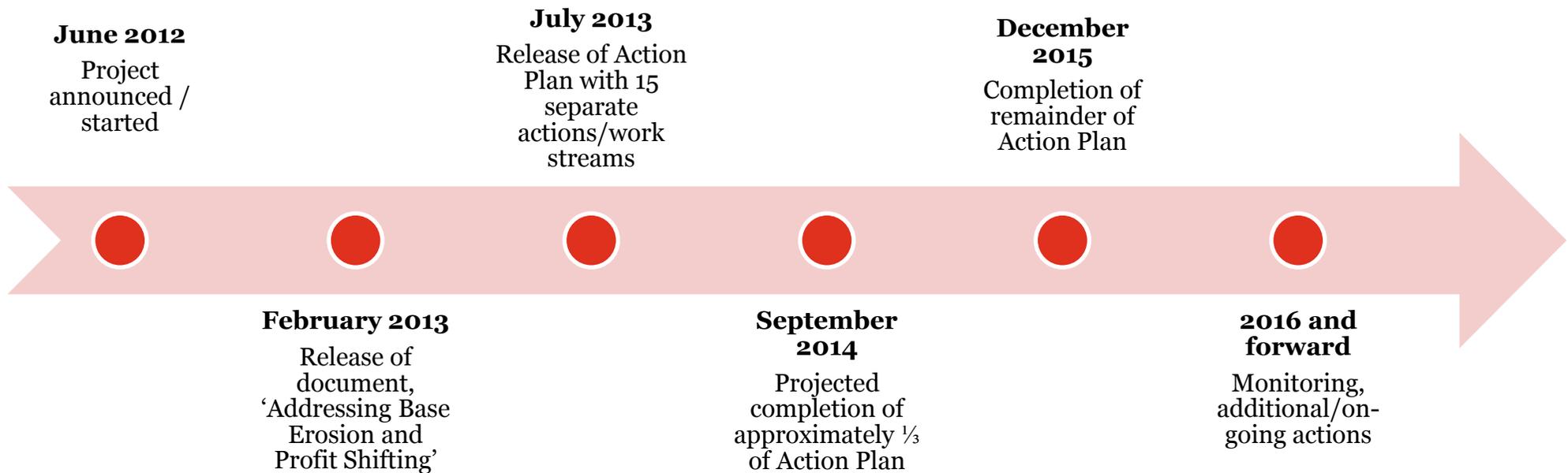
BEPS action plan

Comprehensive action plan published on 19 July 2013 and now endorsed by G20 in St Petersburg:

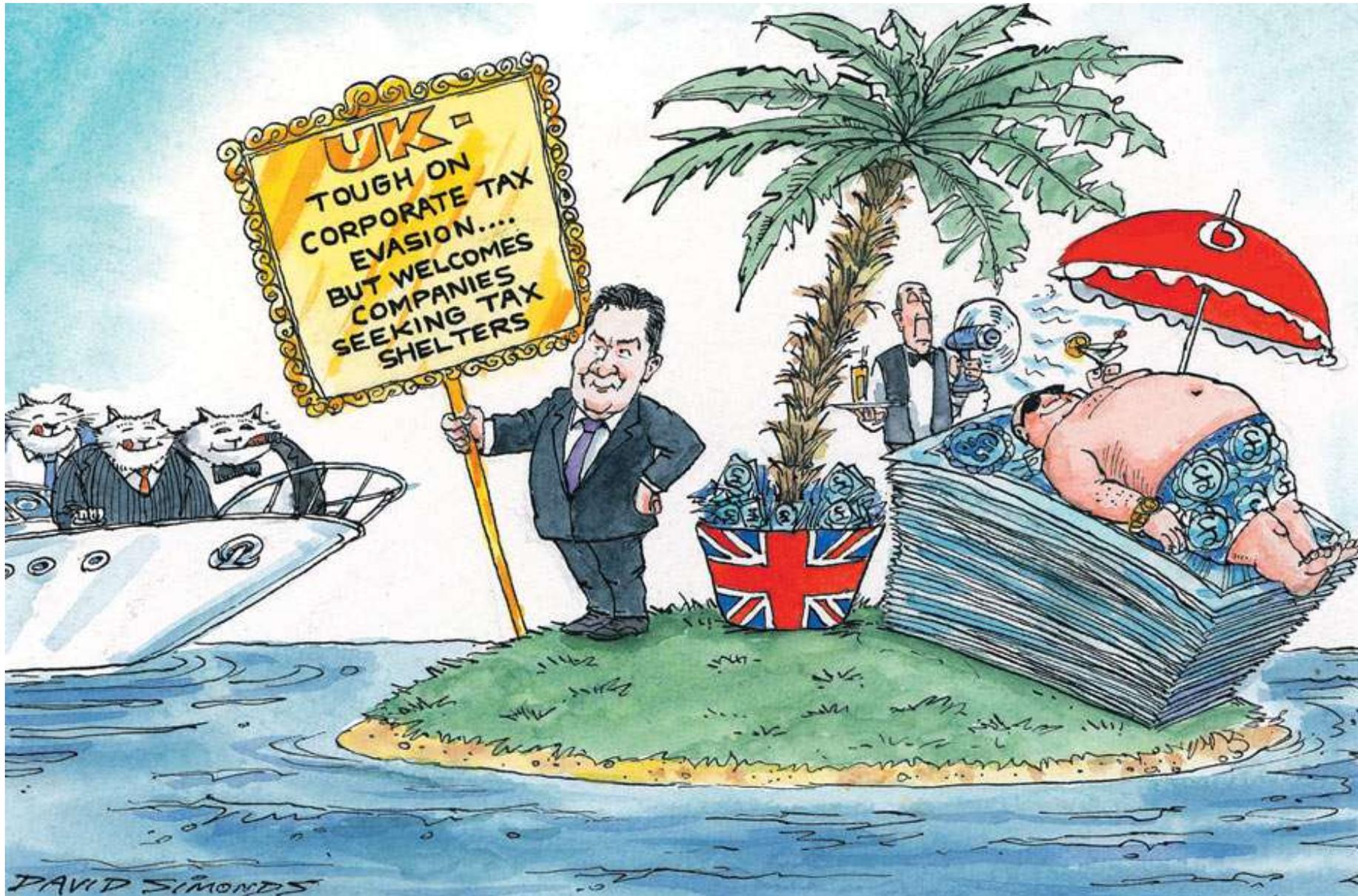
- Identifies 15 actions that are required to address BEPS;
- Sets deadlines for actions (the majority within 24 months); and
- Identifies resources and methodology required to implement solutions.

Work on the 15 actions outlined in the Plan has already started and will continue the technical work to develop concrete measures that countries can put in place to tackle BEPS.

Timeline



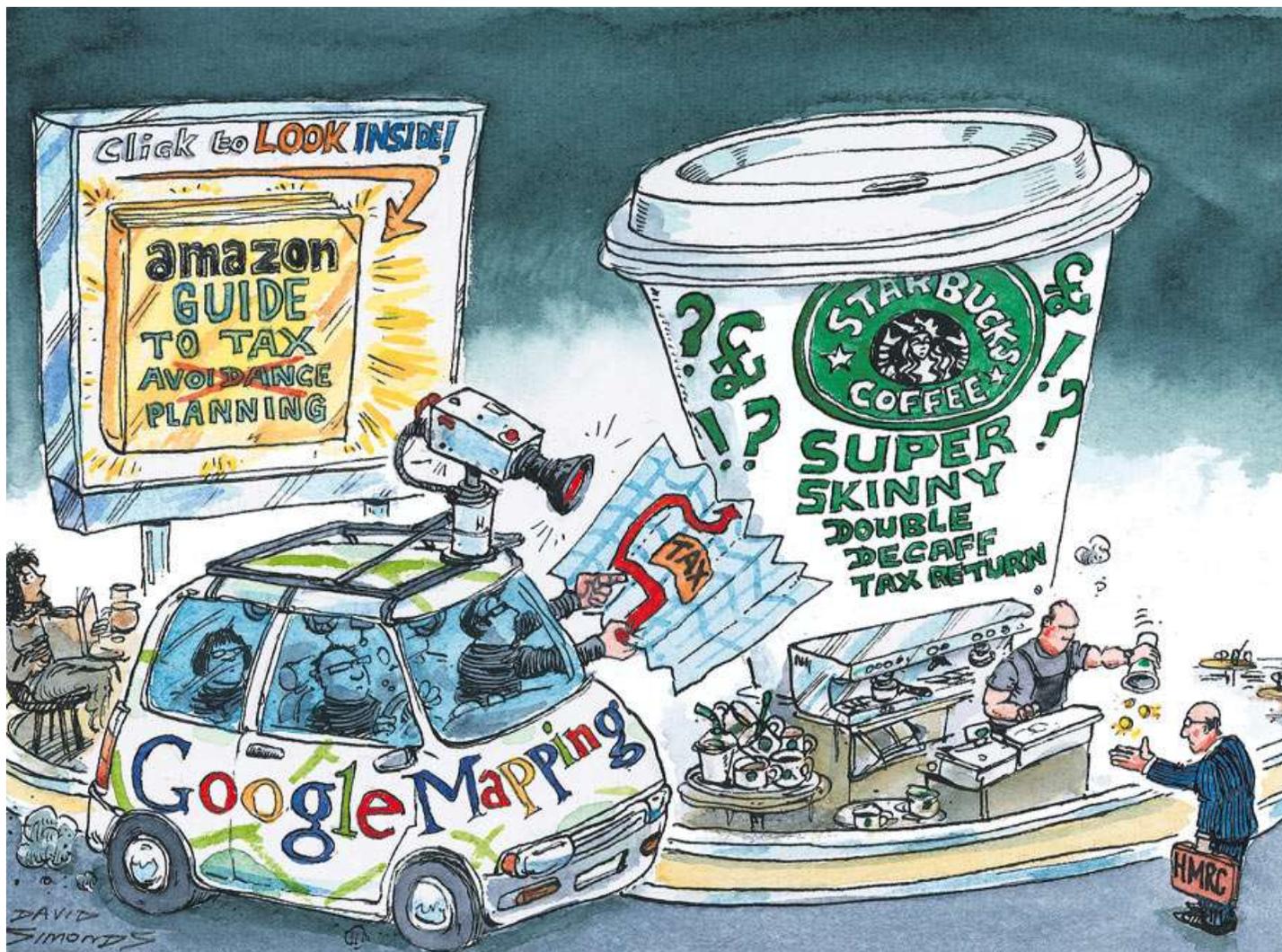
...its complicated!



Background

2

The current environment



Base Erosion and Profit Shifting – the background

Fundamental systemic change

Consensus-based organisation building a base in non-member developing countries – so heavy burden of **broad** consensus requirement

OECD only supranational credibly able to initiate and manage reform

Pressure to observe fundamental principles

Existing principles include PEs, residence, arms length principle, etc.

Reform

Country competition

Managing country tax competition with the BEPS agenda will place greater stress on existing and future incentive regimes

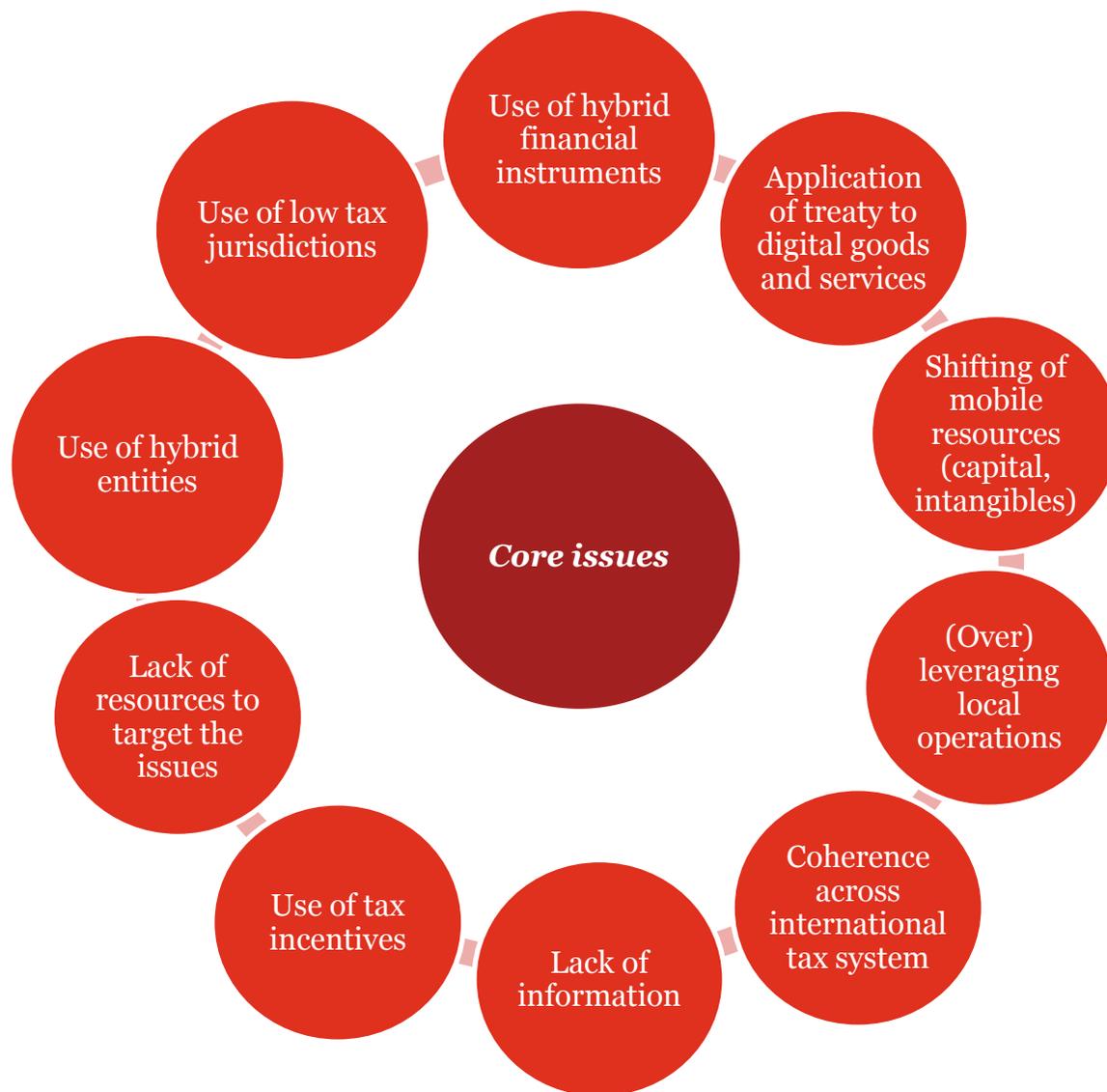
Media perception

It is important for NGOs and the OECD to be seen as ‘doing the right thing’

Short to medium term substance-based anti-avoidance agenda presented for adoption to states

Foundation for BEPS

Core issues



What changes could BEPS lead to?

Macro changes

Jurisdiction to tax

- Harder to deal with tax authorities and secure agreements
- Shift to greater source based approach and potentially some clear winners (US, China, India) and losers (the Netherlands, Switzerland, Luxembourg & Ireland)
- Increased use of CFC regimes by tax authorities
- Treaty-shopping based structures under greater focus

Transfer pricing

- Much more focus on substance (e.g. shift in TP to people-based confirmatory tests derived from Article 7)
- Extended Services PE test for digital business and greater focus on rep offices (prep and auxiliary exemption)
- Increased scrutiny of intangible property and beneficial ownership
- Purpose of capital and risk?
- Documentation and disclosure changes to come

Leverage

- Impact on capital structure (including hybrid instruments)
- Focus on debt financing and guarantees
- Conduit financing structures

Anti-avoidance

- Short term anti-avoidance measures
- General anti-avoidance approach by the tax authorities
- Increased cases where new rules developed with strong anti-avoidance agenda – e.g. OECD proposals on beneficial ownership, PE threshold and IP

What is likely to happen in practice and when?



Key messages for Jersey based businesses

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Key messages for Jersey based businesses

1

The BEPS agenda is not specifically targeted at Jersey – however there will be consequences for businesses to consider directly arising from changes in approach, interpretation or legislation. **Expect collateral impact.**

2

Substance is key – transfer pricing and some areas of taxation should follow the substance and functional arrangements of the group. **There will be an increased focus on functions and less on legal arrangements, risk and capital.**

3

A significant amount of the BEPS Action Plan approach is consistent with the current attitude of fiscal authorities – this will only serve to increase fiscal authorities' confidence. **There will be significant behavioural shift & likely more controversy.**

4

The risk areas highlighted by BEPS (in particular PE threshold and transfer pricing related to risks and capital) are current issues not ones to leave for the future – businesses should be reviewing their positions now. **Risk analysis should be done now.**

5

As the BEPS agenda progresses there will be greater documentation and disclosure requirements – tax systems will need to be configured to make sure these requirements can be met. **The right strategy needs to be implemented to tackle issues.**

BEPS – Impact for Jersey

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BEPS – Impact for Jersey

Summary Taxation Impacts

-  Insignificant impact expected to arise
-  Some impact may arise
-  Significant impact could arise

Action	Relevance	Impact Level
Action 1: Address the tax challenges of the digital economy	Significant impact for all	
Action 2: Neutralise the effects of hybrid mismatch arrangements	Funding structures	
Action 3: Strengthen CFC rules	N/A unless Jersey Parent	
Action 4: Limit base erosion via interest deductions and other financial payments	Gearing	
Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance	Business/ Funds with rulings	
Action 6: Prevent treaty abuse	Withholding tax, structure and IP treaty reliance	
Action 7: Prevent the artificial avoidance of PE status	Mobile employees, board members, secondments,	
Action 8: Assure that transfer pricing outcomes are in line with value creation: intangibles	Legal ownership of intangibles, offshore IP holding companies	
Action 9: Assure that transfer pricing outcomes are in line with value creation: risks and capital	Over-capitalised entities/ seed capital providers	
Action 10: Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions	Inter-co service fees, sub-advisory fees/ marketing fees	
Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it	Out of business' control	
Action 12: Require taxpayers to disclose their aggressive tax planning arrangements	Users of aggressive schemes, including individuals	
Action 13: Re-examine transfer pricing documentation	“one-sided” TP documentation/ disclosure of global value chain	

BEPS – Alternatives sector impacts

Summary Taxation Impacts – funds

-  Insignificant impact expected to arise
-  Some impact may arise
-  Significant impact could arise

Action	Relevance	Impact Level
Action 1: Address the tax challenges of the digital economy	N/A	
Action 2: Neutralise the effects of hybrid mismatch arrangements	Funding structures	
Action 3: Strengthen CFC rules	N/A	
Action 4: Limit base erosion via interest deductions and other financial payments	Gearing	
Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance	Funds with rulings	
Action 6: Prevent treaty abuse	Withholding tax mitigation structures	
Action 7: Prevent the artificial avoidance of PE status	Employees on boards or seconded to investments	
Action 8: Assure that transfer pricing outcomes are in line with value creation: intangibles	N/A	
Action 9: Assure that transfer pricing outcomes are in line with value creation: risks and capital	Over capitalised entities	
Action 10: Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions	Collateral impact	
Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it	Out of business' control	
Action 12: Require taxpayers to disclose their aggressive tax planning arrangements	Aggressive schemes	
Action 13: Re-examine transfer pricing documentation	Collateral impact	

Next steps

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Next steps

1

Input into the business consultation

2

Identify the risk areas and which of these are material

3

Review areas identified with regard to current actions of tax authorities and potential future impact of OECD work

4

Monitor domestic impact of OECD work including behavioural changes and respond as appropriate

5

Consider engagement strategy with tax authorities

Resources and contacts

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Resources

OECD BEPS website:

<http://www.oecd.org/tax/beps.htm>

OECD BEPS action plan:

<http://www.oecd.org/ctp/BEPSActionPlan.pdf>

PwC BEPS action plan bulletin:

http://www.pwc.com/en_GX/gx/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-beps-action-plan.pdf

PwC BEPS action plan webinar:

<http://event.on24.com/r.htm?e=656849&s=1&k=EFDoC3046B6727B19BF452B5C1621A4F>

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Appendix 1 – BEPS action plan actions



OECD BEPS action plan

The digital economy (Action 1)

Digital economy

- The spread of the digital economy has raised new questions for international taxation. In particular there are fundamental questions as to how traditional concepts of source and residence taxation and the characterisation of income applies to enterprises in the digital economy.

Action	Description	Expected output	Deadline
1 – Address the tax challenges of the digital economy	Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.	Report identifying issues raised by the digital economy and possible actions to address them	September 2014

OECD BEPS action plan

Coherence (Actions 2, 3, 4 and 5)

Coherence

- Globalisation means that national economies are more interconnected than ever before. There is currently international consensus on existing rules which cover double taxation but not for those that prevent double non-taxation (e.g., CFCs, hybrid instruments).

Action	Description	Expected output	Deadline
2 – Neutralise the effects of hybrid mismatch arrangements	Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.	Changes to the Model Tax Convention Recommendation regarding the design of domestic rules	September 2014 September 2014
3 – Strengthen CFC rules	Develop recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary.	Recommendation regarding the design of domestic rules	September 2015

OECD BEPS action plan

Coherence (Actions 2, 3, 4 and 5) continued

Action	Description	Expected output	Deadline
4 – Limit base erosion via interest deductions and other financial payments	Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), etc. The work will be co-ordinated with the work on hybrids and CFC rules.	Recommendation regarding the design of domestic rules	September 2015
		Changes to the Transfer Pricing Guidelines	December 2015
5 – Counter harmful tax practices more effectively, taking into account transparency and substance	Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.	Finalise review of member country Regimes	September 2014
		Strategy to expand participation to non-OECD Members	September 2015
		Revision of existing Criteria	December 2015

OECD BEPS action plan

Substance (Actions 6, 7, 8, 9 and 10)

Substance

- Substance is an important theme for the OECD. There is a greater focus on the substance of the arrangements and counteracting those without substance. This includes areas such as treaty abuse, PE status and the transfer pricing rules.

Action	Description	Expected output	Deadline
6 – Prevent treaty abuse	Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.	Changes to the Model Tax Convention Recommendation regarding the design of domestic rules	September 2014 September 2014
7 – Prevent the artificial avoidance of PE Status	Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.	Changes to the Model Tax Convention	September 2015
8 – Assure that transfer pricing outcomes are in line with value creation: intangibles	Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2014 and September 2015

OECD BEPS action plan

Substance (Actions 6, 7, 8, 9 and 10) continued

Action	Description	Expected output	Deadline
9 – Assure that transfer pricing outcomes are in line with value creation: risks and capital	Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
10 – Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions	Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015

OECD BEPS action plan

Transparency (Actions 11, 12, 13 and 14)

Transparency

- Enabling governments to collect more information on the tax affairs of multinational corporations. This includes the disclosure of tax avoidance schemes, transfer pricing documentation and improved government co-operation where required.

Action	Description	Expected output	Deadline
11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it	Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.	Recommendation regarding data to be collected and methodologies to analyse them	September 2015
12 – Require taxpayers to disclose their aggressive tax planning arrangements	Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of ‘tax benefit’ in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.	Recommendation regarding the design of domestic rules	September 2015

OECD BEPS action plan

Transparency (Actions 11, 12, 13 and 14) continued

Action	Description	Expected output	Deadline
13 – Re-examine transfer pricing documentation	Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.	Changes to Transfer Pricing Guidelines and Recommendation regarding the design of domestic rules	September 2014
14 – Make dispute resolution mechanisms more effective	Develop solutions to address obstacles that prevent countries from solving treaty related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.	Changes to the Model Tax Convention	September 2015

OECD BEPS action plan

Developing a multilateral instrument (Action 15)

Multilateral instrument

- Finding a way of implementing the changes from BEPS without having to go through the treaty-by-treaty route which could be very time consuming.

Action	Description	Expected output	Deadline
15 – Develop a multilateral instrument	Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.	Report identifying relevant public international law and tax issues	September 2014
		Develop a multilateral instrument	December 2015

Appendix 2 – Discussion questions

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Discussion questions

General questions

- What is the attitude of the fiscal authority in the territory of relevance and how could BEPS change this?
- Where are the tax risk areas in your operating structure and how many of those risks have historically been dismissed as they were deemed as theoretical risks which were unlikely to be seen in practice? Are these risks likely to become practical risks given the direction of travel of BEPS?

Digital economy

- Do you conduct online sales?
- How much of your digital business is cross-border?
- Have you considered whether your cross-border digital business has created taxable presences?
- Have you considered your strategy were states to unilaterally impose 'digital' taxes?

Coherence

- Do you any of the following in any territory:
 - hybrid instruments or entities;
 - CFCs;
 - intra-group debt pushdowns; and
 - favourable tax rulings from fiscal authorities
- Have you considered your strategy in the relevant territory were such arrangements (as above) to be restricted or stricter rules imposed?

Discussion questions

Substance

- Are there any arrangements where you are relying on a legislative interpretation or the form of those arrangements?
- Are there any instances where there is a separation of process from the decision-making in relation to that process and what is the driver behind this (e.g., separation of booking entity, originating entity, etc.)?
- Are you satisfied that your attribution methodology for PEs is consistent with OECD principles (particularly Part II and III)?
- Are you satisfied that you have identified all taxable presences in territories in which you conduct business?
- Have you considered your strategy if the PE threshold was changed?
- Are you confident that your intra-group (or branch) sub-participation/guarantee arrangements adequately reflect the substance of the risk transfer?
- Is the capital backing your business earning an excessive rate of return giving consideration to the direction of travel of BEPS?
- Do you have globally mobile staff or do you use secondments and/or dual contracts?
- Do you have operating guidelines for globally mobile staff and do you ensure these are adhered to?

Transparency

- Are you confident that your systems can supply or can be modified to provide additional reporting information if required by fiscal authorities?
- Do you have any arrangements that could potentially require disclosure in future or are you planning on undertaking such arrangements in the near future?
- Do you have transfer pricing documentation to support the pricing of your material intra-group transactions?

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