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CbC Reporting

IMPLEMENTATION OF B.E.P.S. ACTION PLAN CAUSES FEDERAL FRICTION IN GERMANY

German state tax authorities disagree with German Federal tax authorities as to whether the sharing of German tax information under B.E.P.S. Action 5 will render governments liable for the violation of German privacy laws.

B.E.P.S. Action 5 – Exchange of Information Framework

The goal of the B.E.P.S. Action Plan is to develop a single global standard for automatic exchanges of information and to stop corporations from shifting profits to jurisdictions with little or no tax. The end result is to ensure taxation in the jurisdiction where profit-generating economic activities are performed and value is created.

Action Item 5 generally recommends the compulsory spontaneous exchange of information with regard to tax rulings related to preferential tax regimes. We previously discussed Action Item 5, noting that:

> [Action Item 5] will introduce an obligation for an individual country to spontaneously exchange information that could be relevant to another country, even when the information has not been requested by the second country. In addition, the Forum on Harmful Tax Practice is authorized to prepare a report on preferential regimes for public dissemination – *viz.*, name and shame.[1]

German State Tax Agencies Believe Tax Information Exchange Will Create Legal Liability

While the German Federal finance ministry agreed to implement Action Item 5, German state tax authorities are uncertain whether the exchange of information will violate German privacy laws. State tax authorities continue to collect tax information, but before entering into the exchange, the authorities want to clarify that the delivery of such information will not violate German domestic privacy laws

Much of the concern was created by a German tax court ruling, which held that a mere agreement at the European level to create a data exchange framework was not sufficient to force such an exchange on the state level. Further, state tax authorities believe that that the Federal government must enact E.U. Council Directives on the matter to prevent liability when German state tax authorities exchange information.

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[1] Stanley C. Ruchelman and Rusudan Shervashidze, "Action Item 5: Countering Harmful Tax Practices More Effectively," *Insights* 9 (2014).

B.E.P.S. ACTION 6 COULD DENY TREATY BENEFITS TO CERTAIN INVESTMENT VEHICLES

Following the release of Action Item 6, the finance industry warned the O.E.C.D. that certain collective investment vehicles ("C.I.V.'s") could be denied treaty benefits due to the "active trade or business test" under the Limitation on Benefits provision. The O.E.C.D. believes that the Action 6 language adequately addresses C.I.V.'s but that commentary is needed to prevent non-C.I.V. funds from being wrongfully denied treaty benefits because of the structure adopted for investments.

B.E.P.S. Action 6

Action Item 6 addresses the abuse of treaties in general, as well as the specific issue of treaty shopping, which it notes as one of the most important sources of B.E.P.S. As we've mentioned previously, "Among other measures, the report recommends inclusion of a Limitation on Benefits ('L.O.B.') provision and a general anti-avoidance rule called the Principal Purpose Test ('P.P.T.') to be included in the O.E.C.D."[2]

"The O.E.C.D. believes that the Action 6 language adequately addresses C.I.V.'s but that commentary is needed to prevent non-C.I.V. funds from being wrongfully denied treaty benefits.

A taxpayer will be entitled to treaty benefits under Action Item 6 if it qualifies as:

> A resident of Contracting State that is engaged in the active conduct of a trade or business, but only to the extent that the income is derived in connection with that business or is incidental to that business:
>
> - An entity generally will be considered to be engaged in the active conduct of a business only if persons through whom the entity is acting, such as officers or employees of a company conduct substantial managerial and operational activities. * * *
> - The business of the person claiming the benefit must be substantial in relation to the business in the payor's state of residence, which is to be determined on a facts and circumstances basis. Where this provision applies, the resident is entitled to the benefit even if not a qualified person.[3]

C.I.V. & Non-C.I.V. Funds

According to the O.E.C.D., investors tend to pool their funds in a C.I.V. with other investors, as it is more economically efficient. C.I.V.'s may take several legal forms, depending on the country in which they are established (*e.g.*, companies, trusts, and contractual arrangements).[4]

Practitioners are concerned that C.I.V.'s would not be entitled to treaty benefits as the making or managing of investments by a C.I.V. would not satisfy the active trade or business test under the L.O.B. provision. According to finance managers, many funds are not listed; they often pool capital from investors across a number

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2 Philip R. Hirschfeld and Stanley C. Ruchelman, "Action Item 6: Attacking Treaty Shopping," *Insights* 9 (2014).

3 *Id.*

4 O.E.C.D., "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles," (April 23, 2010).

of countries, and they are readily marketed outside their home countries. However, the O.E.C.D. believes that the active trade or business test, as listed, will adequately identify those C.I.V.'s that have the economic substance to qualify for treaty benefits and those that do not.

The O.E.C.D. acknowledges that non-C.I.V. funds, such as pension funds, sovereign wealth funds, and charities may be adversely affected by Action Item 6. These institutions could lose the ability to recover withholding tax by not being entitled to treaty benefits. The O.E.C.D. is currently seeking comments on the matter, to prevent such non-C.I.V. funds from being denied treaty benefits merely because the structures of such funds do not satisfy the active trade or business test.

"The U.K. government recently released guidance about large businesses that engage in aggressive tax planning and a potential punitive measure that would force such businesses to publicly publish their 'aggressive' tax strategies."

U.K. TO BATTLE AGGRESSIVE TAX PLANNING

The U.K. government recently released guidance about large businesses that engage in aggressive tax planning and a potential punitive measure that would force such businesses to publicly publish their "aggressive" tax strategies.[5]

The proposed "Special Measure" would take into account not only those businesses administered by the U.K. Large Business Directorate but also "any large business," so long as it is listed under the country-by-country framework, as described by Action Item 13. The U.K. Special Measure would complement the country-by-country framework, not substitute it.

Before punitive action is taken, the U.K. government would issue a warning notice and offer the offending business a one-year improvement period to resolve outstanding issues. Triggering factors for the warning could include discovery that the business is "non-compliant" with the view of H.M.R.C. on certain transactions or when the business has submitted erroneous returns resulting from a tax avoidance plan. The specific definition of these terms is listed in the legislation.

Once targeted by the government, the offending business must publicly list its approach towards U.K. tax planning and its approach towards negotiating with U.K. tax authorities. H.M.R.C. notes that companies subject to the "Special Measure" regime are most likely already listed under the U.K. government's "high risk management system."

CONCLUSION

The above three items – privacy concerns in Germany, entitlement of C.I.V.'s to treaty benefits, and sanctions for corporations pursuing aggressive tax plans – demonstrate that while countries are fully in favor of B.E.P.S. on a national level, issues remain with actual implementation. Under political pressure from N.G.O. watchdogs and minority parties in parliament, governments may continue to create more and more programs to publicly shame multinationals that pursue aggressive tax plans, even if such programs are redundant with respect to the B.E.P.S Action Plan. In sum, the breadth of implementing the B.E.P.S. Action Plan in Europe may result in the creation of a B.E.P.S. compliance industry whose sole purpose is to navigate B.E.P.S. compliance mechanisms. The presence of the compliance officer at all businesses having cross-border operations may be a ubiquitous reality, much like the communist party officer during the Soviet era.

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[5] "Special Measures Guidance: Introduction," HM Customs & Revenue, published March 31, 2016.