BEPS/EU ATAD answer to Panama Papers: CFC rules

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The OECD BEPS Project

SCOPE

American Chamber of Commerce to the European Union (AmCham EU)

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OBJECTIVES

ACTION		OBJECTIVES
1	Address the tax challenges of the digital economy	• Identify the main difficulties that the digital economy poses for the application of international tax rules and develop options to address them
2	Neutralise the effects of hybrid mismatch arrangements	• Develop model treaty provisions and domestic rule recommendations to neutralise the effect of hybrid instruments and entities
3	Strengthen CFC rules	• Develop recommendations regarding the design of controlled foreign company rules
4	Limit base erosion via interest deductions and other financial payments	• Recommend best practice rules to limit "excessive" interest deductions
5	Counter harmful tax practices (taking a/c of transparency & substance)	• Revamp the work on HTPs (priority on rulings transparency and requiring substantial activity for preferential regimes)
6	Prevent treaty abuse	• Model treaty provisions & domestic rules to prevent treaty benefits in inappropriate circumstances
7	Prevent the artificial avoidance of PE status	• Changes to definition of PE to prevent artificial avoidance of PE status

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OBJECTIVES

ACTION			OBJECTIVES
8	Assure that pricing outcomes are in line with value creation:	Intangibles	• Develop rules to prevent BEPS on transfers / pricing of intangibles and intangible related returns (including CCAs and HTVIs)
9		Risk and capital	• Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to group members
10		Other high risk transactions	• Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties
11	Collect and analyse data on BEPS and the actions to address it		• Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis
12	Require taxpayers to disclose aggressive tax planning arrangements		• Recommendations on the design of mandatory disclosure rules for aggressive or abusive transactions
13	Re-examine TP Documentation incl. Country by Country Reporting		• CBCR to enhance transparency + two tier approach (Master/ Country File) to TP documentation
14	Make dispute resolution mechanisms more effective		• Develop solutions to address obstacles that prevent countries from solving disputes under MAP, inc the absence of arbitration provisions and denial of MAP / arbitration access
15	Develop a multilateral instrument		• Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions to implement BEPS recommendations and amend bilateral tax treaties

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WHAT HAS JUST HAPPENED?

- "Final" Deliverables approved by the Committee on Fiscal Affairs (CFA) on 22 September and published on 5 October 2015. Endorsed by the G20 Finance Ministers in Lima on 8 October. G20 Heads of Govt. to approve in November
- Many non-consensus issues remain
- Deliverables consist of:
  - *Revisions to OECD Model Treaty and Guidance (Actions 7, 8, 9, 10) – some (TPG) self-implementing in some countries*
  - *Agreed minimum standards where multilateral implementation was essential for success (Actions 5, 6, 13, and 14)*
  - *Guidance and best practice for domestic rules to allow countries to protect their own tax bases as they see fit (Actions 2, 3, 4, 12)*
  - *Analytical reports with commitment to revisit (Actions 1, 11, 15)*
- Additional multilateral work required, alongside domestic implementation

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FINAL RECOMMENDATIONS

ACTION		RECOMMENDATIONS SUMMARY
1	Address the tax challenges of the digital economy	• No special recommendations, though countries can act unilaterally (e.g. WHT)
2	Neutralise the effects of hybrid mismatch arrangements	• Automatic primary/secondary rules. FS exclusion up to individual countries
3	Strengthen CFC rules	• "Building blocks" seek to ensure rules effectively meet policy objectives
4	Limit base erosion via interest deductions and other financial payments	• Deductible in range 10-30% EBITDA. Groupwide safe harbour(s)
5	Counter harmful tax practices (taking a/c of transparency & substance)	• Minimum standard of nexus for Patent Box regimes; automatic rulings exchange framework
6	Prevent treaty abuse	• Optionality of LOB, or simplified LOB + PPT, or PPT
7	Prevent the artificial avoidance of PE status	• New "principal person" test. Changes to "prep & aux"; independent agent; contract splitting. Attribution of profit guidance to follow in 2016

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FINAL RECOMMENDATIONS

ACTION			RECOMMENDATIONS SUMMARY
8	Assure that pricing outcomes are in line with value creation:	Intangibles	• Owners must have financial capacity + ability to bear risks, or lose return • Ex post outcome may be used by authorities if risks not considered ex ante. CCA's allowed, but must have substance = "mutual benefit" • Elective cost plus 5% approach, with limitations
9		Risk and capital	
10		Other high risk transactions	
11	Collect and analyse data on BEPS and the actions to address it		• Insufficient data. Estimate BEPS at 4%-10% of global CT ($100bn - $240bn)
12	Require taxpayers to disclose aggressive tax planning arrangements		• Modular framework of guidance and best practices for Disclosure regimes
13	Re-examine TP Documentation incl. Country by Country Reporting		• CBCR sent to parent (or surrogate) country, distributed under EOI mechanisms • Consistency of Local File and Master File contents through best practices
14	Make dispute resolution mechanisms more effective		• Min. MAP standards; 20 countries also agree to Mandatory Binding Arbitration
15	Develop a multilateral instrument		• c.90 countries to work together to complete in 2016

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FINAL REPORT ON CONTROLLED FOREIGN COMPANIES (Action 3)

- CFC rules tax parent companies based on some or all of the income of some or all of their foreign subsidiaries.

- There are many different policy considerations when designing CFC rules:
  - Deterrent effect
  - **Interaction with Transfer Pricing Rules**
  - Being effective without undue administrative burden
  - Avoiding double taxation

- The OECD Report specifically notes that under EU jurisprudence:
  - *…the ECJ has stated that <u>CFC rules</u> … justified by the prevention of tax avoidance <u>must 'specifically target wholly artificial arrangements</u> which do not reflect economic reality and whose only purpose would be to obtain a tax advantage'*

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FINAL REPORT ON CONTROLLED FOREIGN COMPANIES (Action 3)

- The following "building blocks" are recommended as comprehensive considerations for those countries wishing to adopt effective CFC rules:
    - CFC definition
    - Exemptions and threshold
    - Definition of income
    - Computation of income
    - Attribution of income
    - Prevention of double taxation

- Each of these "building blocks" should be considered alongside the policy objectives and existing tax rules of the implementing territory

The European Union

BEPS IMPLEMENTATION

- In January 2016, the European Commission launched its Anti-Tax Avoidance Package:

Anti-Tax Avoidance Directive	Recommendation on Tax Treaties	Revisions to Directive on Administrative Cooperation (CbCR)	Communication on External Strategy

- In addition, following public consultation, in April 2016 the European Commission also released a proposal for amending the Accounting Directive to ensure public reporting of some Country by Country information.

The European Union

ANTO TAX AVOIDANCE DIRECTIVE

- The Draft Anti-Tax Avoidance Directive (ATAD) would, if implemented, mandate that all Member States introduce, as a minimum:
    - Controlled Foreign Company Rules
    - Switchover Clause
    - Interest Limitation (based on EBITDA)
    - Exit Taxation
    - Anti-Hybrid Rules
    - General Anti Abuse Rule
- None of these measures were mandated by the OECD (three were not even included in recommendations)
- For the three that were included in OECD recommendations, the ATAD is not aligned with these recommendations
- The ATAD is still being negotiated and it remains unclear which elements will remain, or in what form.
- However, there is political desire to approve a Directive in June.

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POTENTIAL ISSUES WITH MANDATING CFC RULES WITHIN EUROPE

- It was recognised at the OECD that there are no standard CFC rules which will work effectively in different countries
- Arbitrary inclusion based on Member State tax rate.
- Practical concerns with the Commission's approach include:
    - Multiple tiers of EU companies
    - Taxation of active business income
    - "Effective Tax Rate" is an inappropriate metric
    - Creditable taxes
- Movements away from the international consensus to tax profits where value is created causes particular concerns for capital importing EU countries who are competing internationally for FDI

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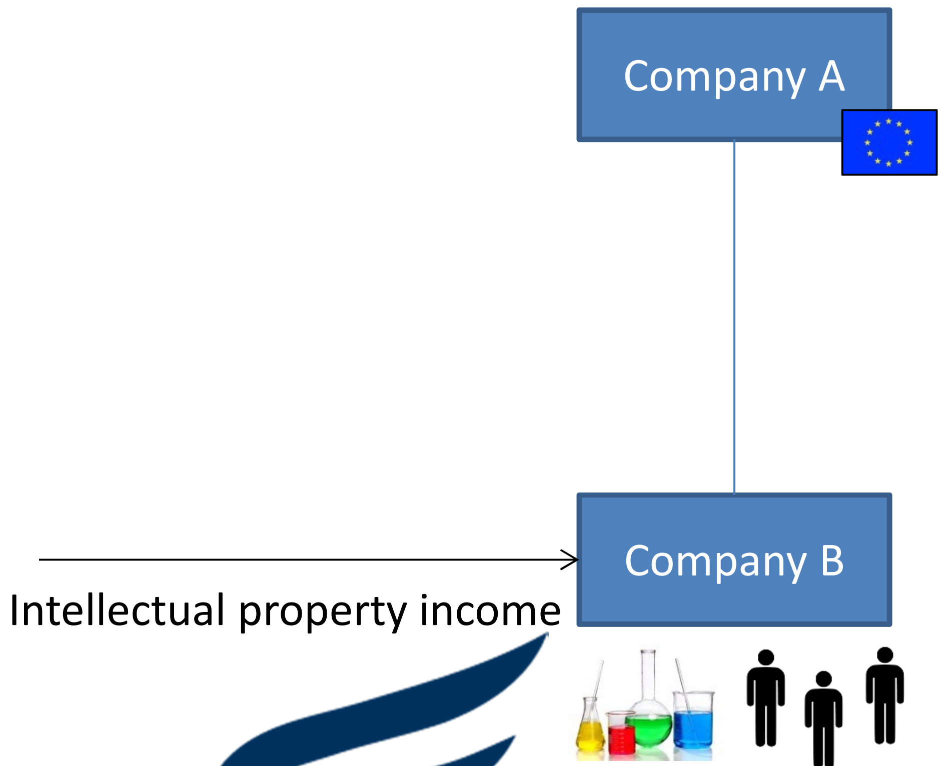
POTENTIAL ISSUES WITH MANDATING CFC RULES WITHIN EUROPE

- Example 1: Taxation that does not respect genuine economic activity



CFC pickup	100
Tax at 30%	30
Credit for tax paid	(10)
Net CFC tax	20

Profit	100
Tax at 10%	10

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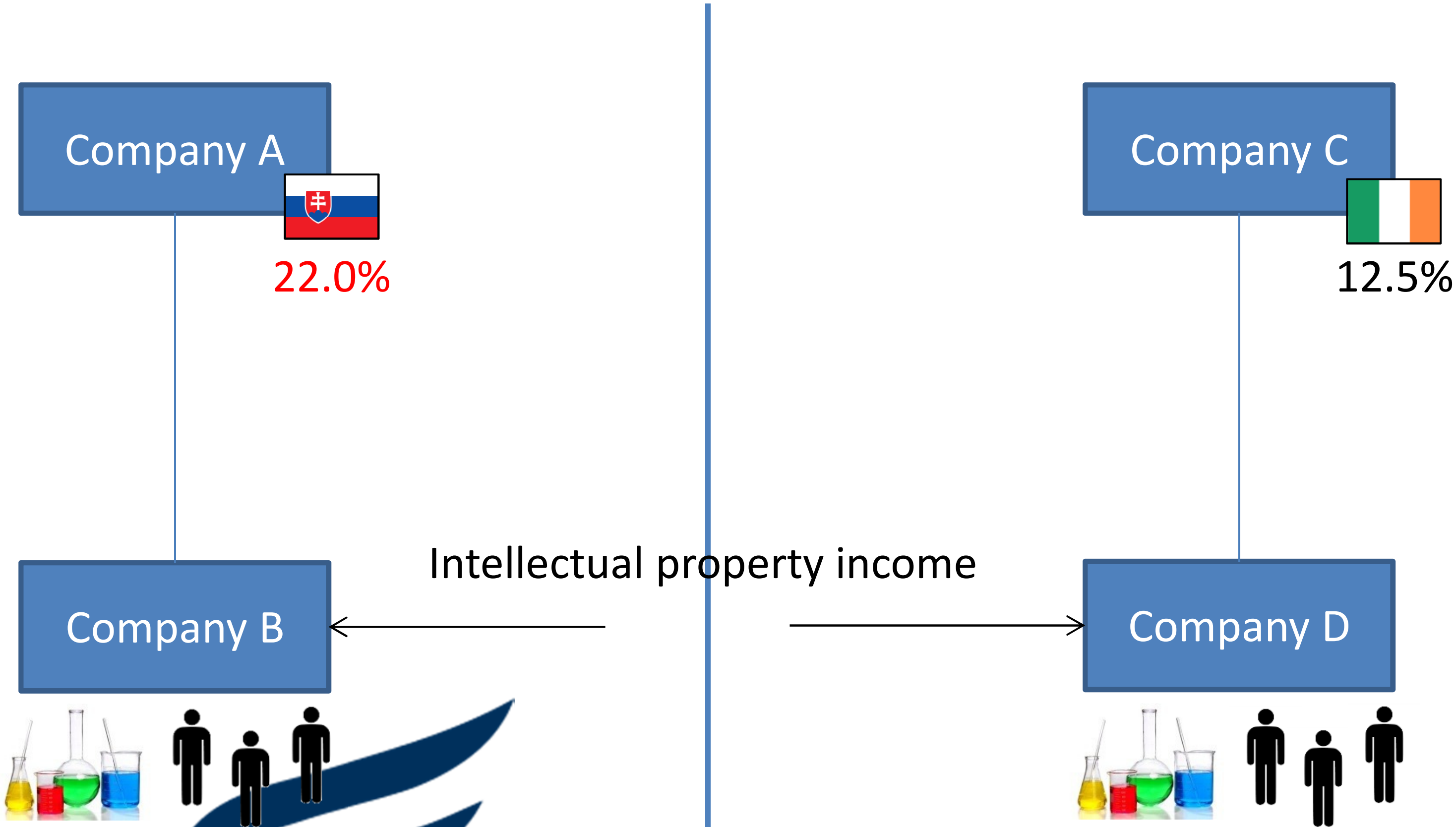
POTENTIAL ISSUES WITH MANDATING CFC RULES WITHIN EUROPE

- Example 2: Intra-union economic distortions



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POTENTIAL ISSUES WITH MANDATING CFC RULES WITHIN EUROPE

- Example 3: Income characterisation