Global Law Week

BEPS Tax Panel

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Action 1

Addressing the Tax Challenges of the Digital Economy

Paul Kraan *Van Campen Liem*
Panelist

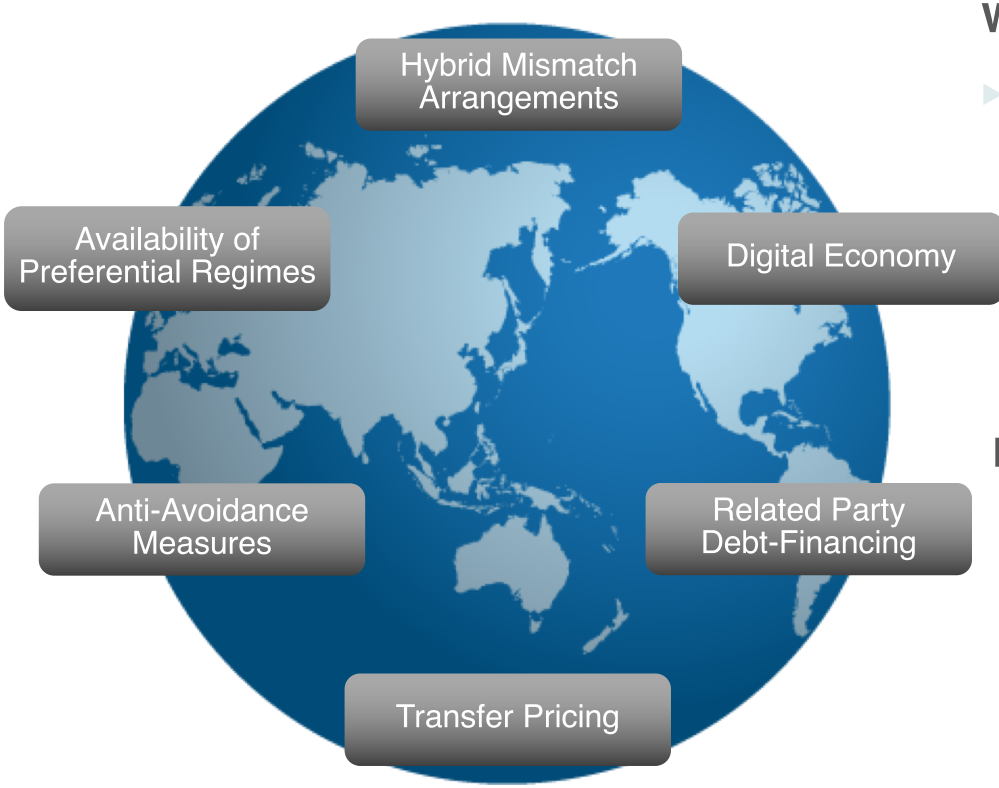
Stanley C. Ruchelman *Ruchelman P.L.L.C.*
Responding Panelist

Contents

- OECD BEPS Project
- Addressing the Tax Challenges of the Digital Economy
- Case Study
- OECD and EU Public Consultation
- Eurozone Big 4 initiative
- European Commission's 21 March 2018 digital tax package
  - significant digital presence
  - digital sales tax

Panelist | **Paul Kraan** *Action 1 – Digital Economy*

BEPS: The Final Deliverables



What is the BEPS action plan really?

- 15 action points based on 3 main pillars
  1. **Coherence** of corporate tax at international level
  2. Realignment of Taxation & **Substance**
  3. **Transparency** (certainty and predictability)

Pressure areas:

- Hybrid mismatches
- Substance
- Tax havens
- Profit shifting
- Treaty abuse

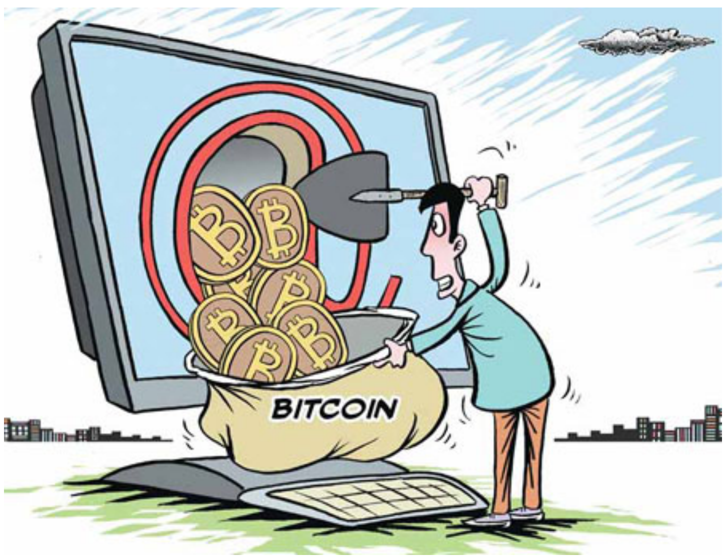
Panelist | **Paul Kraan** *Action 1 – Digital Economy*

BEPS: The 15 Action Points

Issue	Action	Output	Deadline
1 *Digital Economy*	Address Challenges	Report	9/14
2 *Hybrids/Arbitrage*	Neutralize	Domestic Law/Model	9/14
3 *CFCs*	Strengthen Regimes	Domestic Law	9/15
4 *Interest Deductions*	Limit Base Erosion	Domestic Law/TPG	9/15 12/15
5 *Harmful Tax Practices*	Counter More Effectively	Identify OECD/Non-OECD/Revise Criteria	9/14 9/15 12/15
6 *Treaty Abuse*	Prevent	Model/Domestic Law	9/14
7 *Permanent Establishment*	Prevent Avoidance	Model	9/15
8-10 *Transfer Pricing*	Place of Activity	TPG/Model	9/14 9/15
11-13 *Transparency*	Disclosure, Data Analysis	Recommendations/TPG	9/14 9/15
14 *Dispute Resolution*	Make Effective	Model	9/15
15 *Multilateral Treaty*	Identify Issues, then Draft	New Treaty	9/14 9/15

Panelist | **Paul Kraan** *Action 1 – Digital Economy*

Digital Economy: BEPS Action 1



- Action 1 (**BEPS Project**)
- Features of digital economy may exacerbate risks of Base Erosion and Profit Shifting
- Features such as:
  - "**Digitalized**" business models (*e.g.*, P2P platforms)
  - Means and location of value creation (*e.g.*, 3D printing)
  - Virtual 'crypto' currencies (*e.g.*, bitcoins)

Digital Economy: BEPS Action 1

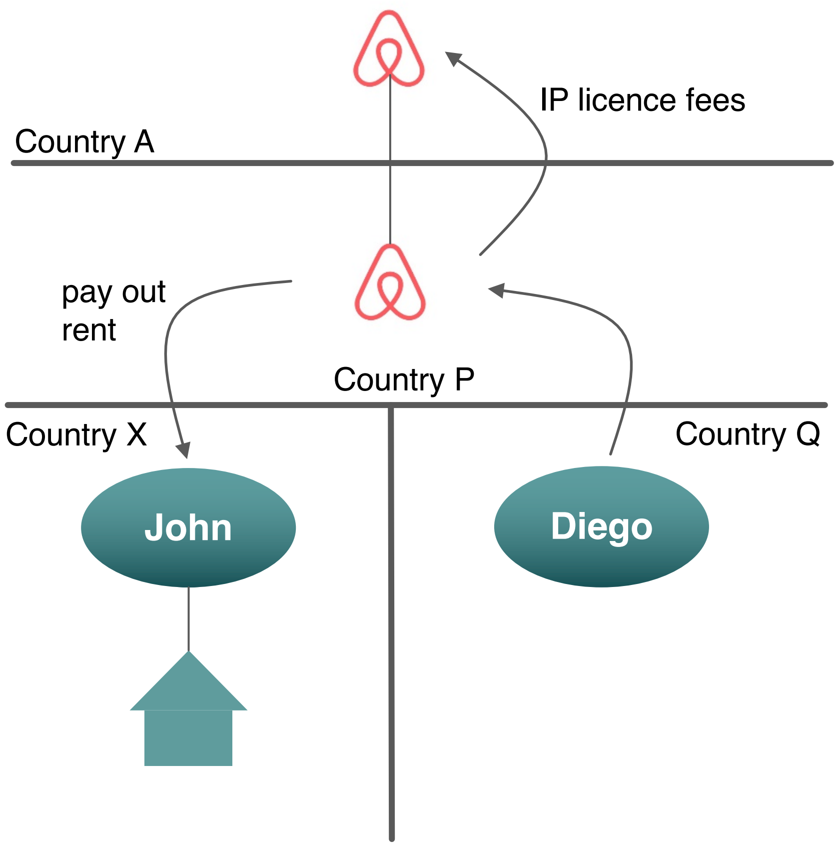
- Proposition that digital economy should not be ring-fenced from rest of economy for tax purposes due to increasingly prevalent nature of digitalization and evolving nature of business models under scrutiny

- Public perception that multinationals with digital business models are not paying 'enough' tax as they are currently subject to low effective tax rate

- Political imperative to take action to tax profits of multinational groups with digital business models

Panelist | **Paul Kraan** *Action 1 – Digital Economy*

Digital Economy: Case Study



- Where should online (**P2P**) platform service fees be taxed?
- Risks of Base Erosion and Profit Shifting?
- Where is the value created?
- Where is the economic presence?
- Does the platform constitute a PE in either Country X or Country Q?

Public Consultation

- **December 2016**: EU Commission public consultation on the *fair taxation of the digital economy*
- **October 2017**: OECD requests public input on *tax challenges of digitalization*

A. Digitalisation, Business Models and Value Creation
B. Challenges and Opportunities for Tax Systems
C. Implementation of the BEPS package
D. Options to address the broader direct tax policy challenges
E. Other comments

Eurozone Big 4 Initiative

- **September 2017**: Eurozone Big 4 (France, Germany, Italy and Spain) jointly request EU presidency and European Commission to explore options and propose solutions based on concept of '**equalization tax**' on turnover generated in EU by companies operating through a digital business model
- **Ministers of Finance**: "*We should no longer accept that these companies do business in EU while paying minimal amounts of tax to our treasuries*"
- Big 4 Eurozone countries push to tax internet giants on turnover rather than profits, trying to prevent them from taking advantage of low tax rates in some member states
  - taxation where revenue is earned (rather than where registered)

EU Digital Tax Package

- **21 March 2018**: European Commission launches its **digital tax package**
- Package concerning taxation of digital economy contains 4 elements:
  1. Communication to European Parliament and EU Council
  2. Proposal for EU Directive on significant digital presence
     - *long-term solution*
  3. Recommendation to EU Directive on significant digital presence
  4. Proposal for EU Directive on common system of digital services tax (**DST**)
     - *short-term solution*

Significant Digital Presence

- **21 March 2018**: European Commission launches its proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence
- Proposed Directive provides rules for establishing taxable nexus (**PE**) where digital business has non-physical commercial presence ('**significant digital presence**' or '**SDP**')
- SDP rules meant to be comprehensive long-term solution
- Directive should apply per 1 January 2020
  - Potential integration into pending CCCTB proposals

Panelist | **Paul Kraan** *Action 1 – Digital Economy*

Significant Digital Presence

- Digital platform constitutes SDP if one or more following criteria are met:
  1. total **revenues** obtained in tax period resulting from supply of digital services to users located in Member State exceeds €7 million
  2. number of **users** of digital services located in Member State in tax period exceeds 100K
  3. number of **business contracts** for supply of digital service concluded in tax period by users located in Member State exceeds 3K
- Attributing of profits to SDP requires functional analysis
- Profit split method is default TP method
  - unless taxpayer can demonstrate alternative and acceptable TP method is more appropriate in view of outcome functional analysis

Significant Digital Presence

- Economically significant activities SDP through digital platform:
  a) collection, storage, processing, analysis, deployment and sale of user-level data
  b) collection, storage, processing and display of user-generated content
  c) sale of online advertising space
  d) making available of third-party created content on a digital marketplace
  e) supply of any digital service not listed in points **(a)** to **(d)**
- Directive covers any taxpayer with SDP in EU, unless prohibited by treaty
- EC's Recommendation outlines how Member States should amend their tax treaties with non-EU jurisdictions to reflect use of SDP concept and attribution of profits in accordance with the Directive

EU Digital Services Tax

- **21 March 2018**: European Commission launches its *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* - COM(2018)148
- Recognition that taxation takes in jurisdiction where value is created should remain fundamental principle for profit allocation
- Proposed Directive is targeted (**short-term**) solution that should already apply as from 1 January 2020
- Introduction of Digital Services Tax (**DST**) at EU level
  - 3% on gross revenue (net of VAT and other similar taxes) derived in the EU

EU Digital Services Tax

- Type of arrangements within scope of Proposed Directive:
  1. *Advertising*: making available on '**digital interface**' of advertising space for advertising aimed at users of interface (*e.g.*, Facebook)
  2. *Multilateral interfaces*: making available to users of '**digital interface**' which allows users to find other users and to interact with them, and which may also facilitate the provision of underlying supplies of goods or services directly between users (*e.g.*, AirBnB)
  3. *Selling of user data*: transmission of data collected about users and generated from users' activities on digital interfaces

EU Digital Services Tax

- Proposal contains *De Minimis* rule as DST applies only to companies with:
  1. Global total annual revenue >€750 million (same as for CbC); and
  2. EU total annual taxable digital revenue >€50 million
- Exclusion of revenue from intercompany transactions
- DST proposal provides rules regarding place of taxation based on location of users taxable service
- Simplification through One-Stop-Shop (**OSS**) for taxable persons with DST liability in multiple Member States

Panelist | **Paul Kraan** *Action 1 – Digital Economy*

EU Digital Services Tax

- To avoid double taxation of revenues, individual Member States are expected to allow deduction of DST paid as cost from corporation tax base
  - Deduction in their territory, irrespective where taxes were paid
- Certain business models out of scope of Proposed Directive due to '*less significant user contribution*'
  - distinction within digital business models?
- Encompassing or excluding from scope certain (elements of) digital business models could potentially raise WTO-related issues

Response

Stanley C. Ruchelman

Action 1

Addressing the Tax Challenges of the Digital Economy

Action 1

- Within the U.S., many states are adopting rules to impose franchise tax or sales tax on venders having a digital presence in a state, generally determined by the number of sales made during the year to local residents

- At issue is a 1967 Supreme Court ruling that states could not force mail-order catalog companies to collect sales taxes unless a buyer lived in a state where the company had a physical presence — a retail store, a headquarters or a distribution center

- This is being revisited this year in a case involving online retailers selling into South Dakota and the arguments involve the burden that would apply if a retailer needed to comply with sales taxes in the ≥12,000 separate local sales tax jurisdictions vs. the loss of state and local sales tax revenue

Action 1

- At the Federal level, the U.S. addresses the issue of stateless digital income through its C.F.C. rules
- Code §951A provides new form of income that is taxed under Subpart F – the Global Intangible Low Tax Income ("**G.I.L.T.I.**")
- Basic premise of G.I.L.T.I. -- only two drivers of revenue for a C.F.C.
  - Q.B.A. (*depreciable tangible property*)
  - Intangible property
- **Q.B.A.I.** = 10% return on average adjusted basis
- **G.I.L.T.I.** = all other income of C.F.C.

Consequences to U.S. Shareholders

- U.S. Shareholders include G.I.L.T.I. in taxable income
- U.S. Shareholders that are corporations are entitled to a 50% deduction (Code §250(a)(1)) – as a result effective tax rate of 10.5%
- Individuals that are U.S. Shareholders are not entitled to a deduction
- **Exception**: if an individual makes a Code §962 election, the G.I.L.T.I. inclusion is reported in a "**corporation silo**" within the individual's return
- Note that this view is not universally accepted among tax advisers based on a hyper technical reading of Code §962

Indirect Foreign Tax Credits

- **Corporate shareholders**:
  - Foreign taxes paid or accrued by each C.F.C. divided between G.I.L.T.I. taxes and non-G.I.L.T.I. taxes based on the group's global percentage of G.I.L.T.I. to total income
  - Under Code §78, all the indirect F.T.C.'s are grossed up into income
  - F.T.C. on G.I.L.T.I. is allowed for foreign taxes of companies with positive G.I.L.T.I.
  - F.T.C. on G.I.L.T.I. limited to 80% of U.S. tax
  - Unused F.T.C.'s are lost
- **Non-corporate shareholders**:
  - **General rule**: no F.T.C.
  - **Exception**: Code §962 election is made

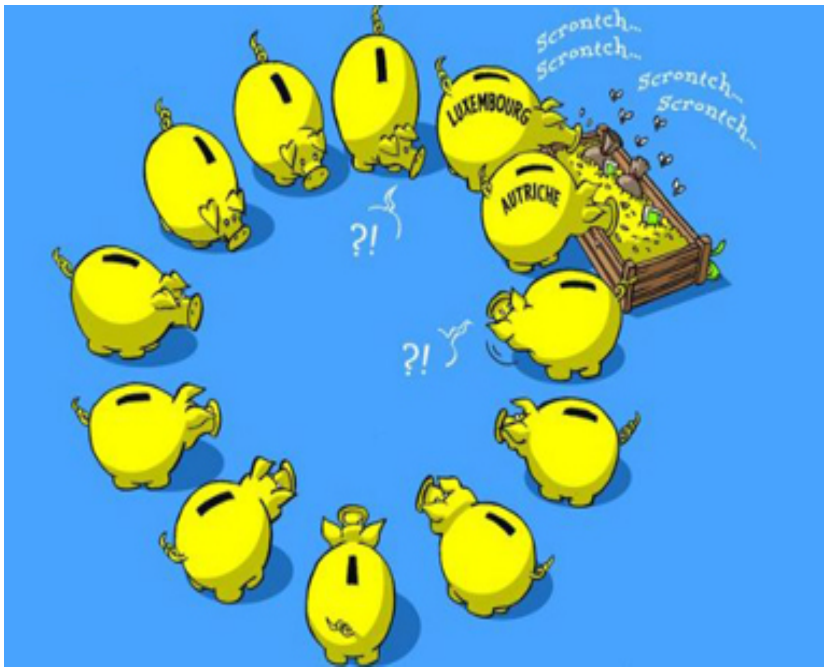
Action 2

Neutralizing the Effects of Hybrid Mismatch Arrangements

Paul Kraan *Van Campen Liem*
Panelist

Stanley C. Ruchelman *Ruchelman P.L.L.C.*
Responding Panelist

EU Picks Up On BEPS Actions 2–4



Anti Tax Avoidance Directive (ATAD)

- **12 July 2016**: ECOFIN reaches agreement on
  - 1st EU Anti-Tax Avoidance Directive (**ATAD 1**)

    aka
  - “**EU BEPS Directive**”
- Implementation ATAD 1 required prior to 1 January 2019

EU Picks Up On BEPS Actions 2–4

- **ATAD 1 contains minimum rules for**:
  - Interest deduction limitation
  - Exit taxation
  - GAAR
  - CFC
  - Hybrid mismatches

Hybrid Mismatches Covered by ATAD 1

- **Hybrid mismatches covered**:
  - only EU
  - hybrid instruments and entities
  - **double deduction** → only deductible in source state of payment
  - **deduction without inclusion** → deduction shall be denied

Taking the Next Step: ATAD 2

- **29 May 2017**: EC adopts Directive amending ATAD 1 (known as **ATAD 2**)
- Implementation ATAD 2 before 1 January 2020 (*one year later*)
- ATAD 2 extends scope of ATAD 1 to mismatches with non-EU countries
  - In relation to '**hybrid**' financial instruments
- ATAD 2 also extends scope of ATAD 1 to mismatches regarding :
  - presence of a permanent establishment (**PE**)
  - dual resident companies
  - entity qualification (use of '**hybrid**' entities)
  - and more .... (*BEPS action 7*)

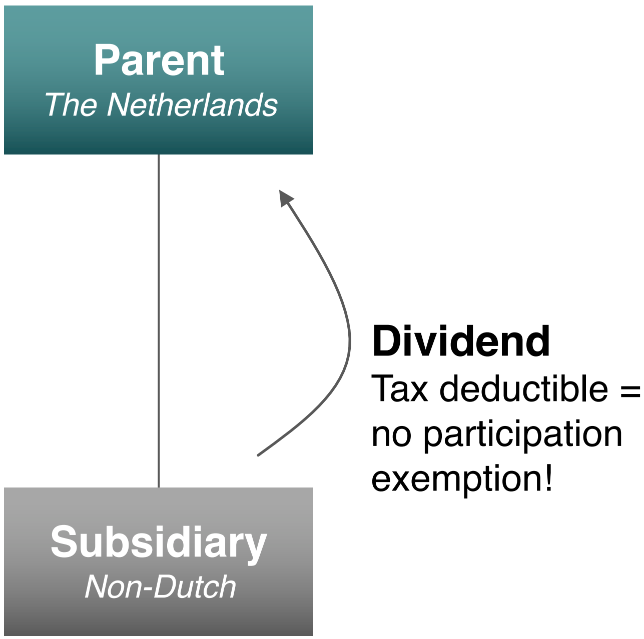
ATAD: Implementation in the Netherlands

- **10 July 2017** – consultation document (draft legislation) for implementation ATAD 1 issued
- Final proposal is expected ultimately by 18 September 2018 (Budget Day in the Netherlands), *i.e.*, with a view on implementation before 2019
- Proposal does not include ATAD 2 (implementation prior to 2020)
- Consultation document by old government
  - just minimum standards
- Hybrid entity mismatches (**ATAD 2**): CV/BV structures

Anti-Hybrid Instruments Legislation in the Netherlands

- Anti-hybrid measurements already implemented as part of implementation of changes to EU Parent Subsidiary Directive
- Entered into force as of 1 January 2016
- **Implementation**:
  - **Anti-Hybrids**: changes to participation exemption regime

Anti-Hybrid Instruments Legislation: Situations Covered



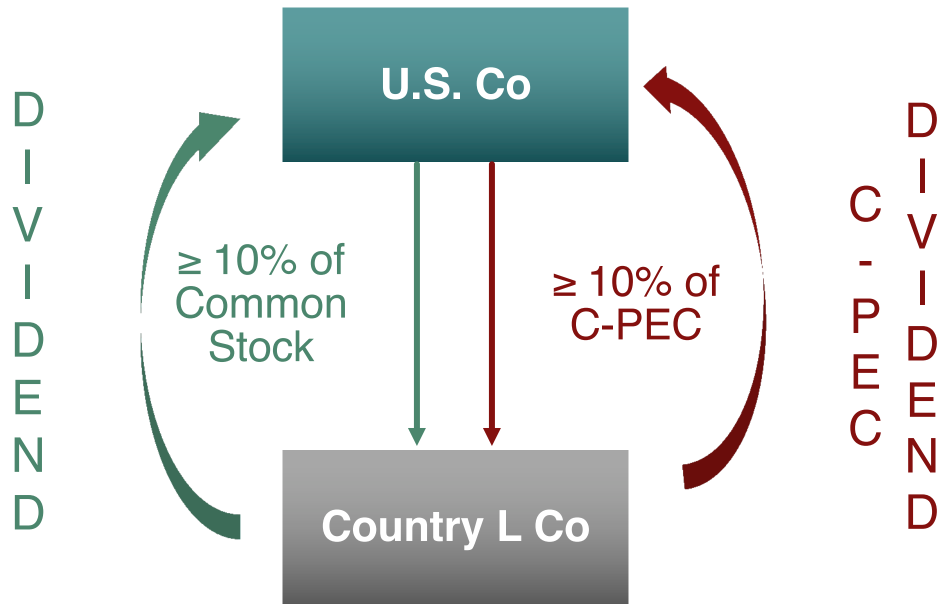
- If distribution is tax deductible at the level of Subsidiary, **NO** participation exemption at Parent level
- Applicable to:
  - *Hybrid instruments*
    - debt at the level of distributor while equity at Holdco level; and
  - *Equity instruments* – true equity where dividend is tax deductible
- Notional interest deduction (**Belgium**)
- Deductible dividends (**Brazil**)

Response
Stanley C. Ruchelman

Action 2
Neutralizing the Effects of Hybrid Mismatch Arrangements

Action 2

- The T.C.J.A. adopted provisions to attack inbound and outbound hybrid payments
- Code §245A provides a dividends received deduction for inbound dividend payments to a U.S. corporation
  - If certain conditions are met, a D.R.D. is allowed for dividend payments received when the U.S. corporation owns ≥10% in the foreign corporation
  - No direct or indirect foreign tax credit is allowed
  - D.R.D. is not allowed for hybrid dividends received by a ≥10% U.S. Shareholder of a controlled foreign corporation; no foreign tax credits allowed
  - A hybrid dividend is an amount received from a C.F.C. for which a deduction would be allowed under this provision and for which the C.F.C. received a deduction or other tax benefit



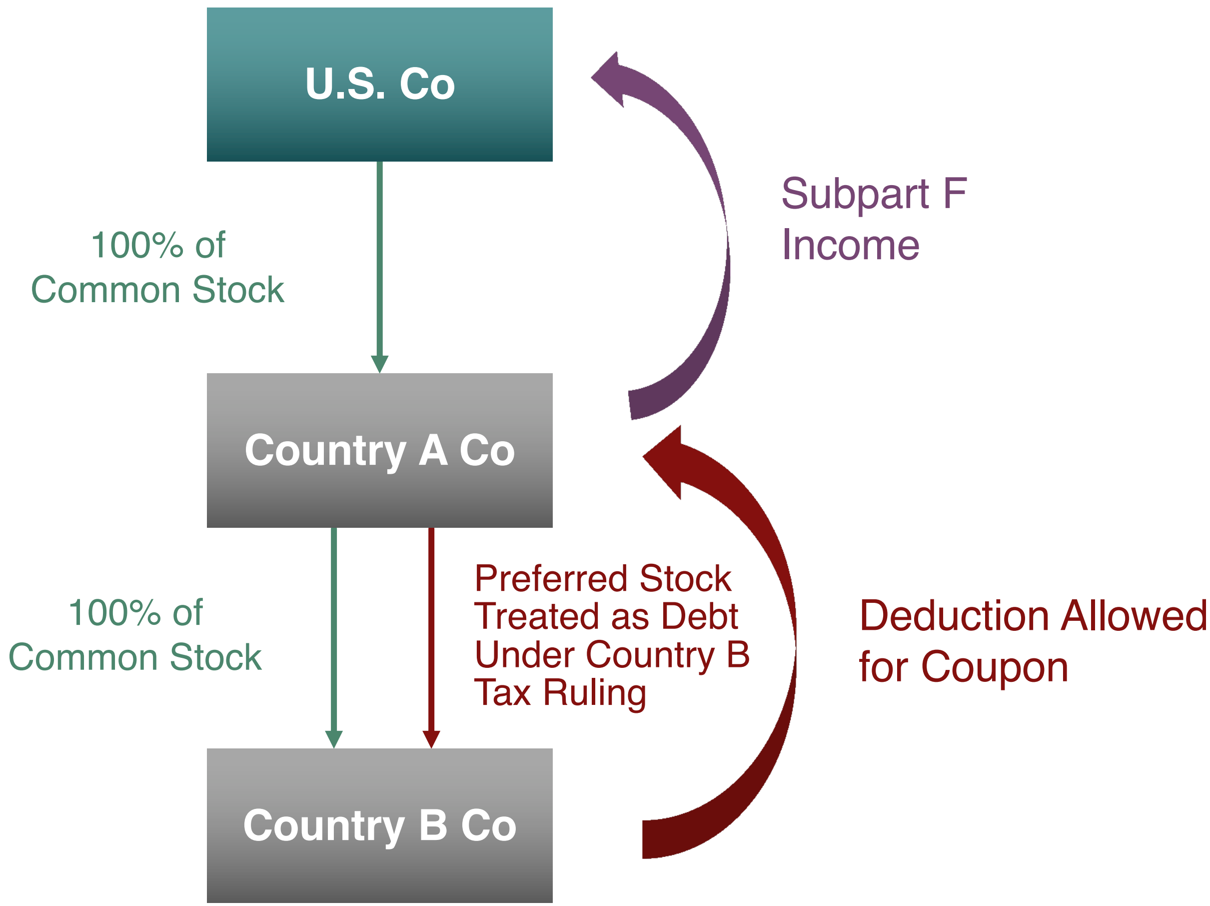
- Receipt of dividend on common stock
  - Not deductible for payor in Country L
  - Dividend is deductible under Code §245A

- Receipt of C-PEC distribution
  - Deductible for payor in Country L
  - Not deductible under Code §245A(e)

Action 2

- A companion anti-hybrid provision exists for a hybrid dividend from by a C.F.C. to a related C.F.C.
  - The U.S. corporation receiving the hybrid dividend has Subpart F Income
  - No exception that might eliminate taxation under Subpart F applies
  - No foreign tax credit applies

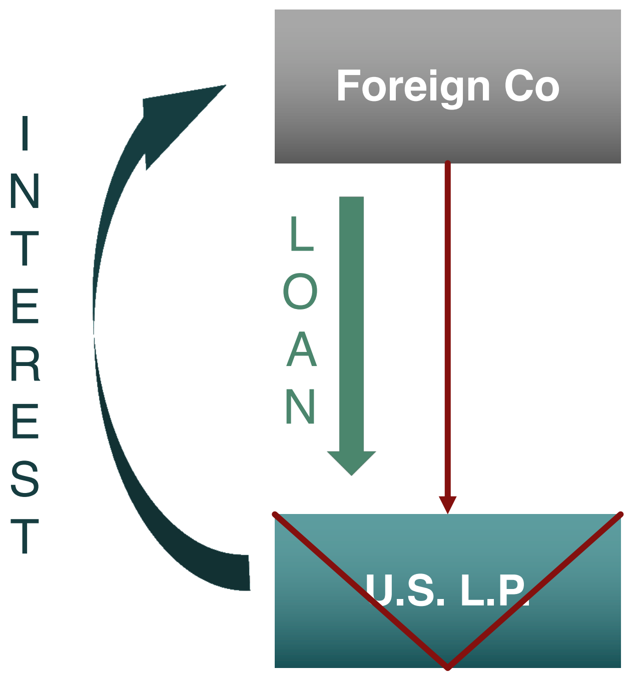
Action 2


U.S. Co
100% of
Common Stock
Subpart F
Income
Country A Co
100% of
Common Stock
Preferred Stock
Treated as Debt
Under Country B
Tax Ruling
Deduction Allowed
for Coupon
Country B Co

Action 2

- **Code §267A** – deduction disallowed for certain hybrid payments made from U.S.
  - Disallows deduction for **Disqualified Related Party Amount**
    - Paid or Accrued pursuant to a hybrid transaction; or
    - Paid or accrued by, or to, a hybrid entity
  - A hybrid transaction involves the payment of interest or royalty from a U.S. person when the receipt of payment is not taxable in the foreign country (or the recipient is entitled to a deduction)
  - A hybrid entity is treated as transparent for U.S. tax purposes but not for tax purposes in the foreign country or is treated as transparent for tax purposes in the foreign country but not in the U.S.

Action 2



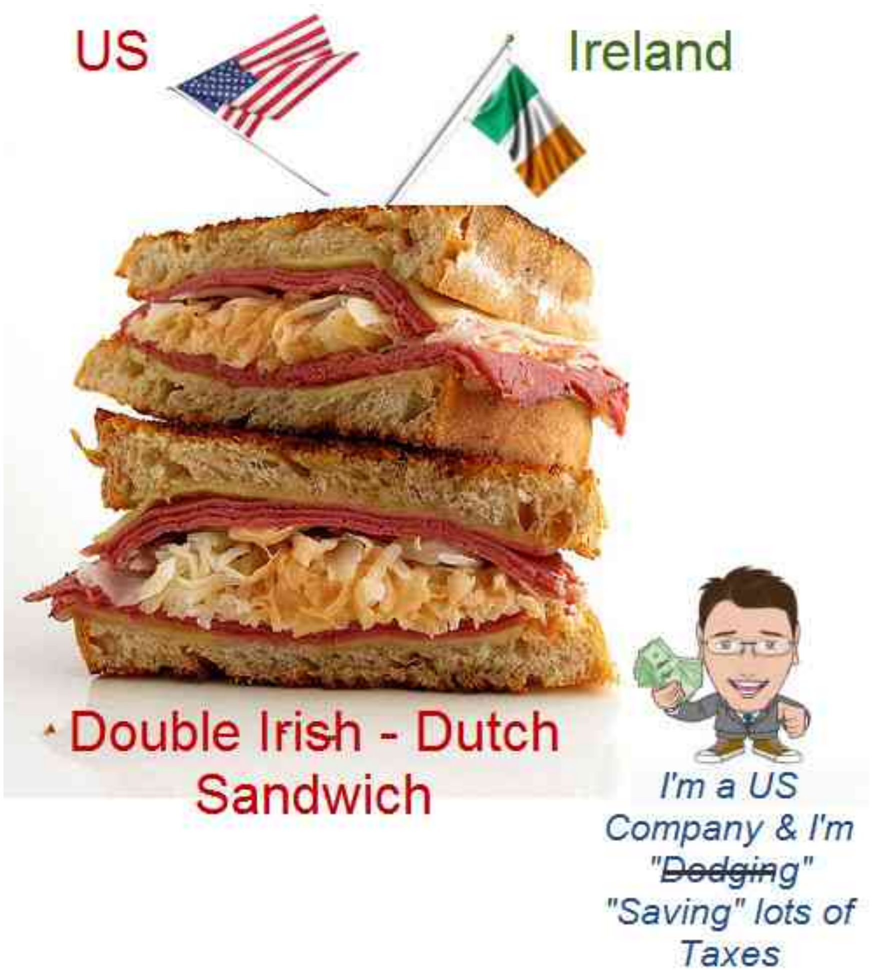
- Foreign Co is formed in Country C
- In Country C, U.S.L.P. is treated as a partnership
- Under Country C tax law, transactions between partners and partnership are eliminated
- In the U.S. the L.P. elects to be treated as a corporation

Action 3
Designing Effective Controlled Foreign Company Rules

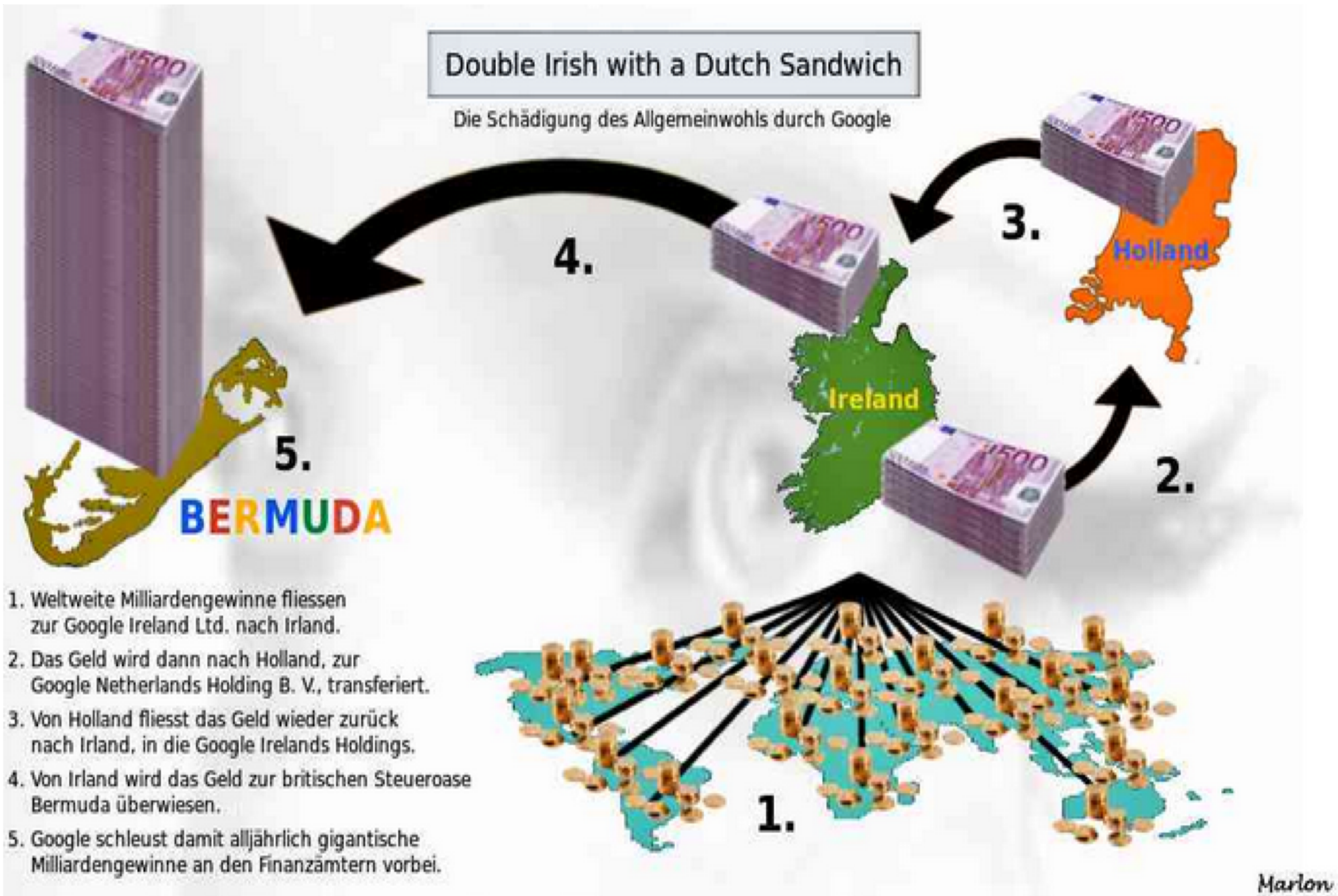
Stanley C. Ruchelman *Ruchelman P.L.L.C.*
Panelist

Rodrigo Machado *Ulhôa Canto, Rezende e Guerra Advogados*
Responding Panelist

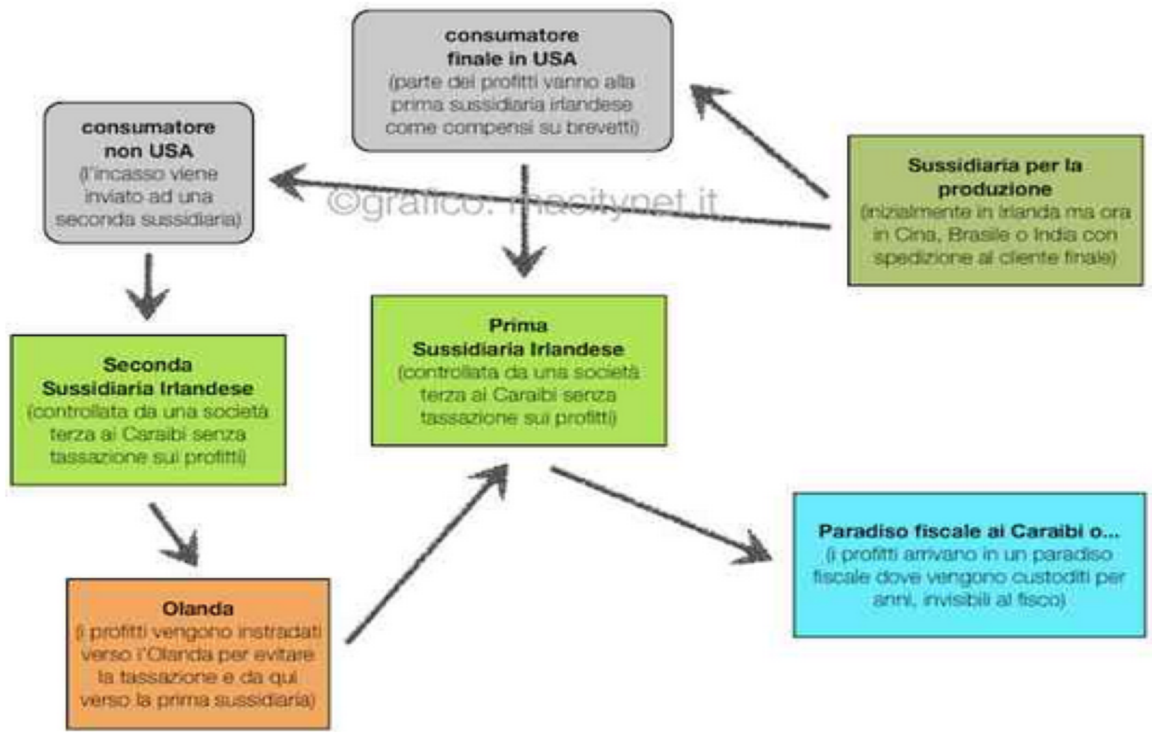
Panelist l **Stanley Ruchelman** *Action 3 – CFC Rules*

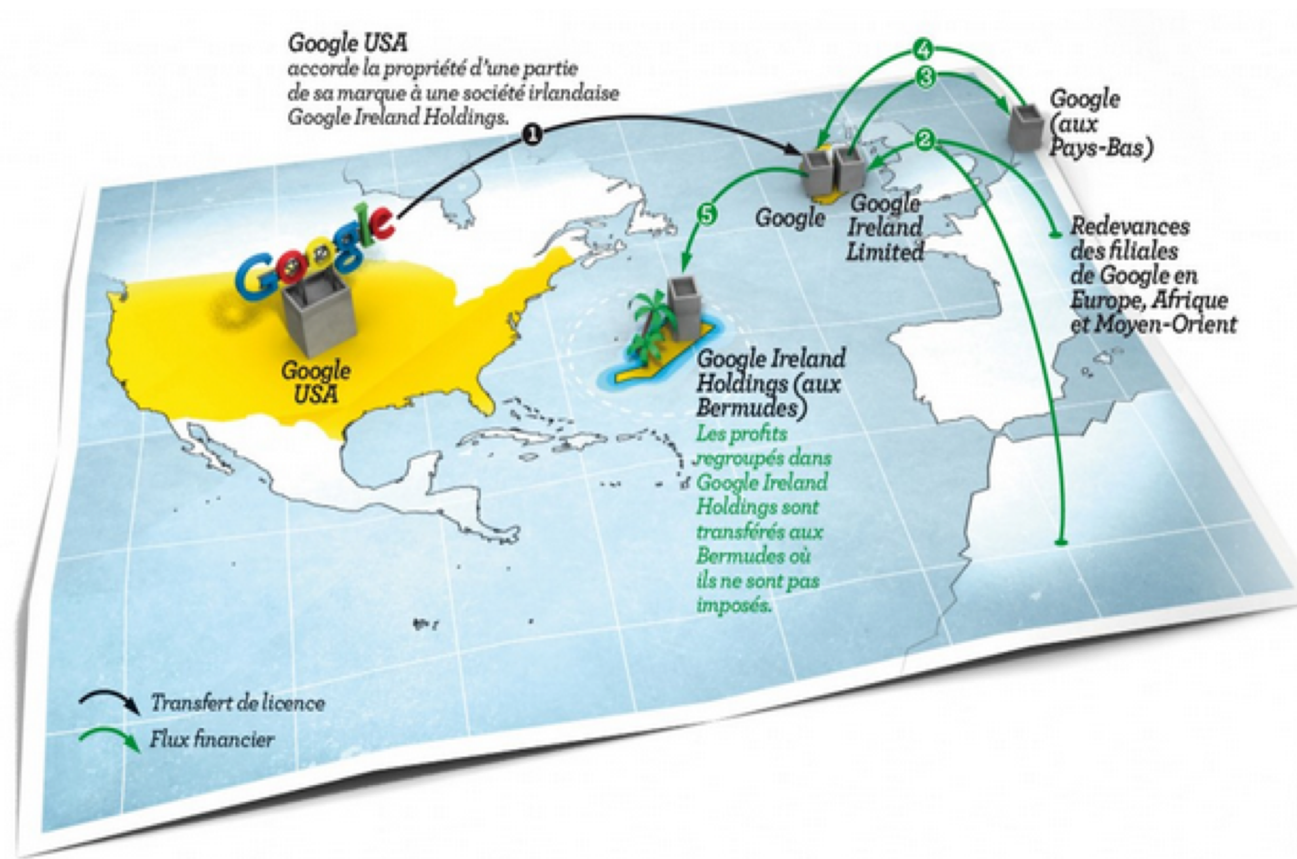


Panelist | **Stanley Ruchelman** *Action 3 – CFC Rules*

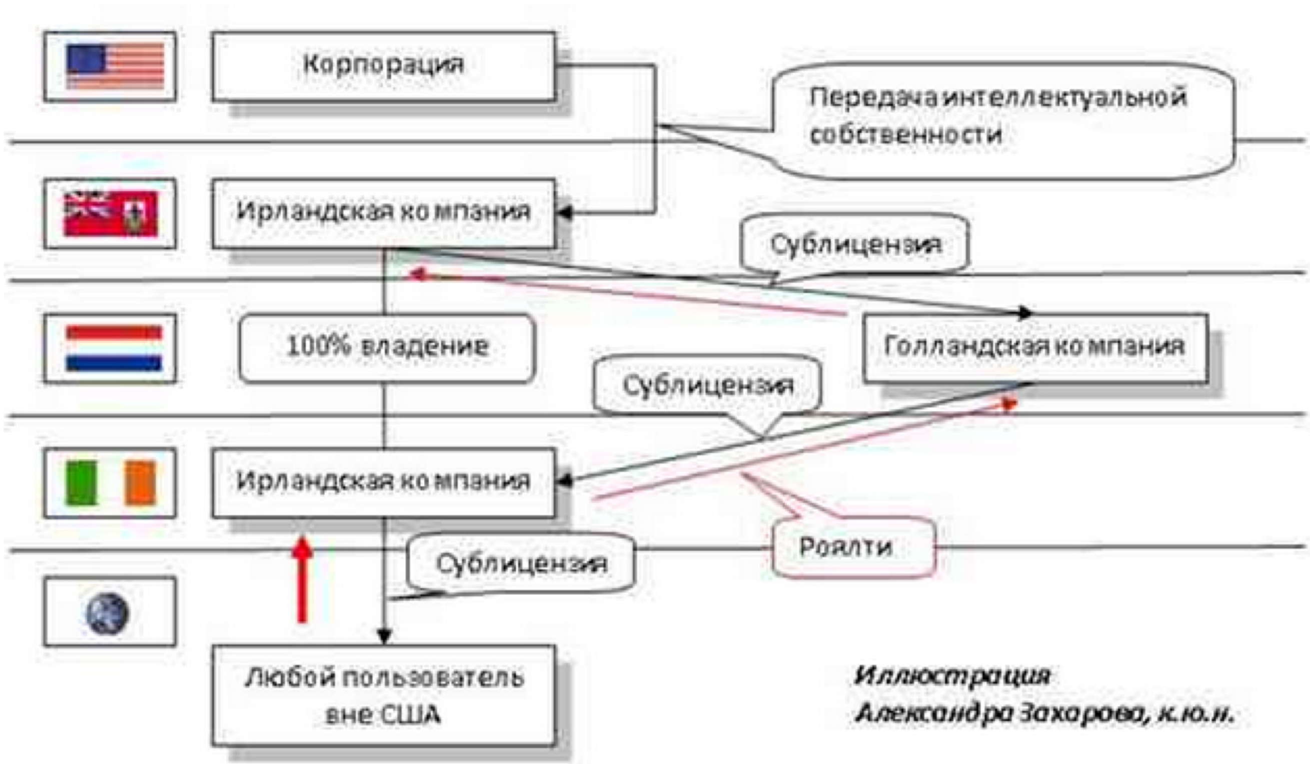


Panelist | Stanley Ruchelman *Action 3 – CFC Rules*




Google USA
accorde la propriété d'une partie
de sa marque à une société irlandaise
Google Ireland Holdings.
1
2
3
4
5
Google
(aux
Pays-Bas)
Google
Google
Ireland
Limited
Redevances
des filiales
de Google en
Europe, Afrique
et Moyen-Orient
Google
Google
USA
Google Ireland
Holdings (aux
Bermudes)
Les profits
regroupés dans
Google Ireland
Holdings sont
transférés aux
Bermudes où
ils ne sont pas
imposés.
Transfert de licence
Flux financier

Panelist | Stanley Ruchelman *Action 3 – CFC Rules*



"Double Irish Dutch Sandwich"

Why Do Governments Have Heartburn?

- The double Irish sandwich results in quintuple no-taxation even though the plan touches four countries and the rest of the world
- Countries are:
  - U.S.
  - Ireland
  - Netherlands
  - Bermuda
  - All other countries that treat the revenue as business profits not subject to local tax in the absence of a permanent establishment

Panelist | **Stanley Ruchelman** *Action 3 – CFC Rules*

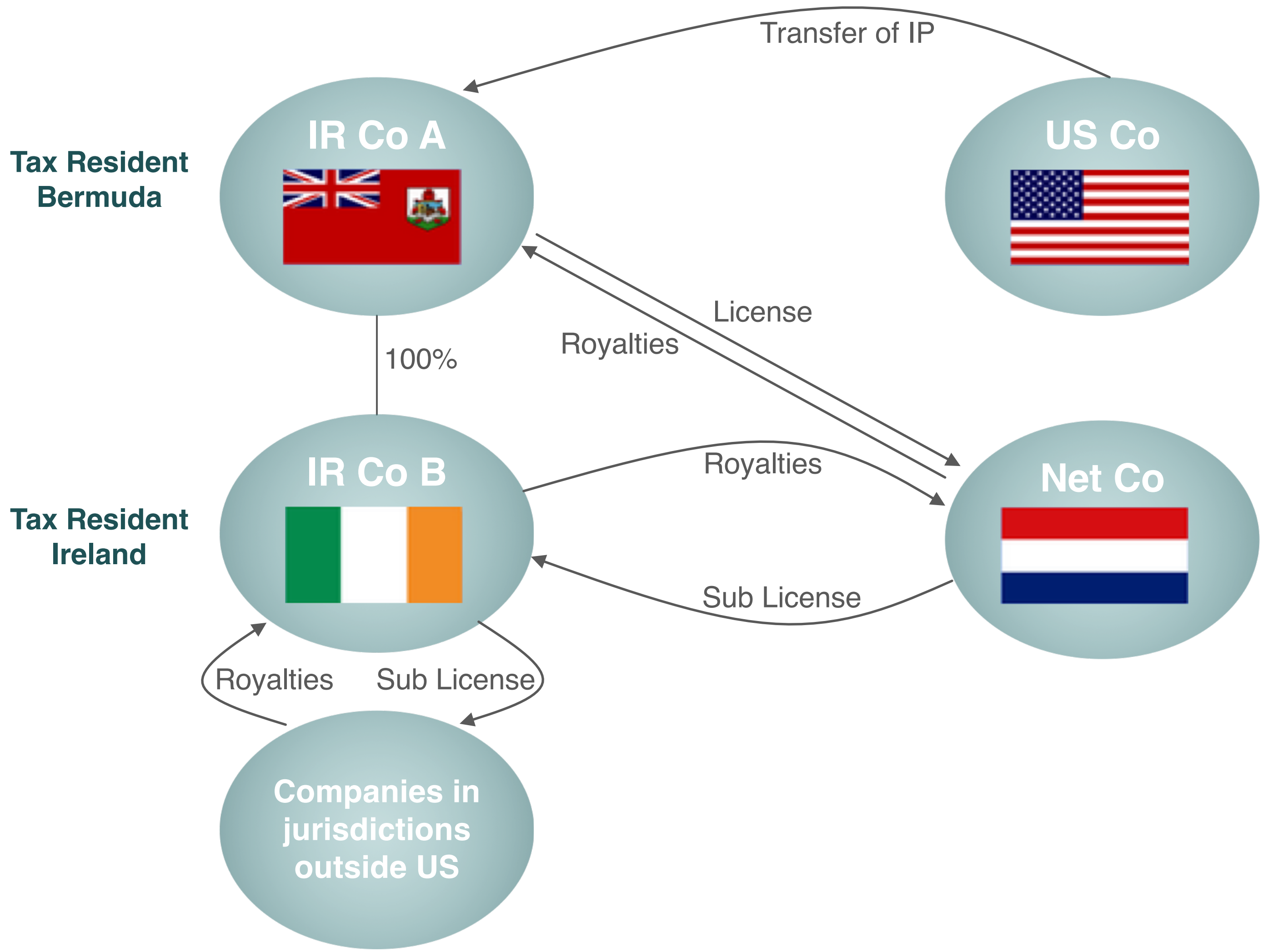
Why is Google Feasting?

- Google is feasting because it has faced U.S. tax rules designed to curb cross-border tax abuse by U.S.-based multinationals and has "**eaten the lunch**" of these provisions
- **Anti-abuse provisions**:
  - §367(d) imposing a deemed royalty equivalent when intangible property is transferred in a nonrecognition provision to a foreign subsidiary
  - §482 involving transfer pricing rules for the use of intangible property by a controlled business affiliate outside the U.S.
  - Subpart F Foreign Personal Holding Company Income provisions designed to prevent deferral of profits derived from the licensing income

What is the Recipe?

- **Step 1**: Form an Irish C.F.C. ("**TOPCO**") that is managed and controlled in Bermuda
- **Step 2**: Have TOPCO enter into a qualified cost sharing agreement with U.S. parent
- **Step 3**: Have TOPCO form Dutch sub ("**DCO**") to serve as licensing company and Irish OPCO to carry on active business operations
- **Step 4**: Make check-the-box elections for DCO and OPCO
- **Step 5**: Have TOPCO license its rights under the qualified cost sharing agreement to DCO and have DCO enter comparable license agreement with OPCO

Panelist | Stanley Ruchelman *Action 3 – CFC Rules*



Action 3

- **Policy**:
  - C.F.C. rules should be designed to protect revenue by ensuring profits remain within the tax base of the parent
  - Backstop to transfer pricing adjustments
  - Reduce administrative compliance burdens
  - Avoid double taxation
- **Objectives**:
  - Maintain competitiveness of parent company
  - Prevent base stripping among foreign subsidiaries
  - Apply economic substance to combat wholly artificial arrangements

Action 3

- **Control**
  - Legal
  - Economic
  - *De facto*
  - Acting in concert
  - Control by related party
- **C.F.C. Income**
  - Dividends
  - Interest
  - Insurance income
  - Royalties and IP income
  - Related party sales and services income.

Tax Cuts and Jobs Act

- Mandatory repatriation of all post-1986 deferred income of C.F.C.'s and certain other companies
- Broadened definition of C.F.C.
- Broadened definition of U.S. Shareholder
- Hybrid payments by one C.F.C. to another are automatically Subpart F income
- Global Intangible Low Tax Income ("**G.I.L.T.I.**") provisions
- Change in computing buy-in of a qualified cost sharing agreement

Response Rodrigo Machado

Action 3

Designing Effective
Controlled Foreign Company Rules

Comments on Action 3

- US seems to apply actual C.F.C. rules, designed to prevent aggressive tax schemes such as the "**Dutch Sandwich**" described above, in line with Action 3

- Brazil, on the other hand, imposes a very peculiar C.F.C rule, that apply to all profits derived by all controlled foreign companies, regardless of the jurisdiction (treaty partners, tax haven, etc.) or the nature of income (passive, operating, etc.)

- Further, since the Brazilian law taxes the gain of the Brazilian parent company assessed through the pick-up method (*i.e.*, the gain derived from the positive variation of the net equity of the foreign controlled company), Brazilian tax authorities uphold that double tax conventions do not prevent the law from applying as there is no double taxation

Comments on Action 3

- The former Brazilian C.F.C. rule was challenged before the Supreme Federal Court in a lawsuit that lasted for more than 13 years, with an inconclusive decision, and lead to a litigation between tax authorities and taxpayers involving more than US$10 billion
- The current Brazilian C.F.C. rule, with similar characteristics, will probably be challenged before the Courts as well, and is in clear conflict with the principles proposed by Action 3 for designing effective C.F.C. rules.

Action 4
Limiting Base Erosion Involving Interest Deduction & Other Financial Payments

Paul Kraan *Van Campen Liem*
Panelist

Sanjay Sanghvi *Khaitan & Co*
Responding Panelist

EU Picks Up on OECD BEPS Program

- ATAD 1 contains minimum rules for:
  - Interest deduction limitation
  - Exit taxation
  - GAAR
  - CFC
  - Hybrid mismatches

Interest Deduction Limitations in ATAD 1

- **Interest deduction limitations (BEPS Action 4):**
  - Earnings stripping rule
  - In principle no deduction of interest payments in excess of 30% EBITDA
  - *However*: some room for local exceptions and alternatives
  - Member States with equally effective rules have until 2024 to implement

Taking the Next Step: ATAD 2

- **29 May 2017:** EC adopts Directive amending ATAD 1 (known as **ATAD 2**)
- Implementation ATAD 2 before 1 January 2020 (*one year later*)
- Specifically in relation to interest deduction limitations, ATAD 2 does not significantly extend the scope of ATAD 1

Implementation of Limitations in the Netherlands

- **10 July 2017** – consultation document (draft legislation) for implementation ATAD 1 issued
- Final proposal expected by 18 September 2018 (Budget Day in the Netherlands), with a view on implementation before 1 January 2019
- Proposal does not include ATAD 2 (implementation required prior to 2020) but ATAD 2 does not so much concern interest limitations
- Consultation document by old government coalition
  - just minimum standards
- Contours sharpened by new coalition government (in office as from October)
  - The Netherlands will not apply group '*escape*' offered by ATAD 1
  - Hurdle will be €1 million
  - Existing other interest deduction limitations (anti-base erosion rules and the like) will likely be preserved

Response Sanjay Sanghvi

Action 4

Limiting Base Erosion Involving Interest Deduction & Other Financial Payments

India's Perspective

Thin Capitalization Rule
• FY 2017-18 onwards, Indian domestic tax law limits interest deduction in certain cases
• It restricts deduction of interest expenditure payable by an Indian company or a PE in India to NR-AE to 30% of EBITDA where interest exceeds INR 10 million.
• **Excess interest** = Total interest paid / payable in excess of 30% of EBITDA or interest paid / payable to AE, whichever is less.
• **Deemed debt from an AE, in case of a non-AE lender and**: AE provides implicit or explicit guarantee, or AE deposits a corresponding and matching amount of funds with the lender *The term used in this proviso is "AE", a strict reading of which would also include resident AEs.*
Unabsorbed interest can be carried forward for next 8 years immediately succeeding the year for which the excess interest expenditure was first computed and allowed as a set-off, subject to the limit of 30% of EBITDA.
Section 94B restricts deductible interest in case of inadequacy of profits **even in presence of debt and interest at arm's length**
Section 94B does not apply to capitalization of interest on loan taken for asset acquisition

India's Perspective

Consequences in the Indian Market

Deterrent to funding transactions

- Interest disallowance in India + pay taxes overseas on the interest income in the hands of the AE.
- Limitation of interest deductibility and carry forwarding to only 8 years might result in higher tax payment, rendering foreign borrowing having competitive interest rate ineffective

Double whammy!

- ***Disallowance of deduction*** → increase in borrowing cost + absence of corresponding changes in WHT or taxation of NR AE.

Affected sectors:

- Capital intensive sectors with long gestation period like Infrastructure, Real Estate, Pharmaceuticals, relying heavily on foreign funding
- **NBFCs**

Grey Areas

- Book EBITDA or Tax EBITDA
- Excess interest calculation – whether total interest is to be considered or only interest paid to AEs
- **Implicit guarantee**: the deemed debt from AE concept includes 'implicit guarantee' given by the AE: 'implicit guarantee' is not defined in the Act
- Whether LOC (Letter of comfort) is also covered under the purview of thin cap?
- **Net interest v. gross interest** – inconsistency: BEPS Action Plan 4 calculates interest expense on a 'net' interest basis, whereas Indian laws calculates it on 'gross' interest basis.
- Whether disallowance of interest by TP officer would overrule the interest deduction of even 30%?

Action 5

Counting Harmful Tax Practices More Effectively, Taking into Account Transparency & Substance

Sanjay Sanghvi *Khaitan & Co*
Panelist

Rodrigo Machado *Ulhôa Canto, Rezende e Guerra Advogados*
Responding Panelist

What and Why…

- ‘**Minimum standard**’ countering harmful tax practices with tools as substance and improved transparency

Requiring ‘substantial activity for preferential regime’

Improving transparency for information exchange

- Countering harmful tax practices like taking unsubstantiated advantage of preferential regimes
- Looking first at IP regimes and then at other regimes (16/43 reviewed regimes are IP regimes)
- “**Nexus Approach**”: expenditure as a proxy for income
- **Example**: in case of IP regime: taxpayer to benefit from the IP regime only to the extent he incurs R & D expenditure giving rise to the IP income in the source state
- ‘**Forum on Harmful Tax Practices**’ (**FHTP**) has been constituted for monitoring and reviewing the implementation of the Action

Panelist | **Sanjay Sanghvi** *Action 5 – Limiting Harmful Tax Practices*

What and Why…

Improving Transparency

- The emphasis is on **exchange of information** which includes 'compulsory spontaneous exchange on rulings'
- Framework prescribes information exchange covering **six categories** of rulings:
  i. rulings related to **preferential regimes**;
  ii. **cross border unilateral advance pricing arrangements** (**APAs**) or other **unilateral transfer pricing** rulings;
  iii. rulings giving a **downward adjustment to profits**;
  iv. **permanent establishment** (**PE**) rulings;
  v. **conduit rulings**; and
  vi. any other type of ruling where the FHTP agrees in the future that the **absence of exchange would give rise to BEPS concerns**

Preferential Regime in India

- **Patent Box**
  - Mandates substantial activity test

Patent Box

In 2016, India introduced the concessional regime for taxation of royalty income from patents developed and registered in India (existing and new patents)

By an Indian resident, who is the true and first inventor as the patentee

The royalty shall be taxed at 10% (plus surcharge and education cess) on the gross amount of royalty for patents developed

No deduction in respect of any expenditure or allowance shall be allowed

Section 115BBF is not subject to Minimum Alternate Tax (**MAT**)

Quantum Expenditure clause: "developed" when at least 75% of the expenditure shall be incurred in India for the invention

India's Efforts Towards Transparency

- **Indian Laws in Consonance with Action 5**: Signatory to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports since 12 May 2016: to bring greater transparency in cross national transactions

Collection of Information

Advance Rulings

- **CBDT**: Draft Notification dated 10 April 2018 proposes to amend the forms filed by an applicant for Advance Rulings
- **Proposed amendment**: applicant to disclose details of its immediate and ultimate parent companies and non-resident it would transact with

Advance Pricing Agreements (APAs)

- 2012 onwards India introduced the APAs regime where CBDT enters into APAs with taxpayers
- APAs can be multilateral, bilateral or unilateral

Exchange of Information

- Template contained in Annex C of Action 5 and its guidelines are distributed to all the offices responsible for filling out the information required
- **Past PE rulings**: centralised office in the CBDT identifies the relevant rulings → designated case officer then completes the Action 5 template
- **Future PE rulings**: departmental representative in the AAR identifies the eligible ruling and prepares the template
- **For past and future APAs**: designated case officers complete the template
- All completed templates are reviewed by CBDT → submits the final templates to the Competent Authority (a team within CBDT) for exchange of information

Response Rodrigo Machado

Action 5

Counting Harmful Tax Practices More Effectively, Taking into Account Transparency & Substance

Comments on Action 5

- Although Brazil has enacted domestic legislation to oblige MNEs controlled by Brazilian companies to file Country-by-Country Reports, the country is still taking the preliminary steps towards countering harmful tax practices. There are only a few tax assessments based on rulings issued by other jurisdictions or on mismatches between Brazilian and foreign tax laws

- One could expect that, with CbC Reports and more exchange of information among the countries, there will be more discussion on whether: **(i)** some preferential regimes and rulings constitute harmful tax practices; and **(ii)** entities that benefit from preferential regimes meet the substance requirements to be entitled to such regimes

Comments on Action 5

- Another important question is whether, in an increasingly competitive environment to attract and retain investments, will the countries be actually willing to disclose their preferential regimes, advance pricing agreements and rulings in favor of improving transparency?

Action 6
Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Sanjay Sanghvi *Khaitan & Co*
Panelist

Rodrigo Machado *Ulhôa Canto, Rezende e Guerra Advogados*
Responding Panelist

What and Why…

- **'Minimum standard' to counter treaty abuse and treaty shopping**
  - Action 6 specifies new treaty **anti-abuse rules** and **safeguards against the abuse of treaty provisions**: with flexibility to adapt jurisdiction specificities and negotiation of bilateral conventions
  - *Treaty Shopping*: strategies through which a NR attempts to obtain benefits granted by tax treaty of the source state to its resident.
  - *Approaches to deal with these strategies*: **clear statement** and **anti-abuse rules**

Clear Statement I Preamble
Action 6 emphasises on having a preamble in the tax treaties, expressing clear common intention of the parties to avoid creating opportunities for: • double taxation • non-taxation, reduced taxation through tax evasion or avoidance
The explanatory to the Multilateral Convention prescribes the **model preamble text**, as follows: *Desiring to further develop their economic relationship and to enhance their co-operation in tax matters, Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)*

Anti-Abuse Rules

Limitation-on-benefits (LOB) (specific rule)	**Principal Purposes Test (PPT)** (general rule)
• Limits availability of treaty benefits to eligible entities only • **Eligibility basis**: legal nature, ownership and general activities of the entity • **To ensure**: sufficient link between entity and its state of residence	• For situations not covered by LOB • **Basis**: principal purposes of transactions/ arrangements • If one of the principal purposes of the transaction/ arrangements is to obtain treaty benefits, these benefits will be denied • **Unless** it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty

India

General Anti-Avoidance Rule (GAAR)	Specific Anti-Avoidance Rule (SAAR)
• FY 2018 onwards, India has implemented GAAR provisions • Tax benefit will be denied, if the transactions or arrangements do not have any commercial substance or consideration other than achieving the tax benefit • ‘**Impermissible avoidance arrangement**’: main purpose of which is to obtain tax benefit • **Deemed ‘impermissible avoidance arrangement**’: if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, irrespective whether the main purpose of the whole arrangement is not to obtain a tax benefit.	• Targets specific ‘**known**’ arrangements of tax avoidance • Specifies the conditions and situations when SAAR will be invoked, and generally do not grant any discretion to tax authorities • Unlike GAAR, SAAR provisions are spread over the Act • **Example**: Thin capitalization rule and transfer pricing provisions

Panelist | **Sanjay Sanghvi** *Action 6 – Prevention of Treaty Abuse*

India

Indian Judicial Precedents
• **Azadi Bachao Andolan** case: the Supreme Court held that in absence of an LOB clause in the tax treaty, treaty benefit would prevail
• **Vodafone** case: while reiterating the same principle the court held that: in the **absence of LOB rules** in a tax treaty, the **tax treaty benefit cannot be denied** unless the tax authorities establish on facts that the **company has been interposed** (as the owner of shares in India) at the time of disposal of shares to a third party solely with a view **to avoid tax** and **without any commercial substance**
• **AAR No. 1128 of 2011**: A Mauritius entity sold Indian shares. Shares of the Indian entity were not really owned by the Mauritius entity, rather they were an investment made by its US parent entity. Thus considering the substance over form, benefit under India-Mauritius tax treaty was denied. (Similar view taken by Bombay High Court in case of Aditya Birla Nuvo. Currently, case is pending before Supreme Court in appeal)

Indian Tax Treaties
• Indian tax treaties with the following partners **have an LOB clause**: US, Armenia, Iceland, Mexico, Mauritius and Singapore
• Indian tax treaties with the following partners **have the PPT rule**: Kuwait, Luxembourg and Finland. India-Luxembourg tax treaty also contains a **provision for supremacy of domestic anti-abuse provisions**.
• India has signed MLI which includes PPT and LOB. India has also opted for Simplified LOB (**SLOB**) which exempts non qualified persons and entitles them to treaty benefits. Since SLOB is optional clause and most of the jurisdictions have not opted for it, PPT in MLI shall apply. PPT clause in MLI has wider scope than PPT promulgated by India under its domestic GAAR.

Response

Rodrigo Machado

Action 6

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Comments on Action 6

- Even before the BEPS project, Brazilian tax authorities have historically applied a very restrictive interpretation of its tax treaties, sometimes reaching to the point of being accused of treaty override

- For example, Brazilian tax authorities denied the benefits of the Brazil-Spain tax treaty to Spanish companies formed as *Entidades de Tenencia de Valores Extranjeros* (**ETVE**), on the grounds that such companies are not taxed in Spain and therefore the application of the treaty would lead to double non-taxation

- In another example, Brazilian tax authorities uphold that tax treaties do not prevent the levy of the Brazilian withholding tax on payments of services rendered by residents in such treaty partners, as such income does not fall within the scope of article 7 of the treaties (in opposition to the prevalent interpretation)

Comments on Action 6

- There are also several tax assessments filed by Brazilian tax authorities, sometimes with aggravated penalties and criminal consequences, disregarding treaty benefits on the grounds of lack of substance, lack of economic purposes, treaty shopping, etc.

- Further, several tax treaties entered into by Brazil (*e.g.*, with Chile) state that their application would not allow tax evasion or unintended tax benefits and, in theses cases, the treaty partners would discuss specific changes in the treaty

Action 7
Preventing the Artificial Avoidance of Permanent Establishment Status

Sanjay Sanghvi *Khaitan & Co*
Panelist

Stanley C. Ruchelman *Ruchelman P.L.L.C.*
Responding Panelist

Panelist | **Sanjay Sanghvi** *Action 7 – Avoidance of Permanent Establishment Status*

What and Why…

PE Definition Changed

- To address techniques used to avoid existence of a PE

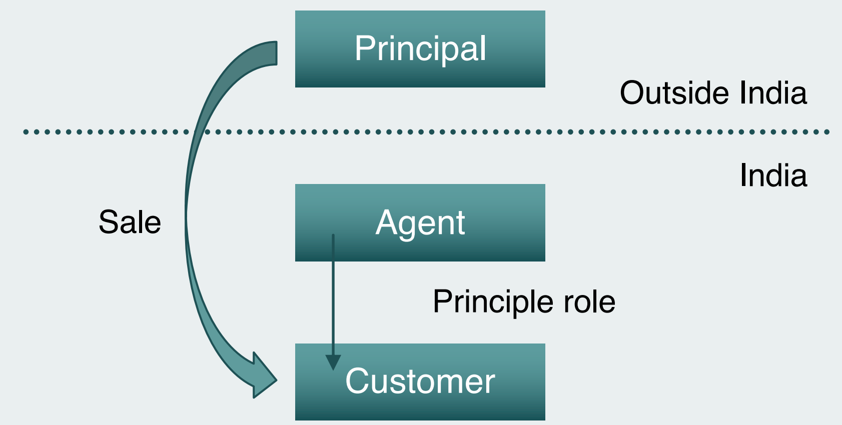
- To prevent use of certain common tax avoidance strategies (such as commissionaire agreements)

Independent Agent Art 5(6)

- Though an '**independent agent**' is closely related to the foreign enterprise on behalf of which it is acting, they are not granted a PE status.

- Albeit in India, if an independent agent/broker acts for its foreign enterprise outside its ordinary course of business, it will constitute a '**business connection**'

Commissionaire Agreements Art 5(5)



- Foreign enterprise is able to sells its products without having a PE
- For tax purposes, no sale is attributed to Indian Agent
- Therefore, profits derived from such sales is not taxable in the source state
- **Successful avoidance of Art 5(5)**: contracts concluded by the commissionaire are not binding in the hands of the foreign enterprise

Panelist | **Sanjay Sanghvi** *Action 7 – Avoidance of Permanent Establishment Status*

What and Why…

Art 5(4)	• Exceptions to the definition of PE
	  • **'preparatory or auxiliary'**
	  • Activities previously considered as 'preparatory or auxiliary' may reflect the core business activities
	  • Modified Art 5(4): ensures that each of the exceptions is restricted to activities that are otherwise of 'preparatory or auxiliary'
	• **Anti-fragmentation-rule**
	  • Combats avoidance of PE status by fragmenting a cohesive operating business into several entities
	  • Non-acceptance of argument that each part is separately engaged in 'preparatory or auxiliary' activities

Splitting Up of Contracts Art 5(3)	• Exceptions to the definition of PE: applicable to construction sites (threshold of 12 months to constitute a PE) • Related enterprises split up the contracts (for a period less than 12 months) and avoid PE status • PPT rule combats such abuse of the treaty • A more automatic rule is proposed to be used as an **alternative provision** for countries concerned with splitting-up of contracts issue: where domestic anti-abuse rules are unable to address this issue and treaties do not include PPT

India's Action

India has signed **Multilateral Instrument** (**MLI**) for implementing BEPS actions. The MLI contains the following articles dealing with PE:

MLI Articles	Particulars	India's Position
12	Artificial avoidance of PE status through commissionaire arrangements and similar strategies	**Adopted**
13	Artificial avoidance of PE status through the specific activity exemptions	**Adopted**
14	Splitting-up of contracts	**Adopted**

- Significant treaty partners of India who have **reserved the right for article 12 of the MLI** to not apply to their tax treaties: **Canada, Cyprus, Luxembourg, Singapore and the UK**
- US is not a signatory to MLI: **no effect on the India US treaty**
- India's treaty with **China, Germany and Mauritius** have **not been listed as a covered tax agreement** for MLI purposes: hence the agency PE articles under these treaties is not affected by the MLI
- India's treaty partners who have **adopted Article 12 of the MLI** and their treaty with India is **listed as covered tax agreement** include **France, Japan and the Netherlands**

Changes to Domestic Law

India & Commissionaire Agreements

- The '**Business connection**' concept under Indian tax law is akin to but wider than PE concept under treaties

- In consonance with Action Plan 7, India has expanded scope of '**business connection**' w.e.f FY 2018

- Now, business connection also constitutes activities of a person, who acting on behalf of the NR:
  - has authority to conclude, habitually concludes or plays the principal role leading to conclusion of contracts
  - Has no authority, but habitually maintains in India stock of goods for regular delivery on behalf of the NR
  - Habitually secures orders in India mainly or wholly for the NR

- **Exception**: activities in the ordinary course of business of an 'independent agent' do not constitute 'business connection'

Response Stanley C. Ruchelman

Action 7

Preventing the Artificial Avoidance of Permanent Establishment Status

Action 7

- While not a participant to the MLI, the U.S. either has or has adopted several provisions designed to prevent the artificial avoidance of a P.E. in the U.S. Model Income Tax Treaty
  - The treaty reflects the opening position of the U.S. in the treaty negotiating process
  - Broadly based on the O.E.C.D. Model Income Tax Treaty
  - Under U.S. case law, the version of the O.E.C.D. Model in effect when a treaty is negotiated is relevant in interpreting a treaty; subsequent revisions of the O.E.C.D. Model are not relevant
  - Where existing treaties are renegotiated to reflect important changes to tax law or changes in economic conditions affecting the apportionment of benefits between the treaty partners, the U.S. Model will be used

Action 7

- The 2016 U.S. Model Treaty Preamble expressly states that it does not reflect the B.E.P.S. recommendations regarding dependent and independent agents; however, it may be because U.S. practice already accepts the concept
- Paragraph 5 of Article 5 (*Permanent Establishment*) provides that a treaty enterprise is deemed to have a P.E. in the Treaty Partner State where:
  - A person
  - Other than an agent of an independent status
  - Acts on behalf of an enterprise
  - Has and habitually exercises in a Contracting State an authority to conclude contracts that are binding on the enterprise

Unless the activities of the agent are limited to preparatory or auxiliary actions

Action 7

- Under the civil law, a distinction is drawn between direct representations and indirect representations
  - In the former, the agent contracts in the name of the principal and binds the principal, but not the agent, to the third party
  - In the latter, the agent acts in its own name and binds the agent, but generally not the principal, to the third party
- In the U.S., no distinction is drawn between direct and indirect representation; the principal is bound under the arrangement with the third party

Action 7

- Under I.R.S. regulations involved in determining whether a foreign company will be taxed in the U.S. on sales of inventory to non-U.S. customers in the absence of a tax treaty, three facts must exist:
  - There must be a U.S. office
  - The office must materially participate in arranging the sale to customers outside the U.S. (with title passing outside the U.S.) and
  - A foreign office must not materially participate, as well, in arranging the sale

Action 7

- Material participation means that and office must provide:
  - A significant contribution to the realization of the income, gain, or loss
  - By being an essential economic element in its realization
- Activity that is not material includes
  - Final approval
  - Storage of the property prior to
  - Display of samples without more
  - Performance of clerical functions

Action 7

- U.S. Model provision on preparatory or auxiliary activities, is that:
  - Each of the listed activities is, by itself, preparatory and auxiliary if the activity is listed, such as storage, display, third party processing, purchasing, and gathering of information
  - If more than one activity is performed, a P.E. will not exist if the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character
- So when are a grouping of activities not of a preparatory or auxiliary character?
  - Possibly, when, other than overall management, the business is entirely conducted by independent agents who manufacture, store, sell, and deliver the product

Action 7

- Regarding the splitting of contracts, the U.S. Model Treaty contains the concept of aggregation when they relate to
  - Building sites
  - Construction or installation projects,
  - Installation or drilling rigs or ships used for the exploration or exploitation of the sea bed, ,subsoil and natural resources

Action 12
Mandatory Disclosure Rules

Rodrigo Machado *Ulhôa Canto, Rezende e Guerra Advogados*
Panelist

Paul Kraan *Van Campen Liem*
Responding Panelist

Main Goals

- Timely identification of aggressive and abusive tax planning
- Enhance information flow among tax authorities and tax policy makers worldwide
- Curb tax planning based on information asymmetry
- Curb taxpayers to enter into aggressive schemes and promoters to offer them

Ideal Characteristics of a Mandatory Disclosure Regime

- Simple and clear
- Low additional compliance costs
- Effective and accurate in providing information
- Flexible and dynamic to apply to new schemes

Panelist | **Rodrigo Machado** *Action 12 – Mandatory Disclosure Rules*

Challenges

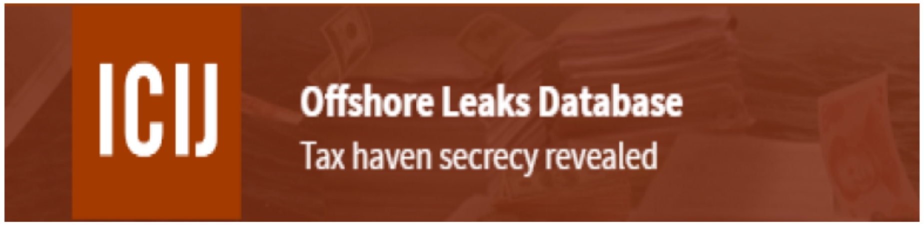
- How to balance the countries' need for information with the compliance burdens for taxpayers?

"Don't let the *compliance* tail wag the investment dog"

Panelist | **Rodrigo Machado** *Action 12 – Mandatory Disclosure Rules*

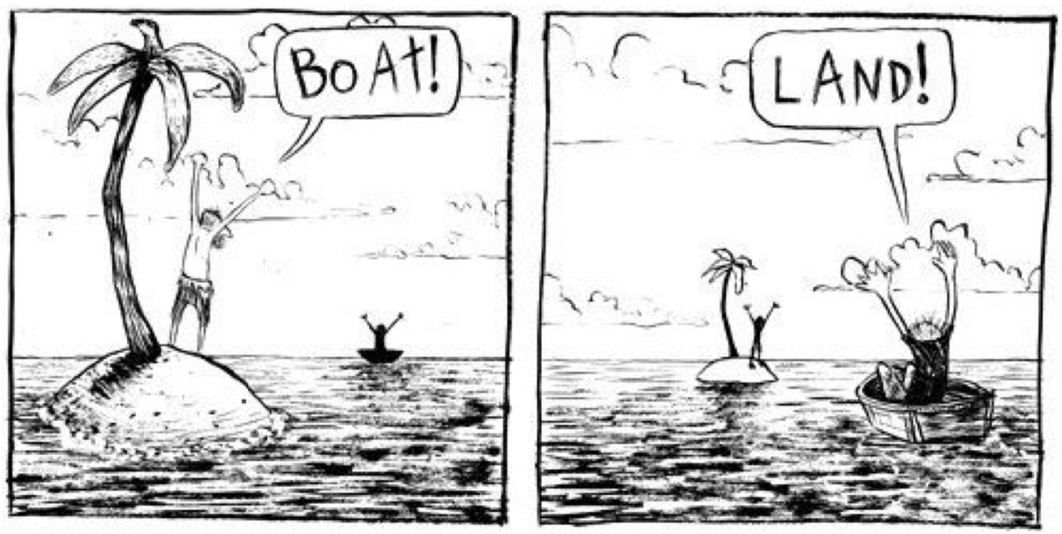
Challenges

- How to assure confidentiality on information provided by the taxpayers and promoters?



Challenges

- How to characterize a tax planning as aggressive or abusive, especially involving cross-border situations?

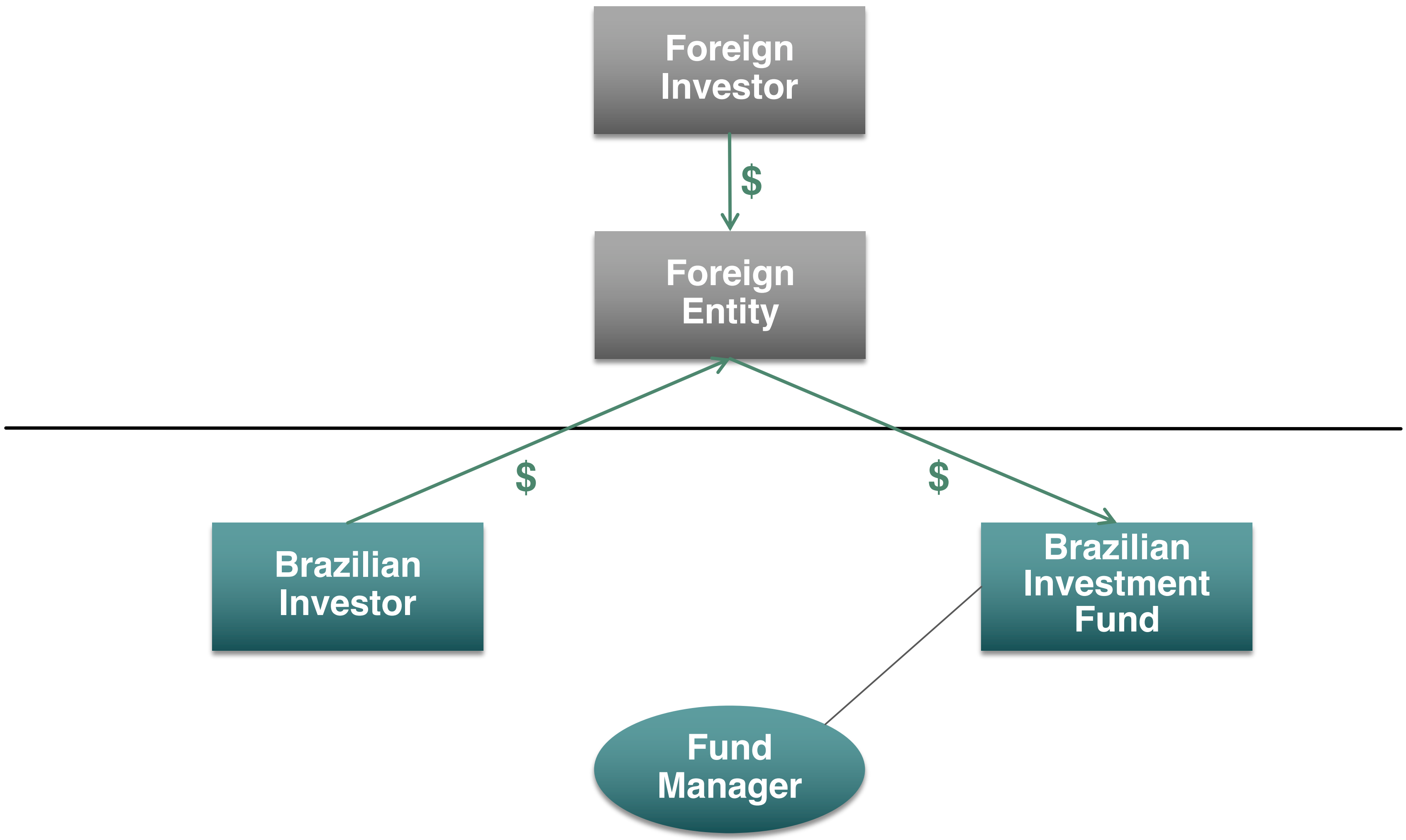


Model Mandatory Disclosure Rules

- In order to deal with the such challenges, OECD issued on March 9, 2018 the Model Mandatory Disclosure Rules for Common Reporting Standard (**CRS**) Avoidance Arrangements and Opaque Offshore Structures, with the following key elements:
  - arrangements that are required to be disclosed
  - persons required to disclose such arrangements
  - triggers for the disclosure obligation
  - description of the information to be disclosed
  - penalties and other mechanisms to address non-compliance

Panelist | **Rodrigo Machado** *Action 12 – Mandatory Disclosure Rules*

Case Analysis



Panelist | **Rodrigo Machado** *Action 12 – Mandatory Disclosure Rules*

Case Analysis

- Provided some conditions are met, foreign investors are entitled to tax benefits in Brazil
- There is a huge controversy on whether such tax benefits apply to foreign companies held by ultimate beneficial owners (**UBOs**) resident in Brazil
- Recent rules impose foreign entities with Brazilian investments to disclose their UBOs to Brazilian Revenue Service (**BRS**)
- BRS issued some tax assessments against Brazilian fund managers on the grounds that they have failed to disclose the UBOs of the foreign entities that invest in the funds managed by them

Response Paul Kraan

Action 12

Mandatory Disclosure Rules

MDR: EU Directive

- Council Directive (EU) 2018/822 of 25 May 2018
- Technically 6th amendment of Directive 2011/16/EU on Administrative Cooperation (**DAC**) in the field of taxation
- AKA '**Tax Intermediaries Directive**' and referred to as '**DAC 6**'
  - ***mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements***
- Published in EU's Official Journal on the 5th of June
  - effective after 20 days

MDR: EU Directive – Who's an Intermediary?

- Person responsible for designing or promoting cross-border tax arrangements
  - resident/based in EU Member State; and/or
  - registered with professional association related to legal/tax/consultancy services in EU Member State.
- Broad definition of intermediary covers:
  - accountants, lawyers and tax advisors
  - banks, financial advisors, other consultants and service providers
- If intermediary is non-EU or bound by professional privilege or secrecy, obligation shifts to taxpayer

MDR: EU Directive – What's Reportable?

- Requirement to disclose information on:
  - Potentially aggressive tax planning arrangements
  - with cross-border dimension
- Full list of hallmarks provided, but what is '**potentially aggressive**'?
- Sanction for not reporting is subject to national competence

MDR: EU Directive – Implementation

- Member States must implement rules by 31 December 2019
- Disclosure requirements apply as from 1 July 2020
  - Initial automatic exchange of information expected by 31 October 2020
- Effectively all arrangements in place as from 25 June 2018 reportable
  - **First step** implemented between 25 June 2018 and 31 December 2019

Action 13
Transfer Pricing Documentation & Country-by-Country Reporting

Rodrigo Machado *Ulhôa Canto, Rezende e Guerra Advogados*
Panelist

Paul Kraan *Van Campen Liem*
Responding Panelist

Main Goals

- Harmonize rules on transfer pricing documentation
- Enhance transparency for tax administration
- Disclose of information of multinational enterprises (**MNEs**) on their global allocation of income, economic activity and taxes paid according to a common template

Transfer Pricing Documentation Three-Tiered Approach

- **Master file** – high-level information regarding their global business operations and transfer pricing policies, available to all involved jurisdictions

- **Local file** – detailed information to be provided to a specific jurisdiction

- **Country-by-Country Report (CbC)** – filed as from 2016 by MNEs with consolidated group revenue equal or to exceeding €750 million, for all jurisdictions in which they do business, with information on business activities revenues, tax paid, number of employees, stated capital, retained earnings and tangible assets

Questions on Transfer Pricing in General

- How to harmonize different local file documentation requirements within the same MNE, *e.g.*, the very detailed "**300-page report**" required in Austria with the straight forward information included in the Brazilian tax return?

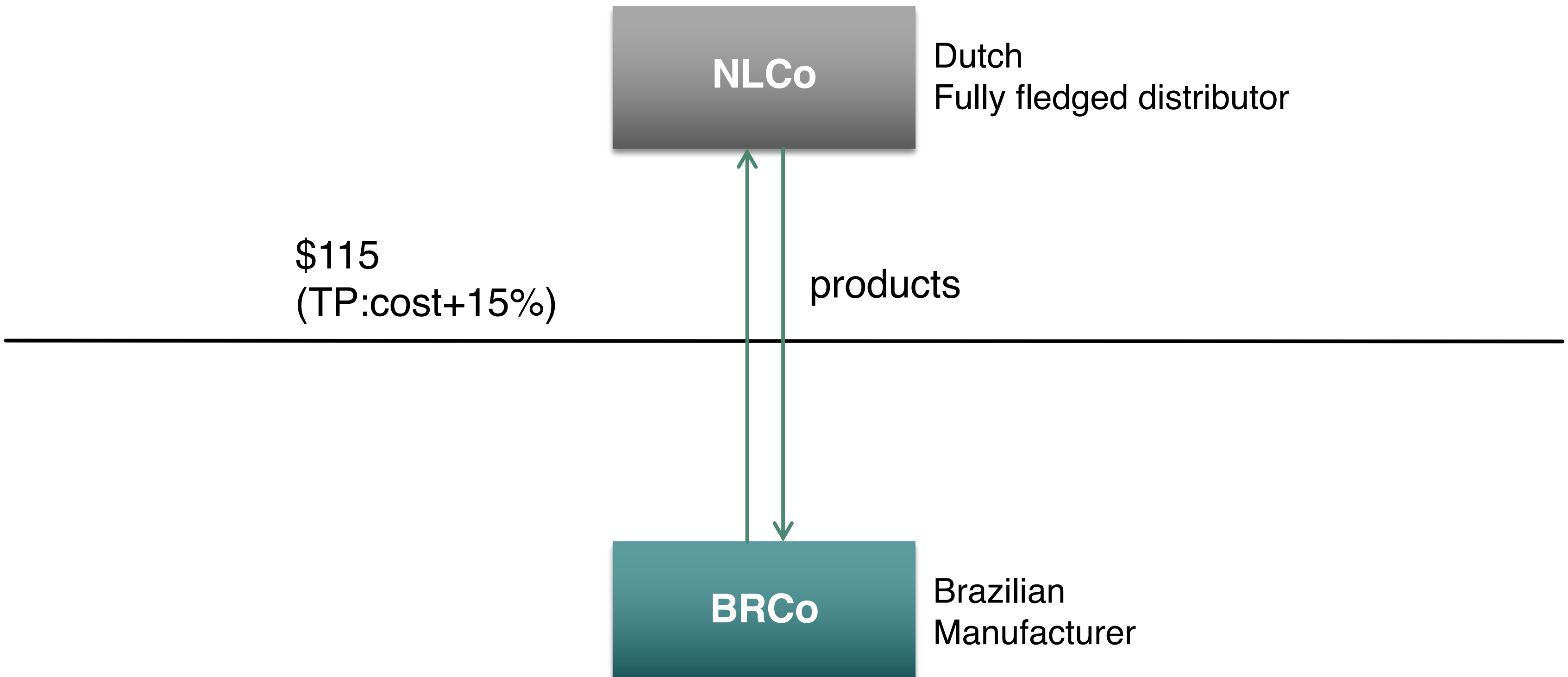
- What would be the best approach? The accuracy and complexity of methods based on comparables or the inaccuracy and practicality of fixed margin methods?

- How to neutralize specific features of the domestic law (berry ratio, informal capital, presumed profit regimes, etc.) when assessing the applicable transfer price?

Questions on CbC Reports

- Is there any limitation on the use by tax authorities of the information provided in CbC Reports?
- Could the information be used to uphold a tax assessment based on treaty shopping or to challenge the substance of a specific entity?
- The CbC Report shall adopt the currency of the MNE's parent company. What adjustments must be done if the MNE as a group applies a different functional currency?

Case Analysis



Case Analysis

- **Assumptions**:
  - NLCo and BRCo belong to the same MNE, subject to CbC Report
  - BRCo applies a transfer pricing of cost plus 15%
  - In accordance with information provided in the CbC Report, NLCo is considered by Dutch tax authorities as a fully fledged distributor
  - As a consequence, Dutch tax authorities impose a transfer pricing equal to cost plus 5%, leading to an adjustment in NLCo

Case Analysis

- **Outcome**:
  - The adjustment in NLCo will lead to an increase in its income tax basis
  - As the tax treaty between the NL and BR does not allow a secondary adjustment, BRCo will not be allowed to reduce its tax basis accordingly
  - The use of the information provided in the CbC Report and the asymmetry between the transfer pricing methods applied by the two jurisdictions will lead to an undesired double taxation

Response Paul Kraan

Action 13

Transfer Pricing Documentation & Country-by-Country Reporting

Responding Panelist | **Paul Kraan** *Action 13 – Transfer Pricing Documentation & CbC Reporting*

Issues Relating to Entities to be Reported in CbC Report

- Application CbC reporting rules to investment funds
- Application CbC reporting rules to partnerships
- Determining the existence of and membership of a group
  - Accounting principles/standards
- Treatment of major shareholdings
- Treatment of an entity owned and/or operated by more than one unrelated MNE Groups

Non-Compliance with Confidentiality, etc.

- Confidentiality, consistency and appropriate use
  - Necessary conditions underpinning obtaining and use of CbC reports
- Peer review
- Consequences of non-compliance depend on terms of QCAA
  - temporary suspension exchange of information
  - role of taxpayer?

Action 15

Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Stanley C. Ruchelman *Ruchelman P.L.L.C.*
Panelist

Sanjay Sanghvi *Khaitan & Co*
Responding Panelist

Panelist | **Stanley Ruchelman** *Action 15 – Multilateral Instrument*

After the teams building the railroad meet, someone must hammer the final bolt

Action 15

- The MLI allows jurisdictions to swiftly implement measures to strengthen existing tax treaties to protect governments against tax avoidance strategies, including
  - **Action 2** *Hybrid Mismatches*
  - **Action 6** *Prevention of Treaty Abuse*
  - **Action 7** *Avoidance of Permanent Establishment Status*
  - **Action 14** *Improving Dispute Resolution*
- To address BEPS in a reasonable timeframe, the MLI is a mechanism to facilitate swift implementation in actual treaties
- Over 3,000 income tax treaties exist; over 1,200 affected by the MLI

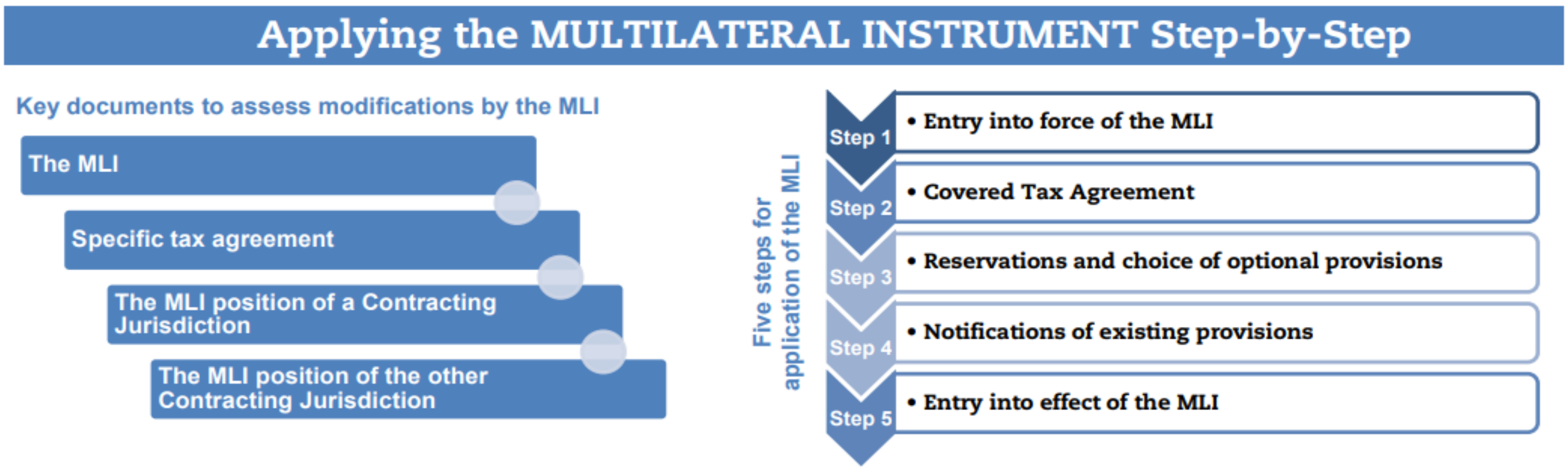
Action 15

- The MLI co-exists with bilateral tax treaties; it applies alongside existing tax treaties, modifying their application
  - To the extent the MLI as adopted by a country with regard to a specific provision differs from an existing treaty, the latter in time controls
- Other options included:
  - The use of a "**self-standing instrument**" that would wholly supersede bilateral tax treaties, governing the relationship between all the parties, whether or not they have concluded bilateral tax treaties among themselves
    - This was viewed as overbroad
  - The use of an instrument whose sole purpose would be to operate like a bundle of "**amending protocols**" that precisely amend the varying language of each the 1,200 tax treaties affected
    - This was more technically complex and less efficient

Action 15

- As of 24 January 2018, the MLI has been signed by 76 signatories, covering 78 jurisdictions
  - Additional jurisdictions have expressed their intention to sign
  - An up-to-date list of the Signatories is available at oe.cd/mli
- The provisional MLI Position of each Signatory indicates:
  - The tax treaties it intends to cover,
  - The options it has chosen, and
  - The reservations it has made.
- Signatories can amend their MLI Positions until ratification
  - Even after ratification, Parties can choose to opt in with respect to optional provisions or to withdraw reservations
  - Signatories that have accepted a provision and provided notice, cannot opt out at a later time, except through a renegotiation of its treaties

Action 15


Applying the MULTILATERAL INSTRUMENT Step-by-Step
Key documents to assess modifications by the MLI
The MLI
Specific tax agreement
The MLI position of a Contracting Jurisdiction
The MLI position of the other Contracting Jurisdiction
Five steps for application of the MLI
Step 1
• Entry into force of the MLI
Step 2
• Covered Tax Agreement
Step 3
• Reservations and choice of optional provisions
Step 4
• Notifications of existing provisions
Step 5
• Entry into effect of the MLI

Action 15

Step 1 • Entry into force of the MLI: Verify if the MLI has entered into force

(i) Is the MLI itself in force? (Have five jurisdictions deposited the instrument of ratification, acceptance or approval?)	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply.*	More information:
(ii) Is the MLI in force for both Contracting Jurisdictions to the tax agreement? (Are both Contracting Jurisdictions Parties to the MLI?)	☐ YES: *The MLI could apply to the tax agreement. Go to **Step 2*** ☐ NO: *The MLI does not apply.*	▪ Article 34 ▪ Explanatory Statement, para. 320-323

Step 2 • Covered Tax Agreement: Verify if the tax agreement is a Covered Tax Agreement

(i) Do both Contracting Jurisdictions list the tax agreement in their MLI positions as an agreement to be covered by the MLI?	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply to the tax agreement.*	More information:
(ii) Is the tax agreement in force?	☐ YES: *The MLI can apply to the tax agreement (The tax agreement is a Covered Tax Agreement). Go to **Step 3*** ☐ NO: *The tax agreement will be a Covered Tax Agreement after entry into force.*	▪ Article 2(1)(a) ▪ Explanatory Statement, para. 25-33 ▪ Flowchart on Article 2

Action 15

Step 3

- **Reservations and choice of optional provisions: Identify which MLI provisions apply**

**This step must generally be followed to identify which MLI provisions apply to a Covered Tax Agreement.
For detailed information and specificities of each Article, please see the MLI flowcharts.**

Reservations: Does either Contracting Jurisdiction to the Covered Tax Agreement make a reservation on the application of a provision of the MLI?	☐ YES: *The MLI provision for which the reservation is made does not apply and does not modify the Covered Tax Agreement.* ☐ NO: *The MLI Article could apply and modify the Covered Tax Agreement.*	More information: ▪ Each MLI provision and its Explanatory Statement ▪ Flowchart on each Article

Note: Each Contracting Jurisdiction is allowed to make a reservation unilaterally, while the effect of reservation applies symmetrically (see Article 28(3)). Accordingly, a reservation made by a Contracting Jurisdiction with respect to a provision generally blocks the application of the provision, whether or not the other Contracting Jurisdiction has also made the reservation.

Optional provisions: Do both Contracting Jurisdictions to the Covered Tax Agreement choose to apply an optional provision of the MLI?	☐ YES: *The optional provision chosen could apply and modify the Covered Tax Agreement.* ☐ NO: *The optional provision does not apply.*	More information: ▪ Each MLI provision and its Explanatory Statement ▪ Flowchart on each Article

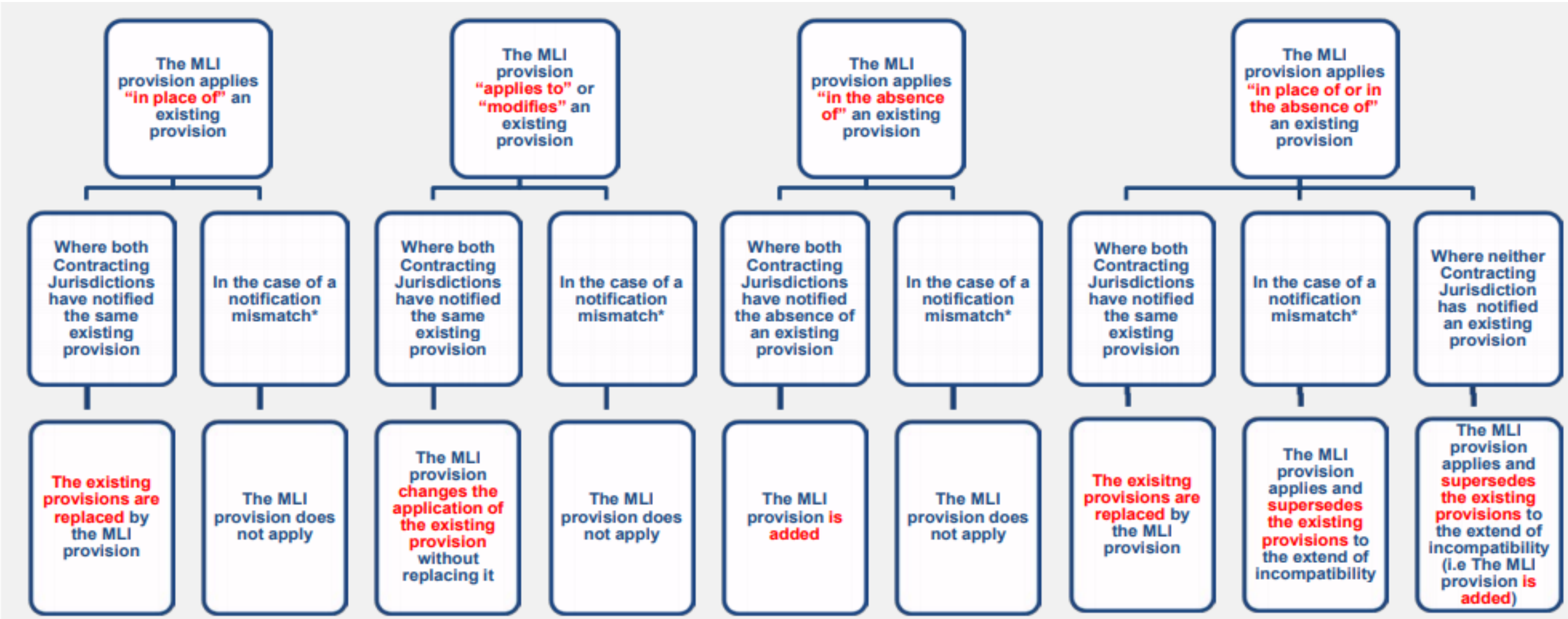
Note: Contrary to reservations, both Contracting Jurisdictions are required to choose to apply the same optional provision in order to apply the provision (except for Article 5 and 23(5)).

Action 15

Step 4

- **Notifications of exsiting provisions: Identify which existing provisions are modified**

To ensure clarity and transparency about the application, the MLI requires Parties to notify existing provisions to be modified by the MLI provision. In addition, each Article contains provisions describing details on how the applicable MLI provisions modify a Covered Tax Agreement (compatibility clauses). The effect of notificaitons depends on the type of compatibility clause which could provide that the MLI provision applies "in place of", "applies to" or "modifies", "in the absence of", or "in place of or in the absence of" (see also the Explanatory Statement, para. 15-18).



** Notification mismatches are cases where one Contracting Jurisdiction has notified an existing provision but the other has not, or where the Contracting Jurisdictions have made a different notification with respect to existing provisions in their MLI positions (except for minor differences).*

Action 15

Step 5

- **Entry into effect of the MLI: Verify if the MLI provisions have effect**

The MLI provisions will generally have effect in the Contracting Jurisdictions with respect to a Covered Tax Agreement at different moment with respect to taxes withheld at source and with respect to all other taxes levied by a Contracting Jurisdiction.

<u>With respect to taxes withheld at source:</u>

As of the latest date on which the MLI enters into force for each of the Contracting Jurisdictions → Go to the 1st day of the next calendar year → MLI provisions have effect

<u>With respect to all other taxes levied by a Contracting Jurisdiction:</u>

As of the latest date on which the MLI enters into force for each of the Contracting Jurisdictions → Expiration of a period of 6 months → MLI provisions have effect for taxes levied with respect to taxable periods beginning as of that moment

More information:

- Articles 35 and 36
- Explanatory Statement, para. 324-350

Note: The MLI provides exceptions to the above general rules of entry into effect. Please see Articles 35 and 36 as well as the MLI positions.

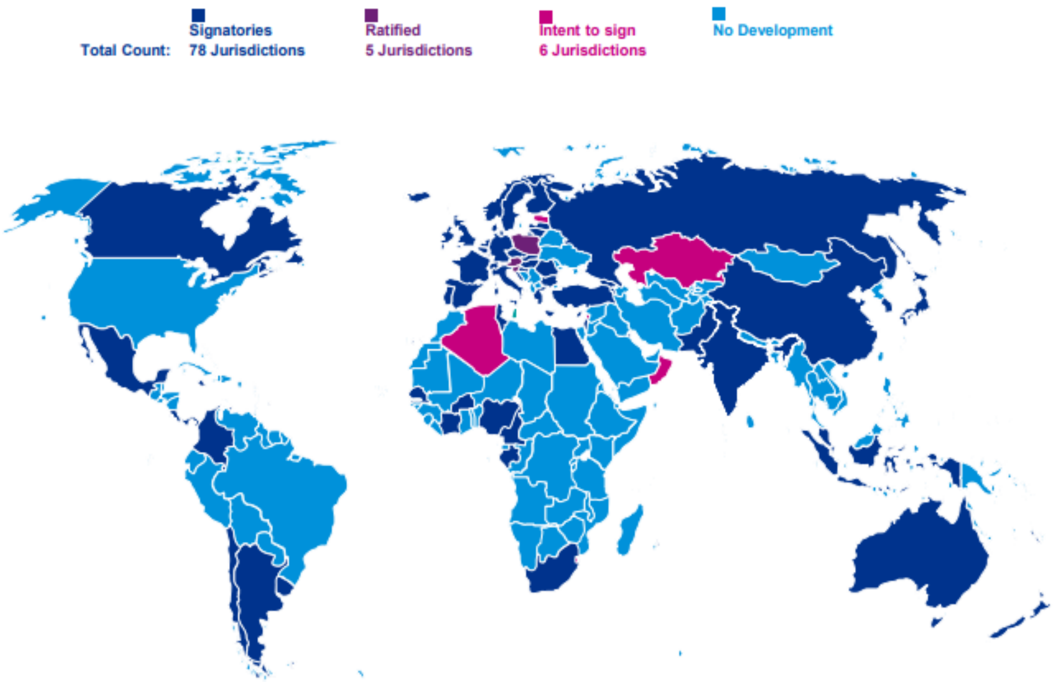
Action 15

Multilateral Instrument – Signatories

- Andorra
- Argentina
- Armenia
- Australia
- Austria
- Barbados
- Belgium
- Bulgaria
- Burkina Faso
- Cameroon
- Canada
- Chile
- China
- Colombia
- Costa Rica
- Cote d'Ivoire
- Croatia
- Curacao
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Fiji
- Finland
- France
- Gabon
- Georgia
- Germany
- Greece
- Guernsey
- Hong Kong
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Isle of Man
- Israel
- Italy
- Jamaica
- Japan
- Jersey
- Korea
- Kuwait
- Latvia
- Liechtenstein
- Lithuania
- Luxembourg
- Malaysia
- Malta
- Mauritius
- Mexico
- Monaco
- Netherlands
- New Zealand
- Nigeria
- Norway
- Pakistan
- Panama
- Poland
- Portugal
- Romania
- Russia
- San Marino
- Senegal
- Serbia
- Seychelles
- Singapore
- Slovakia
- Slovenia
- South Africa
- Spain
- Sweden
- Switzerland
- Tunisia
- Turkey
- United Kingdom
- Uruguay

Intent to sign:

- *Algeria*
- *Estonia*
- *Kazakhstan*
- *Lebanon*
- *Oman*
- *Swaziland*



Source: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf

Action 15

Multilateral Instrument – Americas

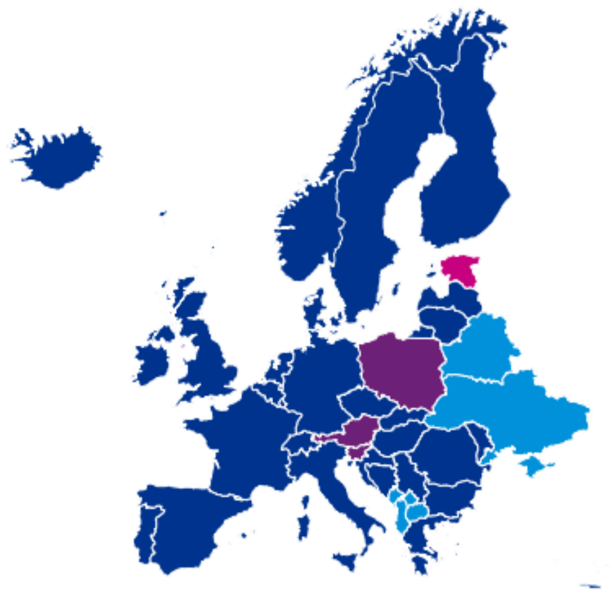
This summary depicts initial elections made by the listed countries with respect to Article 7 – Prevention of Treaty Abuse, Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies, Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions and Article 18 – Arbitration

Source: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf

Action 15

Multilateral Instrument – Europe

This summary depicts initial elections made by the listed countries with respect to Article 7 – Prevention of Treaty Abuse, Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies, Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions and Article 18 – Arbitration



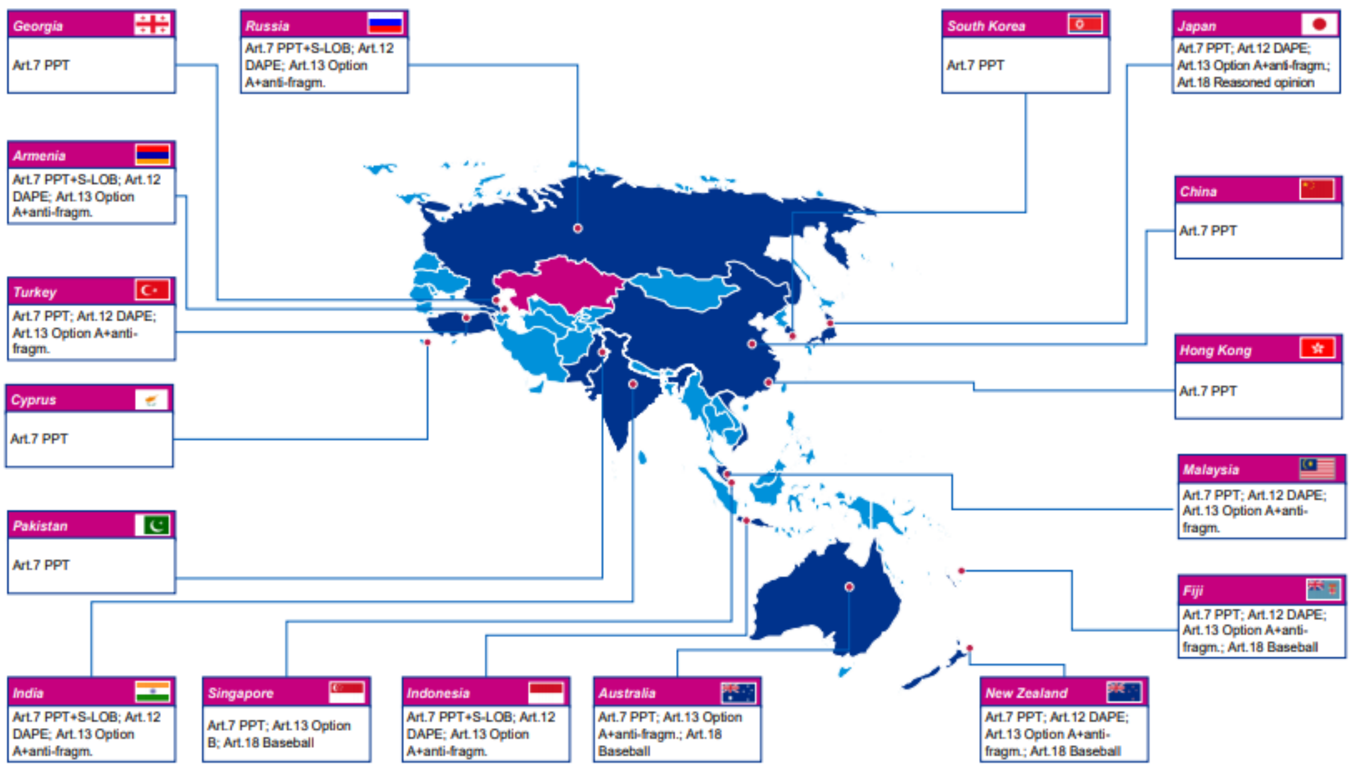
Andorra	Art.7 PPT; Art.18 Reasoned Op.
Czech Republic	Art.7: PPT
Austria	Art.7 PPT; Art.13 Option A; Art.18 Baseball
Denmark	Art.7 PPT
Belgium	Art.7 PPT; Art.13 Option B+anti-fragm.; Art.18 Baseball
Finland	Art.7 PPT; Art.18 Baseball
Bulgaria	Art.7 PPT+S-LOB
France	Art.7 PPT; Art.12 DAPE; Art.13 Option B+anti-fragm.; Art.18 Baseball
Croatia	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.
Germany	Art.7 PPT; Art.13 Option A; Art.18 Baseball
Guernsey	Art.7: PPT
Greece	Art.7 PPT; Art.18 Reasoned Opinion
Hungary	Art.7 PPT
Iceland	Art.7 PPT
Ireland	Art.7 PPT; Art.13 Option B+anti-fragm.; Art.18 Baseball
Isle of Man	Art.7 PPT
Italy	Art.7 PPT; Art.13 Option A+anti-fragm.; Art.18 Baseball
Latvia	Art.7 PPT
Lithuania	Art.7 PPT; Art.12 DAPE; Art.13 Option B+anti-fragm.
Malta	Art.7 PPT; Art.18 Reasoned Opinion
Jersey	Art.7 PPT
Liechtenstein	Art.7 PPT; Art.18 Baseball
Luxembourg	Art.7 PPT; Art.13 Option B; Art.18 Baseball
Netherlands	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.; Art.18 Baseball
Monaco	Art.7 PPT
Norway	Art.7 PPT+LOB; Art.12 DAPE; Art.13 Option A+anti-fragm.
Slovakia	Art.7 PPT+S-LOB; Art.12 DAPE; Art.13 Option A+anti-fragm.
Poland	Art.7 PPT+LOB
Slovenia	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.; Art.18 Reasoned Opinion
Portugal	Art.7 PPT; Art.13 only anti-fragm.; Art.18 Reasoned Opinion
Spain	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.; Art.18 Baseball
Romania	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.
Sweden	Art.7 PPT; Art.18 Reasoned Opinion
San Marino	Art.7 PPT; Art.13 Option B+anti-fragm.
Switzerland	Art.7 PPT; Art.18 Baseball
Serbia	Art.7 PPT; Art.12 DAPE; Art.13 Option A+anti-fragm.
U.K.	Art.7 PPT; Art.13 only anti-fragm.; Art.18 Baseball

Source: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf

Action 15

Multilateral Instrument – Asia Pacific

This summary depicts initial elections made by the listed countries with respect to Article 7 – Prevention of Treaty Abuse, Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies, Article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions and Article 18 – Arbitration



Source: http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf

Action 15

- No action has been taken in the U.S. regarding the MLI
- Under the U.S. Constitution, the Senate must give its approval to treaties
  - The Senate Foreign Relations Committee has jurisdiction over income tax treaties
  - The Senate Finance Committee has jurisdiction over all other tax matters in the Senate.
- No income tax treaty that has been signed in 2010 or later has received Senate approval
  - Under Senate rules, any Senator may place a "**hold**" on a motion for a vote, preventing it from reaching the Senate floor
  - Senator Rand Paul of Kentucky has held up each tax treaty and protocol, objecting to the automatic exchange of information provisions that are in the treaties
    - The opposition is directed to the bulk exchange of information on U.S. citizens and residents

Response

Sanjay Sanghvi

Action 15

Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Background

- **Action 15**: *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*
- Focuses on addressing artificial avoidance of PE, splitting of contracts, treaty abuse
- MLI conceived to address changes to more than 3000 bilateral tax treaties to align them with BEPS Project
- Developed by an ad-hoc group of 100 countries, which was endorsed by G20 Finance Ministers and Central Bank Governors in February 2015 (India was one of the members of the ad-hoc group)
- Operate alongside covered existing bilateral tax treaties

Background

- Revenue loss through treaty abuse and BEPS addressed
- Treaty Shopping (otherwise not restricted by Covered Tax Agreements) now plugged
- Profits taxed where substantive economic activities generating profits are carried out
- Opened for signature on 31 December 2016, Joint signing ceremony on 7 June 2017
- Flexibility to exclude a DTAA
- Binding upon ratification
- Final lists for both (*i.e.*, CTAs and Reservations) will be submitted by India at the time of submission of instrument of ratification

Responding Panelist | **Sanjay Sanghvi** *Action 15 – Multilateral Instrument*

India's Perspective

India's Participation

- India's signing of the MLI – indicates her commitment and proactive approach in combating BEPS
- India is a member of the ad hoc Group responsible for developing the MLI
- India is a '**Key Partner**' for information at the Participation Plan Committee on Fiscal Affairs constituted by the OECD

India's Reservations

Part VI of the Convention	**Arbitration**: not adopted
Article 3	**Transparent Entities**: ***not to apply to its Covered Tax Agreements*** (**CTAs**)
Article 5	**Application of Methods for Elimination of Double Taxation**: ***not to apply with respect to all of its CTAs***
Article 8	**Dividend Transfer Transaction**: ***not to apply to its CTAs*** to the extent that the provisions described in Article 8(1) already include a minimum holding period longer than 365 days
Article 16	**Mutual Agreement Procedure 'MAP'**: ***adopted the minimum standards*** prescribed under dispute resolution by allowing MAP access in the resident state and by implementing a bilateral notification process
Article 35	**Entry into Effect**: has replaced the timelines prescribed

India's Perspective

Simplified LOB (SLOB)
• India has chosen to additionally apply SLOB
• SLOB provides an objective determination to deny treaty benefits, along with the mandatory minimum standard of the principal purpose test (**PPT**) to counter treaty shopping

Permanent Establishment
• India has opted for a wider scope of dependent agency PE to include activities of an agent playing a principal role in concluding contracts even though such contracts are formalized abroad or such activities of an agent who claims to be independent even though he is working exclusively or almost exclusively for closely-related enterprises. (*Daikin Japan ruling of Indian tax tribunal*)
• India adopts that the specific activity exemption from creating a PE is available, subject to fulfilment of preparatory or auxiliary conditions.
• India has not opted to implement changes related to the granting of treaty benefits to fiscally transparent entities with respect to substituting '**place of effective management rule**' with the '**competent authority rule**' for resolving the issue of dual residency of non-individuals.

Important Notice

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.

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- He is a member of the Swedish Bar Association, the International Bar Association, the International Fiscal Association, and the New York State Bar Association, where he is co-chair of the Swedish Chapter. He is a member of the reference groups on taxes and CSR to the ICC Sweden.