

# INTERNATIONAL TAX & B.E.P.S. A REALITY CHECK

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INTERNATIONAL TAX DISCUSSION GROUP PANEL  
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# B.E.P.S. PULLING THE WOOL OVER YOUR EYES?

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JOHN GRAHAM

# ARE B.E.P.S. STRATEGIES ILLEGAL?

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- ACCORDING TO THE O.E.C.D. WEBSITE MOSTLY NOT

# ARE DOMESTIC TAX SYSTEMS COHERENT?

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THE OECD TAKES THE VIEW THAT THEY ARE, WHICH MEANS THAT A DEDUCTION BY ONE PERSON WOULD AUTOMATICALLY BE TAXED IN THE HANDS OF ANOTHER. CERTAINLY IN THE CASE OF DIFFERENT TYPES OF ENTITY OR INDIVIDUAL THIS IS NOT THE CASE.

# SUBSTANCE

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- THERE IS A PROBLEM WITH SHELL COMPANIES WITH LITTLE ECONOMIC SUBSTANCE
- THIS IS NOT A PROBLEM IN MANY DOMESTIC SITUATIONS, FOR INSTANCE PURE HOLDING COMPANIES

# GOVERNMENTS ARE HARMED BECAUSE THEY RECEIVE LESS REVENUE

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LACK OF TAX REVENUE IN DEVELOPING COUNTRIES  
LEADS TO UNDERFUNDING OF PUBLIC INVESTMENT

# BUT:

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THE A TAX GAP IN MANY DEVELOPING COUNTRIES IS QUITE HIGH

- BANGLADESH 36%
- SOUTH AFRICA 23%
- THAILAND 53%
- AFGHANISTAN 60%
- ROMANIA VAT GAP OVER 45%
- MOST OF THIS IS NOT FROM SHIFTING PROFITS OVERSEAS
- IS IT NOT BETTER TO GET THEM TO COLLECT WHAT THEY ARE ENTITLED TO ALREADY?

# AND:

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- SMALLER BUSINESSES HAVE DIFFICULTY COMPETING WITH MNEs
- MOST NEW PROPOSALS REQUIRE MORE SUBSTANCE, MORE INFORMATION, MORE COST



# TRANSFER PRICING

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- FORMULA BASED PRINCIPLES REJECTED
- COMPLIANCE COSTS SHOULD BE TAKEN INTO ACCOUNT

# NEW PROPOSALS

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- NEW PROPOSALS REQUIRE MORE EXTENSIVE INFORMATION

# COUNTRY BY COUNTRY REPORTING

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- IS COUNTRY BY COUNTRY REPORTING A FORERUNNER TO FORMULARY APPORTIONMENT?

# WHAT DO YOU HAVE TO SHOW?

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- TAX JURISDICTION
- UNRELATED PARTY REVENUES
- RELATED PARTY REVENUES
- PROFIT AND LOSS BEFORE TAX
- INCOME TAX PAID ON CASH BASIS
- INCOME TAXES ACCRUED FOR CURRENT YEAR
- CAPITAL
- ACCUMULATED EARNINGS
- NUMBER OF FULL TIME EMPLOYEES
- TANGIBLE ASSETS
- MAIN BUSINESS ACTIVITIES OF ENTITIES IN EACH JURISDICTION

# B.E.P.S. AND THE DIGITAL ECONOMY

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Peter Utterström, Sweden

# The B.E.P.S. Project – Basics

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- An O.E.C.D. administered project
- 15 actions points – no 1 digital economy
- Update of O.E.C.D. Guidelines – not necessarily legislative changes
- Expedient – very short period to comment
- I.B.A. Taxes Committee active part

Will all countries comply and act as expected?

# B.E.P.S. AND THE DIGITAL ECONOMY

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- Ringfence or not? Conclusion by the O.E.C.D. no – not now at least!
- Would entail special tax rules for business using the internet? How define? How charge tax?
- Taxes Committee view – look behind the façade! Most business' use digital technology as a mean to get the product or service to the customer!
- No difference between sending e.g. a book by mail or by internet

# B.E.P.S. AND THE DIGITAL ECONOMY

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- A modern way of distribution – not necessarily a new industry!
- New industry – work with the current rules and redefine if necessary



# INTERNATIONAL TAX AND B.E.P.S. - THE U.S. PERSPECTIVE

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1. ACTION ITEMS'  
FOCUS
2. U.S. CONCERNS
3. ACTION ITEM 8; A  
CLOSER LOOK
4. PATH FORWARD

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# B.E.P.S. ACTION PLANS ARE MEANT TO ADDRESS PERCEIVED CONCERNS

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But do they align with the U.S. view of international tax?

# B.E.P.S. Action Plans' Focus

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- Action Plans 2, 3, 4, and 5 focus on ensuring that tax deductible payments by one person are income inclusions to the recipients so that double “non-taxation” may be avoided.
- Action Plans 6,7,8,9, and 10 focus on aligning taxing rights with substance (insuring that there is tangible economic substance to an entity, e.g. office space, tangible assets and employees).
- Action Plans 11,12,13, and 14 focus on procedures to improve transparency such as: improved data collection and analysis regarding the impact of B.E.P.S.; taxpayers’ disclosure about their tax planning strategies; and less burdensome and more targeted transfer pricing documentation.
- Action Items 1 and 15 focus on specifically identified opportunities for tax reform.

# U.S. Concerns - By Action Plan Focus

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## **U.S. “Stakeholders” Government; Industry; Taxpayers; Tax Advisors**

- Avoidance of double “non-taxation” (2,3,4,5)
  - Proper Debt/Equity determinations-Commercial and tax standards must be applied.
  - Administration of hybrid proposals from a “top down” perspective is unworkable.
- Alignment of taxation to substance (6,7,8,9,10)
  - Protection of the U.S. tax base is a concern
  - Return on cash should be considered
  - Transfer pricing should not deviate from the arms-length standard
  - Identification of the value add to an IP transaction should not be “politicized”
- Transparency ( 11,12,13,14)
  - Current U.S. tax law is enough.
- Special Situations (1,15)
  - Concern with the Action Item 1’s concept of a “virtual permanent establishment”
  - “Virtual permanent establishment” inconsistent with taxing income where earned
  - Potential of double taxation of digital companies
  - Multilateral instrument concept is not well-defined

# ACTION ITEM 8

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A Closer Look

# Action Item 8:

## Outcomes=Value Creation-Intangibles

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- Adopting a broad and clearly delineated definition of intangibles.
- Ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation.
- Developing transfer pricing rules or special measures for transfers of hard-to-value intangibles
- Updating the guidance on cost contribution arrangements, and
- Adopt transfer pricing rules or special measures to ensure inappropriate returns will not accrue to an entity solely because it contractually assumed risks or provided capital.

# Action Item 8 - Core Principles

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- Location savings, assembled workforce, group synergies are relevant to TP but are not IP
- IP definition for TP purposes; “something which is not a physical asset or a financial asset, and which is capable of being owned or controlled for use in commercial activities and whose use or transfer would be compensated had it occurred in a transaction between independent parties (expanded definition).
- Marketing intangibles-“customer facing”.
- Unique and valuable IP defined by incremental profit generating capability.
- Entities entitled to income from IP are those who contribute to successful return from exploiting the IP (anti IP holding cos.)

# Action Item 8 - U.S. Concerns

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- Does a focus on income allocation from the exploitation of the intangible reflects the arms-length standard?
- Over-emphasis on functions and risks to allocate intangible profit makes it unclear as to what to allocate to the source of the capital
- Allocations based on “value add” could get overly political, resulting in respective countries’ efforts to allocate as much income as possible to their own jurisdiction.



# Conclusions/Suggested Path Forward

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“In addition to the aggressive actions by some foreign countries to levy more taxes on U.S. taxpayers before a consensus has been reached, the process established by the O.E.C.D. raises serious questions about the ability of the United States to fully participate in the negotiations. Ultimately, we believe that the best way for the United States to address the potential problem of B.E.P.S. is to enact comprehensive tax reforms that lower the corporate rate to a more internationally competitive level and modernize the badly outdated and uncompetitive U.S. international tax structure.”

- 2014 midterm elections
- 2016 Presidential Campaign
  - International tax reform
- Inversions (Notice 2014-52)

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# Disclaimer: A Note to Readers

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.

# Relevant Reading Material

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- Cadesky, Rinninsland, & Lobo-U.S. Views on B.E.P.S. Presentation by Michael Cadesky to the AOTCA Conference, October 24, 2014
- Life After B.E.P.S. Is there anything left in international tax planning, I.B.A. Panel Presentation in Tokyo, October 20, 2014, provided by Peter Utterström.
- Ruchelman P.L.L.C. Insights Vol. 1 # 7, U.S. Based Push-back on B.E.P.S.
- Ruchelman P.L.L.C. Insights Vol. 1 # 9, Discussion of Released B.E.P.S. Action Plans.