



OECD'S BEPS PROJECT

Why BEPS will change the way you operate?

- BEPS Project: Trigger Points
- BEPS Project: Action Plans
- Action Plans with Focussed Transfer Pricing Implications
- Other Action Plans: Transfer Pricing Implications
- BEPS Project Impact: SKP Insights



BUILDING UP

TO BEPS

- Globalisation benefited domestic economies and impacted corporate income tax regimes across countries
- As the economy became more globally integrated, it opened up opportunities for MNEs to greatly minimise their tax burden
- For companies tax is a cost – feel legitimate right to reduce it especially in challenging economic conditions post global financial crises
- Cash-strapped governments under significant pressures to reduce deficits
- Simultaneously countries are competing for profitable investments
- Taxation systems have not kept pace with changes in the business model
 - Digital economy and increasing globalisation of business

Tax Evasion versus Tax Planning and Avoidance – A Big Moral Debate



Starbucks not a bean in taxes, thanks to transfer pricing

Starbucks UK sales in 2011 were worth £ 398 million, but paid nil taxes by charging UK operations high prices for 'use of logo'



Amazon

With sales of £ 3.35 billion reports tax paid of € 1.8 million (0.005%) in UK



Apple uses subsidiaries to dodge billions in taxes

US Senate Panel alleged that Apple is using 'so-called' cost-sharing agreement to transfer valuable intellectual property assets offshore and shift resulting profits to tax haven jurisdictions



Dolce and Gabbana stylists face £ 320 million tax fraud case

Accused of evading more than £ 400 million in tax when they sold their D&G and D&G brand to a holding company Gado, which they set up in Luxembourg in 2004



Google

UK unit paid £ 6 million to treasury in 2011 on UK turnover of £ 395 million (1.5%)



A GIGANTIC PARASITE
Mail comment, April 25

Google does do evil by avoiding taxes in Britain, say MPs
Mail report, May 17

NOW SHOW YOU'RE NOT AMORAL, GOOGLE!
Mail report, June 1

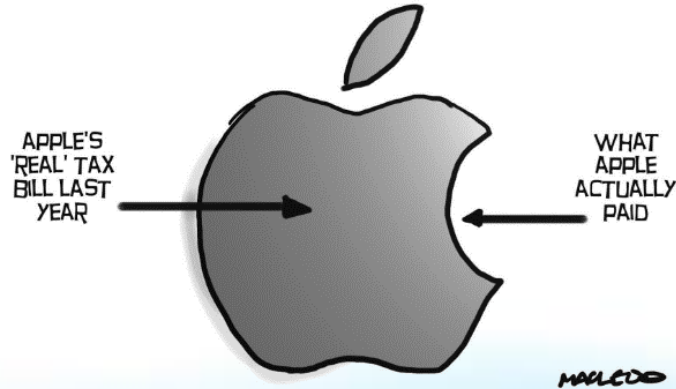
Brazen! Google's tax ploys savaged by MPs
Mail report, June 13

'Paltry': MP Hodge attacked Google

WORLDWIDE PROTESTS



iAvoid



Base Erosion and Profit Shifting (BEPS)

- Tax planning, which exploits gaps in tax rules, making profits shift to locations with little or no activity and having low taxes
- Three popular mechanisms for profit shifting are
 - Hybrid Mismatch
 - Special Purpose Entity/Vehicle
 - Transfer Pricing
- Not always illegal, but taking advantage of current archaic tax rules that is disassociated with today's environment

BEPS arises because under existing rules MNEs are often able to artificially separate allocation of their taxable profits from the jurisdiction in which these profits arise...

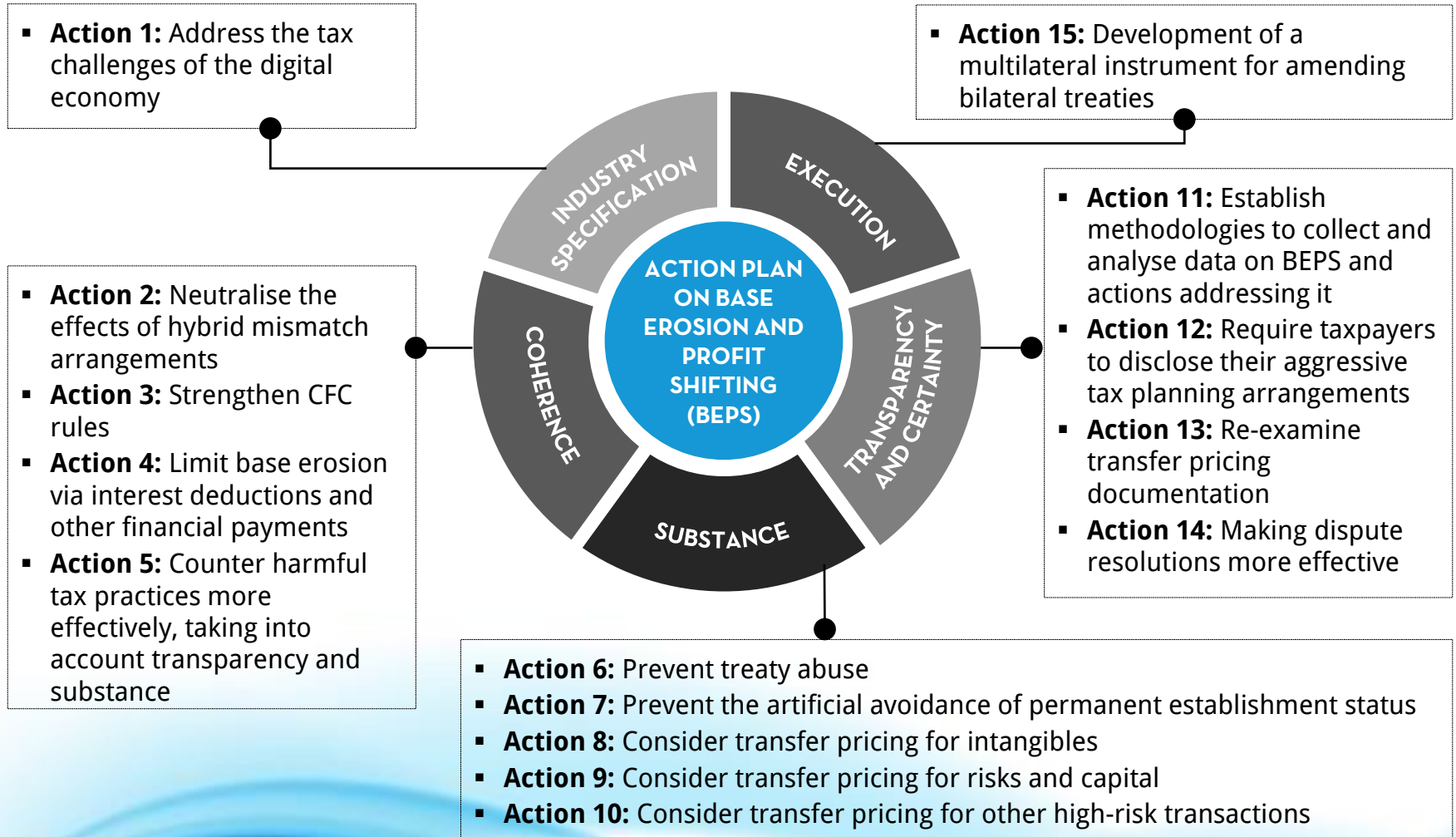
- OECD

- Group of G20* countries realised the need of preventing BEPS and approached OECD to address the issue related to BEPS
- OECD published a report on BEPS in February 2013
- In July 2013, OECD released an Action Plan on BEPS which was presented to the meeting of G20 Finance Ministers in Moscow
- Action Plan covers 15 specific which are broadly to be achieved over a 2 year period i.e. by end of 2015



*** Worlds largest advanced and emerging economies which include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States of America and European Union**

Changes to the international taxation landscape



OECD BEPS Action Plan – An ambitious timeline

June 2012

Project announced/started

July 2013

Release of Action Plan with 15 separate actions/work streams

December 2015

Completion of reminder Action Plan

Jul 2012

Feb 2013

Jul 2013

Sep/Oct/Nov 2014

Sep 2015

Dec 2015

2016 onwards

February 2013

Release of document addressing Base Erosion and Profit Sharing (BEPS)

September 2014

Release of recommendations pertaining to 7 out of 15 Action Points and Oct/Nov additional 2 Action Points

2016 and onwards

Monitoring additional/on-going compliance

Action	Particulars	Expected Output	Timeline
1	Addressing tax challenges of a digital economy	Report identifying issues raised by digital economy and possible actions to address them	September 2014
2	Neutralising effects of “Hybrid Mismatch Arrangements”	Changes to model tax convention and recommendations regarding the design of domestic rules	September 2014
3	Strengthening Controlled Foreign Company (CFC) Rules	Recommendations regarding the design of domestic rules	April 2015
4	Limit base erosion via interest deductions and other financial payments	Recommendations regarding the design of domestic rules and changes to transfer pricing guidelines	December 2014
5	Countering harmful tax practices more effectively, taking into account transparency and substance	Finalise review of member country regimes, strategy to expand participation to non-OECD members and revision of existing criteria	September 2014
6	Preventing granting of treaty benefits in inappropriate circumstances	Changes to model tax convention, recommendations regarding the design of domestic rules	May 2015 (Revised Draft Released)
7	Preventing the artificial avoidance of PE status	Changes to model tax convention	May 2015 (Revised Draft Released)

Action	Particulars	Expected Output	Timeline
8	Assuring transfer pricing outcomes are in-line with value creation – intangibles	Changes in transfer pricing guidelines and possibly to model tax convention	December 2014 April 2015 June 2015
9	Assuring transfer pricing outcomes are in-line with value creation – risks and capital	Changes in transfer pricing guidelines and possibly to model tax convention	December 2014
10	Assuring transfer pricing outcomes are in-line with value creation – other high risk transactions	Changes in transfer pricing guidelines and possibly to model tax convention	November 2014 December 2014 February 2015
11	Establishing methodologies to collect and analyse data on BEPS and actions to address them	Recommendations regarding data to be collected and methodologies to analyse them	April 2015
12	Recommending mandatory disclosure rules	Recommendations regarding the design of domestic rules	March 2015
13	Re-examining and providing guidance on transfer pricing Documentation and Country-by-Country Reporting	Changes in transfer pricing guidelines and recommendations regarding the design of domestic rules	September 2014 June 2015
14	Making dispute resolution mechanisms more effective	Changes to model tax convention	December 2014
15	Developing a multilateral instrument and modifying bilateral tax treaties	Report identifying relevant public international law and tax issues and develop a multilateral instrument	September 2014



TRANSFER PRICING

ACTION PLANS

Transfer pricing landscape continues to evolve, heralding enormous future changes

Action	Particulars	Current Status	
8	Assuring transfer pricing outcomes are in-line with value creation – intangibles	Sep 2014	Revision of transfer pricing guidelines with respect to intangibles
		Dec 2014	Revision of transfer pricing guidelines (includes intangibles, risks, re-characterisation and special measures)
		Apr 2015	Transfer pricing guidelines with respect to Cost Contribution Agreements
		Jun 2015	Transfer pricing guidelines relating to hard to value intangibles
9	Assuring transfer pricing outcomes are in-line with value creation – risks and capital	Dec 2014	Revision of transfer pricing guidelines (includes intangibles, risks, re-characterisation and special measures)
10	Assuring that transfer pricing outcomes are in-line with value creation – other high risk transactions	Nov 2014	Transfer pricing guidelines relating to low value-adding intra-group services
		Dec 2014	Revision of transfer pricing guidelines (which includes intangibles, risks, re-characterisation and special measures)
			Transfer pricing aspects of cross-border commodity transactions
13	Guidance on transfer pricing documentation and Country-by-Country reporting	Sept 2014	Guidance on three tier transfer pricing documentation
		Jun 2015	Release of implementation package for CbC Reporting

Key features of Action Plan and major changes

- Broader definition of intangible property (6 specific categories)
- Allocation of returns should be in line with **value creation**
- Ownership of intangibles and entitlement to returns
- Special focus on marketing intangibles and R&D arrangements
- Inclusion of “Valuation Techniques” as part of the five OECD transfer pricing methods
- Detailed guidance on local market features (Location Savings), assembled workforce and MNE group synergies
- Transfers of hard to value intangibles
 - Distinguish between anticipated and actual remuneration and guidance on treatment of profits or losses relating to unanticipated events (ex-post returns) and sharing of same between MNE group members
 - Situations may demand use of transactional profit split method
- Guidance on Cost Contribution Arrangement (CCAs)

Key features of Action Plan

- Assuring transfer pricing outcomes are in line with value creation in areas of risk and capital
- Crucial to delineate inter-company transactions – commercial and financial relations
- **Enhanced focus on the risk allocation aspects** – expressed as well as implicit risks should be identified and considered for determining arm's length nature
- Inappropriate returns should not accrue to an entity solely because it has contractually assumed risks or has provided capital
- Non-recognition of related party transaction – when the transaction does not have the fundamental economic attributes of arrangements between unrelated parties
- Sets out options for potential special measures to reduce the possibilities for BEPS that are either within or beyond arms length principle

Intra-group low-value adding services – a simplified approach

- Defining intra-group low value adding services
 - Are of supportive nature
 - Are not a part of the core business of the MNE group
 - Do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles
 - Do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk
- Determination of Arm's Length Price (ALP)
 - Determination of cost pools and allocate costs to those group companies which benefit from those services
 - Suggested profit markup of 2-5%
- Relevant documentation to be maintained

Measures proposed would help reduce the scope for erosion of tax base through management fees and Head Office expenses

Cross-border commodity transaction

- Reliable quoted price (commodity exchange, industry reports, etc.) can be used as 'CUP' for commodity prices
- Important to consider the economic context, industry dynamics and business model

Use of profit splits in the context of global value chains

- Increased integrated business models – use of intangibles, digital platforms
- One sided methods are proving insufficient to reflect arm's length result
- Lack of suitable comparable
- The above would necessitate increased use of profit split method

- Enhancing transparency for tax administrations by providing them with adequate information to conduct transfer pricing risk assessments and examination
- Three-tiered approach to transfer pricing documentation which consists of
 - Master file containing standardised information relevant for all MNE group members
 - Local file referring specifically to material transactions of the local taxpayer
 - Country-by-country (CbC) report containing certain economic information within the MNE group
- Contents of CbC Report
 - Aggregate information in relation to revenue, profit/loss, income taxes, stated capital, accumulated earnings, number of employees and tangible assets for each jurisdiction in which the MNE group operates
 - Identification of each constituent entity including jurisdiction of tax residence, nature of business activity of each constituent activity, etc.
- MNE group with annual consolidated group revenue of less than € 750 million (or equivalent amount in local currency) may be excluded from CbC reporting requirement
- CbC report to be filed by Ultimate Parent Entity or a Surrogate Parent Entity
- Government to government mechanism to exchange CbC Reports (Automatic Exchange of CbC Reports)
- Proposed date for reporting is fiscal year beginning on or after 1 January 2016

Action Plan 1: Address tax challenges of the digital economy

- Many BEPS structures adopted in the digital economy involves the transfer of intangibles or rights to intangibles to tax-advantaged locations
- Any restrictions on deductions for excessive interest whether in respect of related party or third party debt and inbound or outbound investment scenarios, would apply equally to the funding of innovative digital businesses
- The work on transfer pricing, and particularly intangibles, through action point 8, 9 and 10, will be key to assisting in relation to valuable intangibles within innovative digital businesses

Action Plan 4: Limit base erosion via interest and other financial payments

- Arrangements where an entity has an excessive level of interest expense which does not reflect its actual economic activity
- Options for approaches to tackle BEPS in addition to CFC rules
 - Group-wide interest allocation or ratio approach (group-wide tests) linking interest deductibility to the position of group
 - Fixed ratio test – interest deduction up to a specified proportion of entity's earnings, assets or equity
- CbC reporting will require disclosure of financial indicators across the MNE group at a consolidated and entity level



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INSIGHTS



Clear signs of global impact

- Following countries have already proposed to revise/rewrite their transfer pricing regulatory rules in alignment with BEPS project recommendations
 - Australia, Germany, France, Singapore, United Kingdom and Mexico
- Major developing countries which are non-OECD members – such as India, China, South Africa, Brazil are actively supporting the BEPS Project and expressed their intention to adopt the outcomes
- Demands for Mutual Agreement Procedures (MAPs) have increased
- General rise in demand for Advanced Pricing Agreements (APAs)

Key challenges to watch out for

- Different countries adopting BEPS Project recommendations in piece meal
- United States of America does not appear to follow the BEPS Project outcomes in totality
- Resultant risk of double taxation

Emergence of new concepts in the international tax world

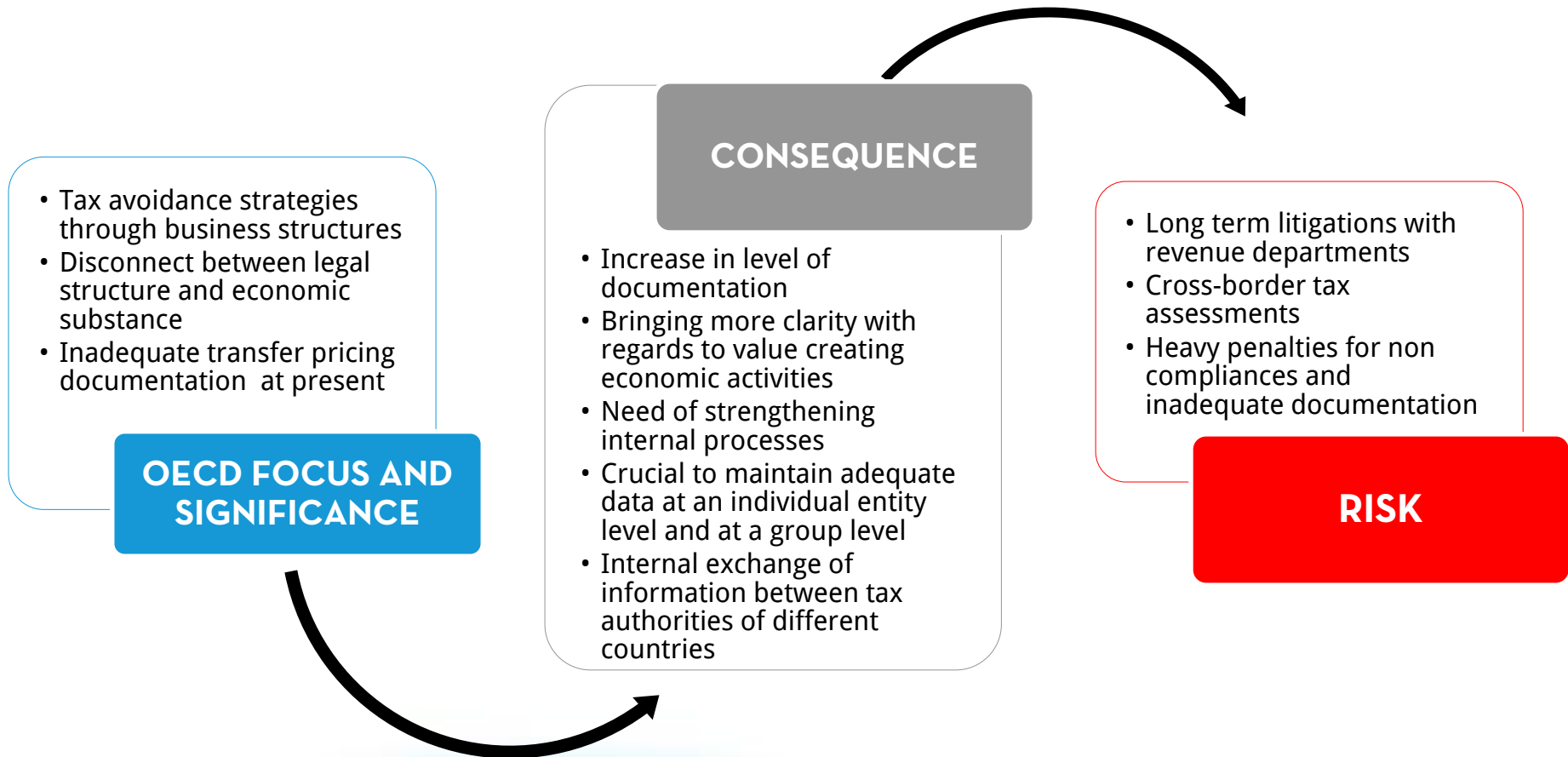
- Tax inspectors without borders
- Automatic exchange of information
- Gradual movement from bilateral to multilateral instruments

Key takeaways for your business

- No longer be possible to look at value creation, transfer pricing and tax planning strategies in isolation – all should work in harmony
- Crucial to ensure that transfer pricing and relevant supporting documentation are kept up to date in the robust manner
- Thorough internal process within the organisation, with clear responsibility and accountability between departments to ensure a proper audit trail
- Increased scrutiny by the tax authorities because of the big picture economic information at their disposal
- Better to avoid fire fighting – proactive study of your existing business models and transfer pricing positions will be advantageous

Gearing up your business for BEPS

- Perform a global BEPS check and ask various questions:
 - Is the nature of group business clearly defined?
 - How much of international and domestic transfer pricing is involved in your business?
 - Do you have transfer pricing documentation that demonstrates your positions?
 - What is the company's global supply chain policy?
 - Does that policy have substance for each function performed and risk assumed in each local taxing jurisdiction?
 - Is transfer pricing documentation in-line with economic reality of current supply chain in each jurisdiction and the supply chain as a whole?
 - Do you have robust systems to align group-level as well as country-specific economic details and generate convincing audit trail documents?
 - Do the existing business models need to be altered in view of the BEPS?
- Devise a strategic plan to be consistent in the responses so that if exchange of information is invoked between governments, the responses to one jurisdiction are not contradicted or incriminating in another jurisdiction



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