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Measures Limiting Base Erosion under BEPS : A Critical Review

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Background to BEPS Programme

Uproar and negative public opinion

- Starbucks, Google, Amazon in the UK
- Though Starbucks announced UK business to be profitable, reported losses in the UK
- Claimed legitimate and legal deduction of expenses by way of significant amounts paid to its group companies in NL & Swiss
- Boycott by British public of Starbucks led to Starbucks announcing to pay some taxes.
- Similar issues were reported around the world in case of many multinational companies who paid minimum or no tax in the country where they earned revenue
- Became genesis of the Base Erosion and Profit Shift movement spearheaded by the G 20 Nations and then gathered momentum with OECD's action Plan Programme





Roadmap of BEPS

Broad outline of the BEPS Programme

- OECD released its BEPS Action plan on 19 July 2013
- Two-pronged approach :
 - Offer global roadmap to allow governments to protect their tax base & collect revenues they need
 - Gives businesses the certainty they need to invest and grow.
- General theme running through the action plan is to align economic activity with right to tax.

Who is most affected?

- Multinationals who use the legitimate tax loopholes in overlapping tax systems





Will the BEPS Action Plan succeed in limiting Base Erosion?

- The OECD Itself does not have the mandate to change the law, so the success of the Action Plan will depend on the take-up by the affected sovereign states.
- 15 Action Plans suggested by the OECD for this purpose.





Will the BEPS programme be effective?

- The efficacy of domestic law provisions
- Existing treaty provisions & the possibility of their re-negotiations
- Existence of treaty override in domestic law
- Interpretation and application of treaty provisions based on judicial precedents
- Ability of comity of nations to develop multilateral agreement in a time bound manner

Development of general awareness of nations to protect their tax base and their ability to push through this agenda with the developed and underdeveloped countries





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Overview of the BEPS Action Plans of the OECD



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Action Plan 1 : Address challenges of Digital Economy

- Change in how PE is created : Exclusion clauses to require that each of the activity carried out from fixed place is preparatory and auxiliary;
- Commissionaire arrangement to create PE; concluding contracts by dependent agent signed by principal, but mostly negotiated and determined by agents to result in PE;
- Addressing the challenges of nexus, data and characterisation for direct tax purposes as well as addressing challenges for levy of VAT for consumers having acquired goods & services online from suppliers located in another jurisdiction
- Connected with Action 7 on PE and relies on success on the conclusion of a multilateral instrument to modify bilateral treaties under Action 15

Recognises that the proposed actions need monitoring and a report to be produced by 2020





Action Plan 2 : Neutralise the effects of Hybrid Mismatch Arrangements

Address double non-taxation or deferral through exploiting differential tax treatment of entity or instrument in different jurisdiction:

- Countries to deny taxpayer's claim for deduction of payment if not included in taxable income of the recipient or is also deductible to the recipient
- Address mismatch arrangement arising out of dual residency of the entity
- Not grant benefit of treaty to the entity if not treated as resident of the state under domestic law





Action Plan 3 : Design Effective CFC Rules

Recommendations to determine CFC in a variety of circumstances :

- Application of CFC rules where the controlled foreign company is subject to a meaningfully lower effective tax rate than the rate applied in parent jurisdiction.
- Provides for the manner in which to define income of the CFC, including approach for the definition
- Computation of income
- Attribution threshold to be tied to control threshold
- However need to provide for double taxation by ensuring credit for taxes paid in the source jurisdiction as well as for capital gains taxes





Action 4 : limiting base erosion on account of interest and other financial payments

Financing arrangements of multinationals

- Placing of high level debt in high tax jurisdiction
- Use of intra group debt to generate interest deduction in excess of third party interest cost
- Using third party intragroup financing to fund generation of tax exempt income

Recommendations

- fixed ratio for debt, recognising the variations used in domestic laws - 10%-30% ; and
- give recognition to the multinational group's own leverage ratio, established throughout the group companies for non- tax reasons.

de minimus thresholds and exceptions where due to the public interest nature of projects for which debt funding is used, carve outs for banking and insurance industries





Action 5 : Countering Harmful Tax Practices | Transparency & Substance

Addressing the concern of using artificial profit shifting & lack of transparency

Recommendations

- Entitlement of IP regime tax to be made available to the extent of activities of R&D in the jurisdiction
- Review of preferential regimes

Providing ongoing monitoring and review mechanism of preferential tax regimes, including IP regimes





Action 6 : Preventing Treaty Benefits in Inappropriate Circumstances

Anti Abuse Provisions in the Tax Treaties

Recommendations

- Anti treaty shopping provision
- Introduction of LOB clause in the treaties
- Introduction of Principal Purpose Test (PPT)

The principal purpose of the transaction or arrangement not to be to obtain treaty benefit (India- Sing Treaty)





Action 7 : Preventing Avoidance of PE

Propositions

- Tightening of PE Rules
 - Changes in treaty provisions
 - Addressing commissionaire arrangement which avoided PE creation
 - Narrowing of exclusion through preparatory & ancillary activities
 - Anti fragmentation rules
 - Addressing splitting up of contracts in construction & installation activities to avoid PE





Action 8-10, 11, 12, 13, 14, 15

Action 8-10

- Alignment of TP outcomes with Value Creation

Action 11

- Measuring & monitoring of BEPS

Action 12

- Mandatory disclosure rules

Action 13

- Transfer Pricing Documentation and country-by-country reporting

Action 14

- Making dispute resolution mechanism more effective

Action 15

- Developing Multilateral Instrument to Modify Bilateral Tax Treaties





Will the BEPS programme be effective?

Depends on several aspects :

- The efficacy of domestic law provisions
- Existing treaty provisions & the possibility of their re-negotiations
- Existence of treaty override in domestic law
- Interpretation and application of treaty provisions based on judicial precedents
- Ability of comity of nations to develop multilateral agreement in a time bound manner

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