

BEPS and ATAD: Where do we stand?

by Nicky Gouder
Tax Partner



Summary

- Quick Overview of the BEPS Project and ATAD;
- A Comparison of the BEPS Recommendations and the ATAD – obstacles, conflicts. Is harmonious implementation possible?;
- Implementation issues;
- Is CCTB/CCCTB really the next step?

BEPS Project – Why?

- Global Corporate Income Tax (CIT) revenue losses estimated between 4% - 10% of CIT revenues (\$100b - \$240b)
- “The affiliates of MNEs in low tax countries report almost twice the profit (relative to assets) of their global group..” – OECD/G20 Explanatory Statement;
- “BEPS arises because under the existing rules MNEs are often able to artificially separate the allocation of their taxable profits from the jurisdictions in which these profits arise” – OECD Webinar

What is the BEPS Project?

- The main BEPS project objective: “profits are taxed where economic activities take place and value is created”;
- “to prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from activities that generate it.”
- OECD and G20 countries (+) recommendations through 15 Action Plans to prevent beps

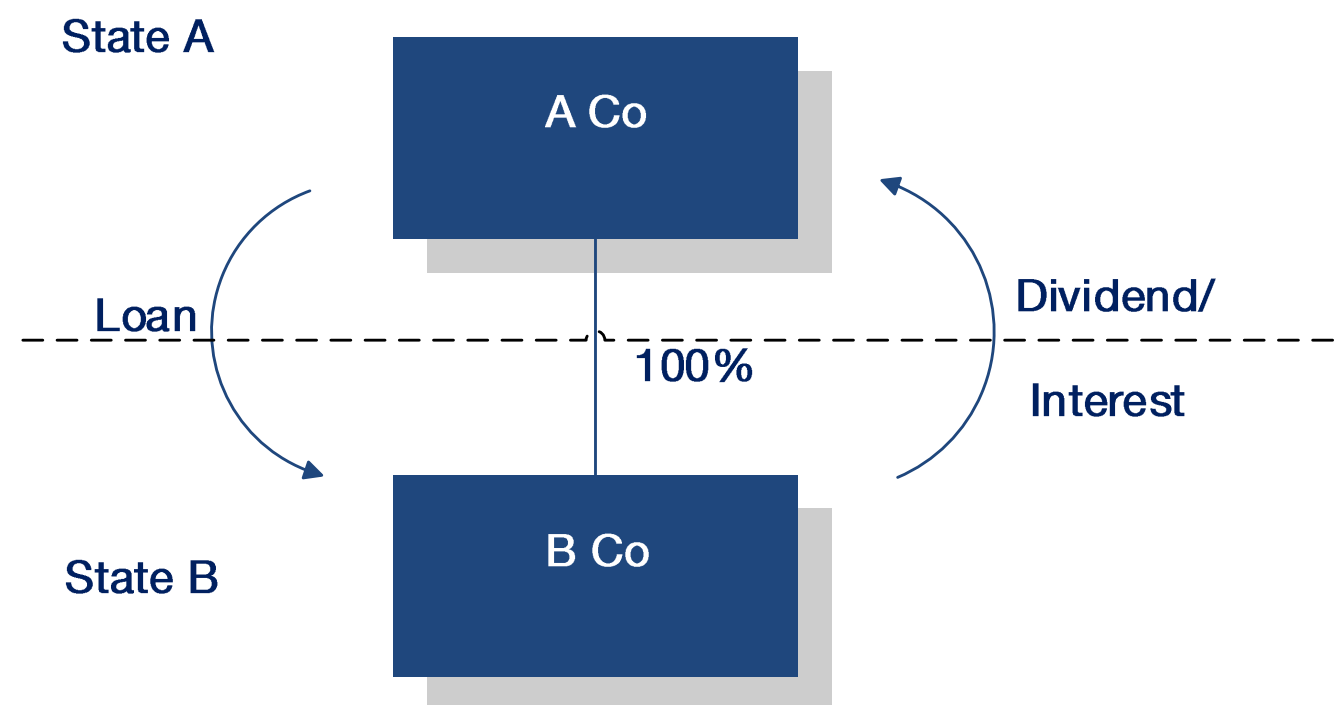
What is the BEPS Project?

- Substance, substance and more substance

BEPS Action Plans

Action 1: Address the challenges of the digital economy	Action 2: Neutralise the effect of hybrid mismatch arrangements	Action 3: Strengthen CFC rules	Action 4: Limit base erosion via interest deductions and other financial payments	Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance
Action 6: Prevent treaty abuse	Action 7: Prevent the artificial avoidance of PE status	Action 8: Assuring that TP outcomes are in line with value creation Intangibles	Action 9: Assuring that TP outcomes are in line with value creation (Risks & Capital)	Action 10: Assuring that TP outcomes are in line with value creation (Other high-risk transactions)
Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it	Action 12: Require taxpayers to disclose their aggressive tax planning arrangements	Action 13: Guidance on transfer pricing documentation and Country-by-Country reporting	Action 14: Make dispute resolution mechanisms more effective	Action 15: Develop a multilateral instrument

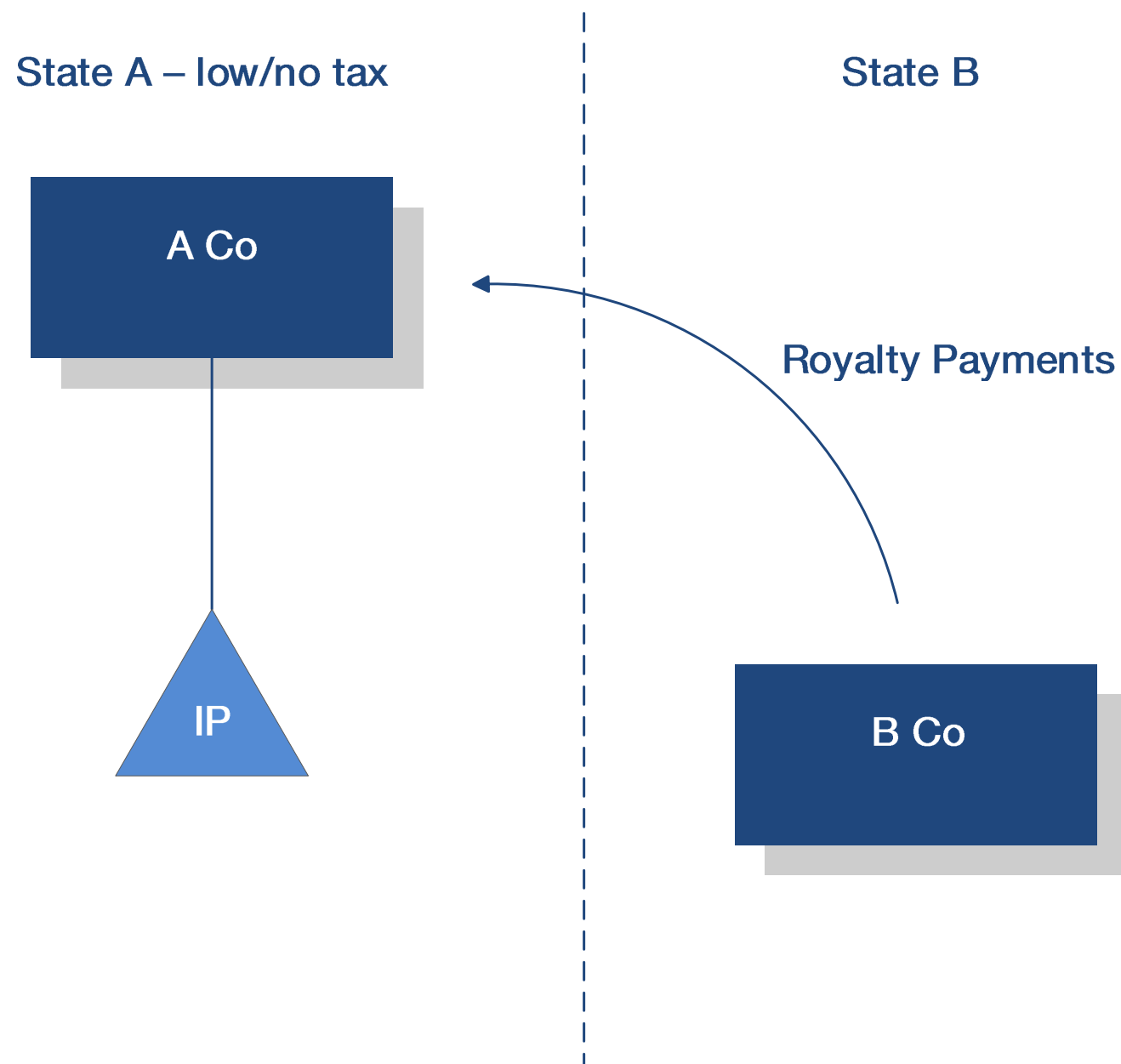
AP 2 - Hybrid Mismatch Arrangements



Recommendation : Denial of exemption in State A.

If State A doesn't apply the recommendation, State B denies the deduction of interest payment.

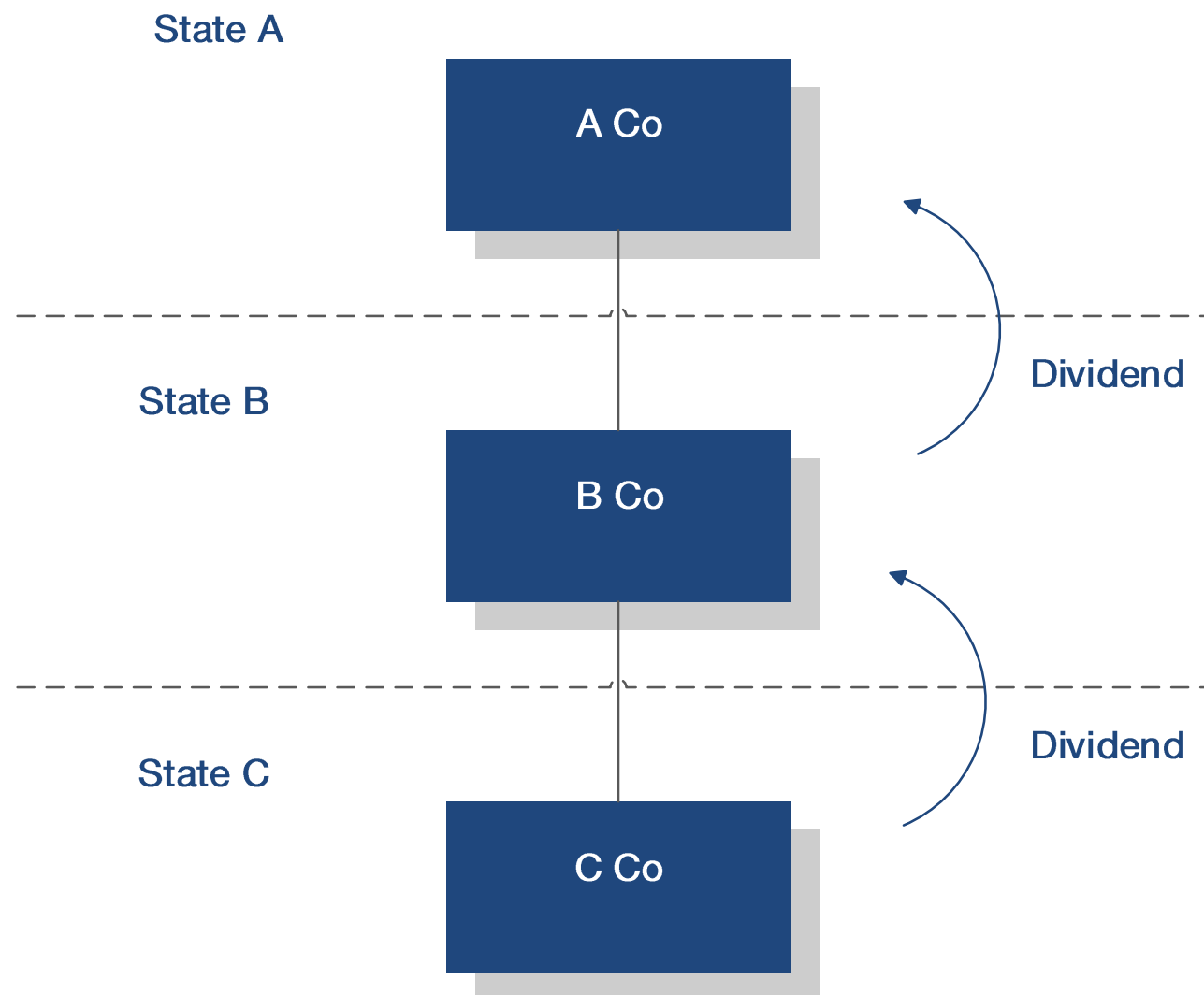
AP 5 – Preferential IP regimes



Recommendation:

“Nexus approach” – allows a taxpayer to benefit from an IP regime only to the extent that such taxpayer incurred qualifying R&D expenditure relating to the royalty income it is receiving.

AP 6 – Granting Treaty Benefits in Inappropriate circumstances.



Is B Co really the Beneficial owner of the dividend income or has it been set up simply to benefit from the B-C and A-B Treaties?


Recommended Changes to the OECD Model Tax Convention;
'Beneficial Owner' concept;

BEPS Implementation

- Via changes in domestic law and practices;
- Via treaty provisions;
- Via Changes to the Commentaries to the OECD Model;
- Via the Multi Lateral Instrument (MLI).

AP 15 – Multilateral Instrument

- The preferred vehicle to implement BEPS APs;
- More than 100 jurisdictions have concluded negotiations on the MLI;
- Jurisdictions have prepared their list of treaties to be covered by the MLI (options and reservations);
- Does this provide the necessary flexibility or could this lead to a potential nightmare?

MLI Matching Database beta © OECD 2017		Select jurisdictions:	Malta	Netherlands	Read the Disclaimer
			Malta	Netherlands	
		Signature MLI	6/7/2017	6/7/2017	
		Status of List	To Be Confirmed	Provisional	
Article 2 Covered Tax Agreement		Notification mismatch. Need to check whether both jurisdictions have identified the same agreement.			
Article 3 Transparent Entities		Article 3 would not apply.			
Article 4 Dual Resident Entities		Article 4 would not apply.			
Article 5 Application for methods for Elimination of Double Taxation		Article 5 would not apply.			
Article 6 Purpose of a Covered Tax Agreement		The preamble language would be replaced by the text described in Article 6(1). The preamble text described in Article 6(3) would be included in the agreement.			
Article 7 Prevention of Treaty Abuse		P.(IV) would be replaced by Article 7(1) and (4). The Simplified Limitation on Benefits Provision would not apply.			
Article 8 Dividend Transfer Transactions		Article 8 would not apply.			
Article 9 Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property		Article 9(1) would not apply. Article 9(4) would not apply.			
Article 10 Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions		Article 10 would not apply.			
Article 11 Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents		Article 11 would not apply.			
Article 12 Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies		Article 12 would not apply.			
PE	Article 13 Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions	Article 13 would not apply.			
	Article 14 Splitting-up of Contracts	Article 14 would not apply.			
	Article 15 Definition of a Person Closely Related to an Enterprise	Article 15 would not apply.			
MAP	Article 16 Mutual Agreement Procedure	A.27(1)1st would be replaced by the first sentence of Article 16(1). The second sentence of Article 16(1) would not apply. The first sentence of Article 16(2) would not apply. The second sentence of Article 16(2) would not apply. The first sentence of Article 16(3) would not apply. The second sentence of Article 16(3) would not apply.			
	Article 17 Corresponding Adjustments	A.9(2) would be replaced by Article 17(1).			

<http://www.oecd.org/tax/treaties/mli-matching-database.htm>

EU Anti Tax Avoidance Directive (ATAD)

Background

- 28 January 2016 - the European Commission (EC) released a proposal for a *Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market* (COM(2016) 26 final);
- Unanimity on the proposal was never achieved and a number of amendments were proposed;
- 12 July 2016 - compromise text was adopted as *Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market*.

Background

- July text doesn't include the Switch Over Clause
- Applicable from 1 January 2019
- ATAD II amending ATAD– on the 29 May 2017, the Council adopted ATAD II. Member States must transpose the Directive by 1 January 2020.

Specific Provisions

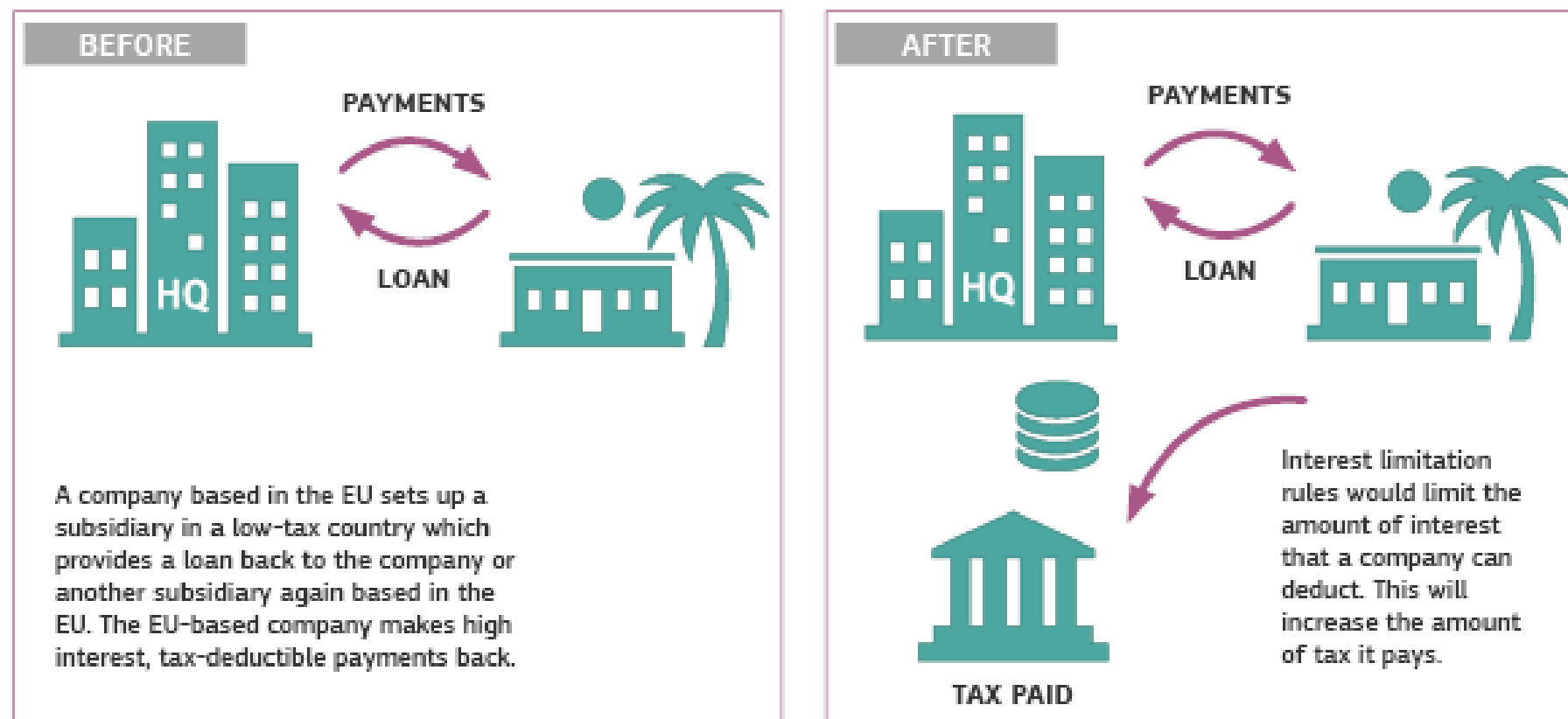
- Interest limitation;
- Exit taxation;
- General anti-abuse;
- Controlled foreign company; and
- Hybrid mismatches.

Implementation

- Implemented as of 1 January 2019, with two derogations:
 - the Exit Tax rule is to be implemented as of 1 January 2020;
 - MS which on 8 August 2016 have equally effective rules as the interest limitation rule may apply these until the end of the first full fiscal year following the date of publication of the agreement between the OECD members on a minimum standard, but at the latest until 1 January 2024.

Interest Limitation Rule

THE LOW TAX LOANS: Interest Limitation Rules



Interest Limitation Rule

- Interest expense in excess of interest income (exceeding borrowing costs) may only be deducted up to 30% of EBITDA
- Tax exempt income shall be excluded from the EBITDA

Interest Limitation Rule

By derogation, the taxpayer may be given the right to:

- Deduct exceeding borrowing costs by Eur3m;
- Fully deduct exceeding borrowing costs if the tax payer is a standalone entity;
- Exclude exceeding borrowing costs on loans concluded before 17/06/16;
- Exclude exceeding borrowing costs on loans used to fund long-term public infrastructure projects.

Interest Limitation Rule

Consolidated Groups

By derogation, the taxpayer may be given the right to:

- Fully deduct exceeding borrowings costs if it can demonstrate that its equity/ total assets ratio is equal to, or higher than, the equivalent group ratio;
- To increase the limitation of exceeding borrowing costs to the following:

$$\frac{\text{Group Exceeding 3}^{\text{rd}} \text{ party Borrowing Costs}}{\text{Group EBITDA}} \times \text{Taxpayer EBITDA}$$

Exit Taxation

Tax shall be charged on an amount equal to the MV of the asset, at the time of exit, less their value for tax purposes, in the following scenarios:

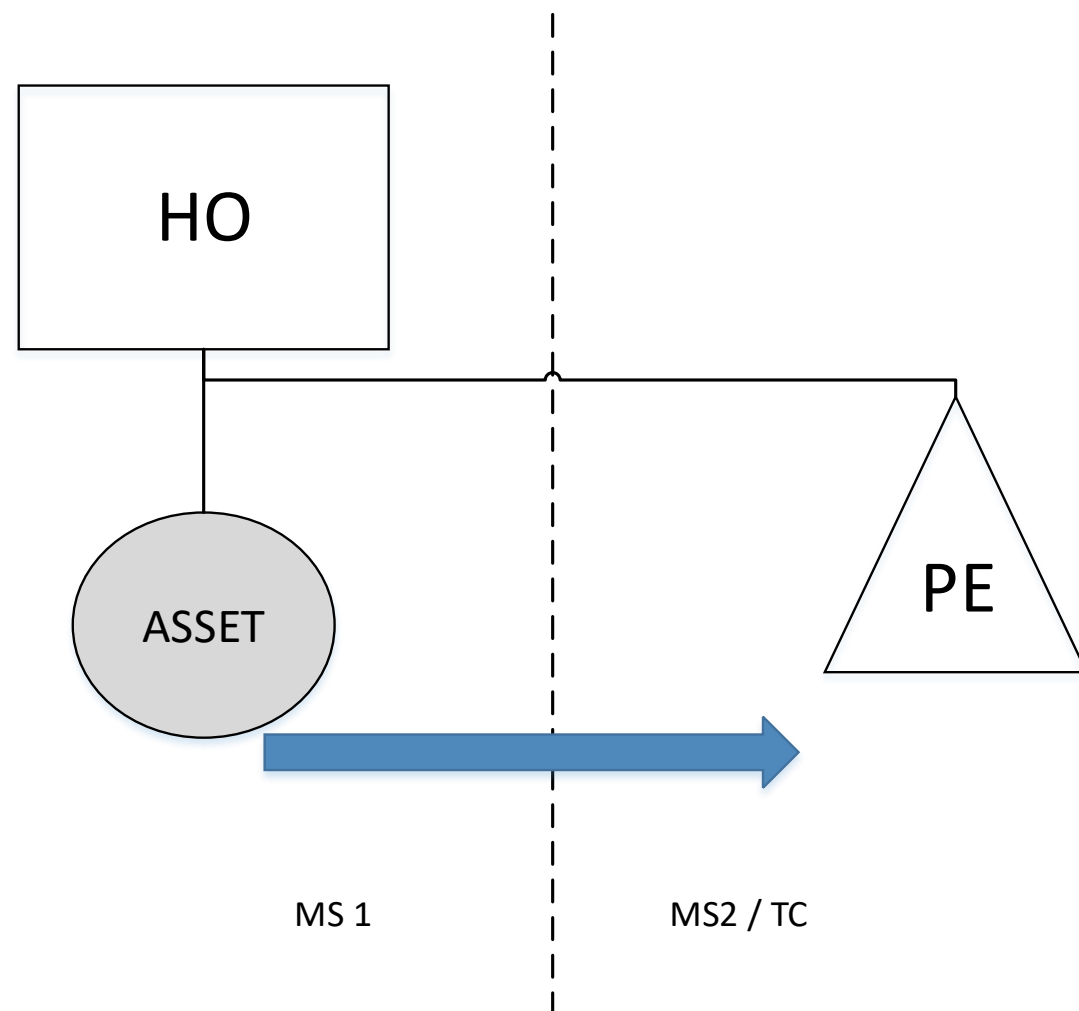
- Transfer of assets from HO to PE (EU or TC);
- Transfer of assets from PE to HO/PE (EU or TC);
- Transfer of residence (to EU or TC);
- Transfer of a PE Business (to EU or TC).

Exit Taxation

Transfer of assets from HO to PE (EU or TC)

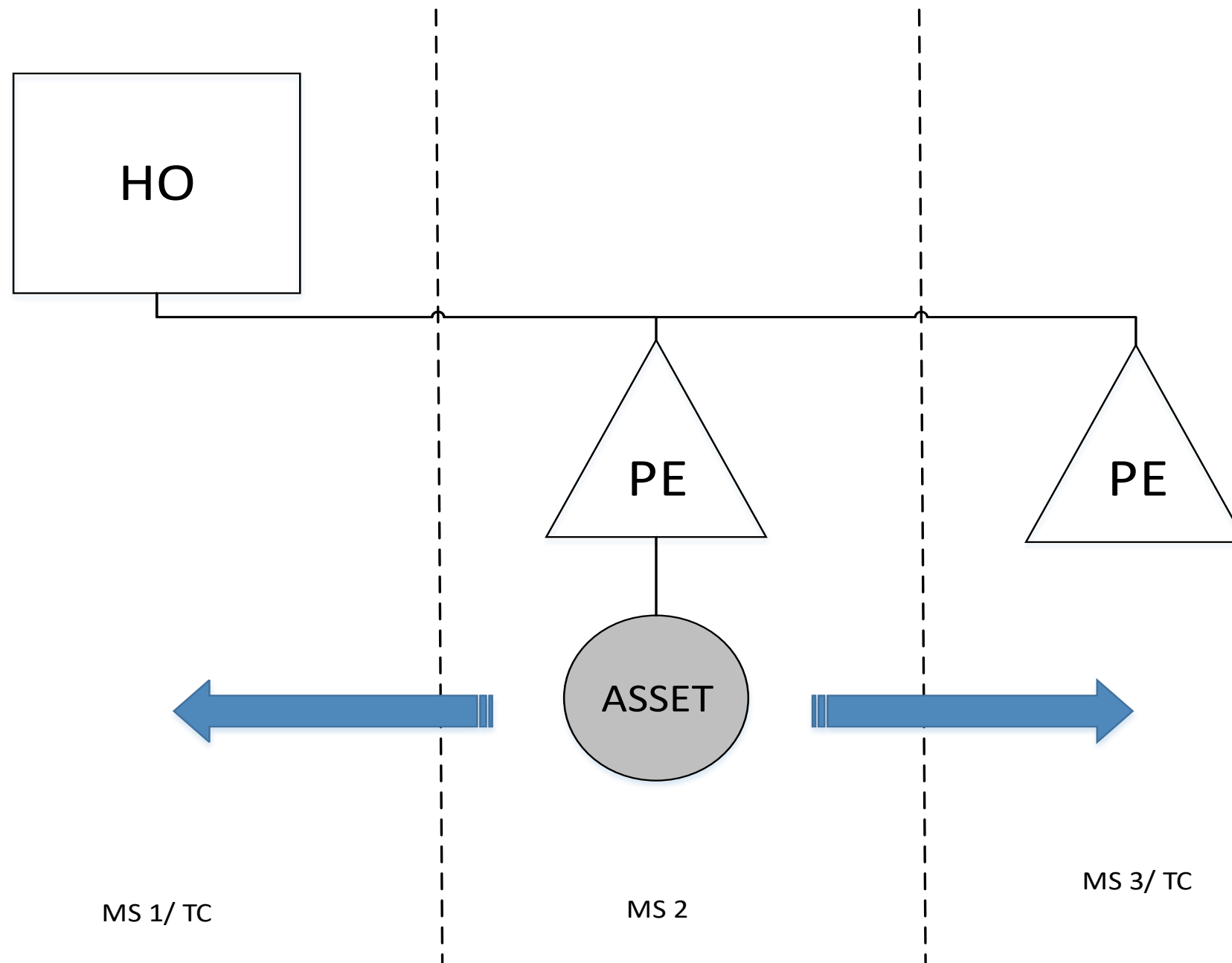
“The MS of the HO no longer has the right to tax the transferred asset due to the transfer”

Ownership remains with the same tax payer.



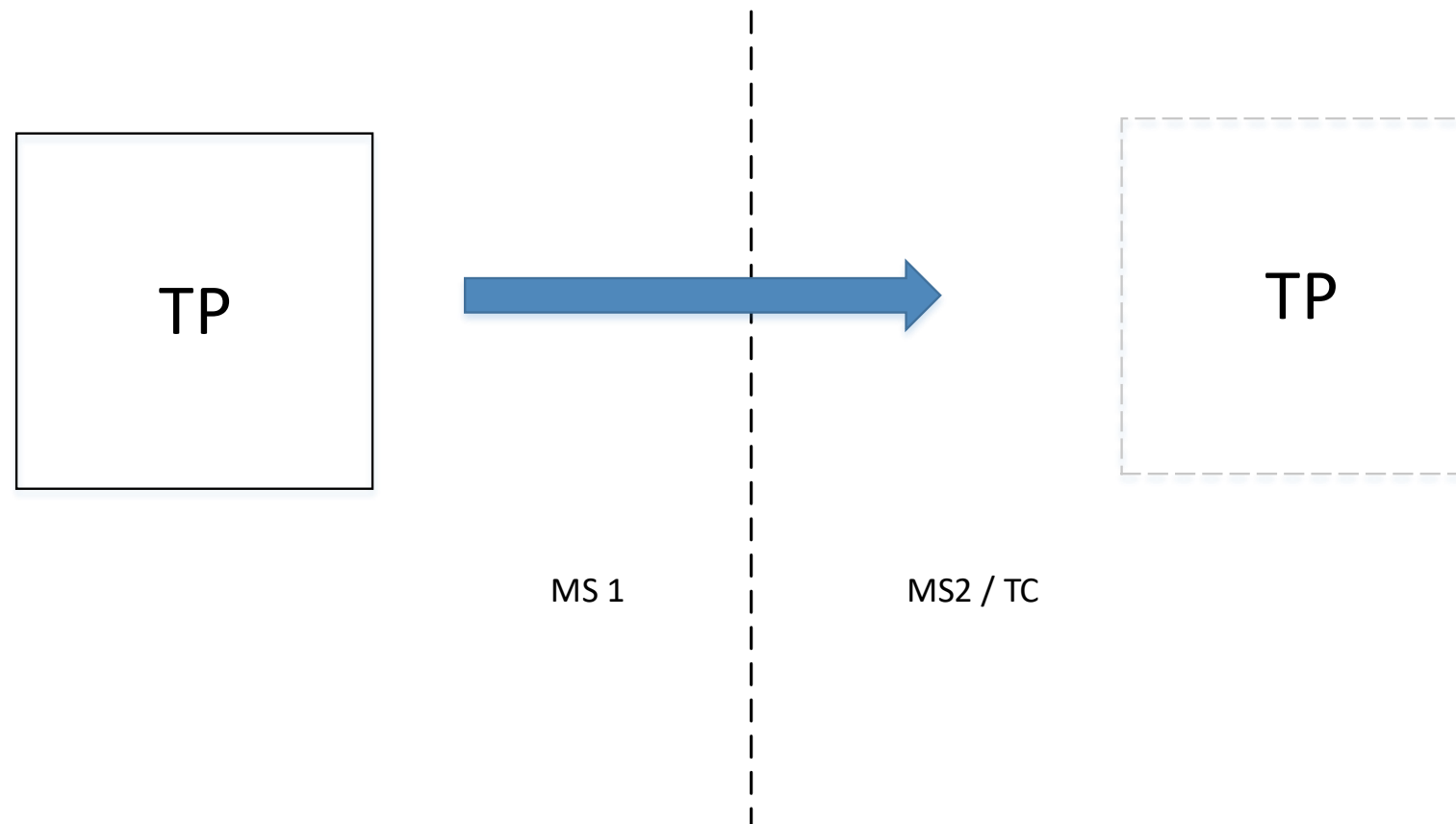
Exit Taxation

Transfer of assets from PE to HO/PE (EU or TC)



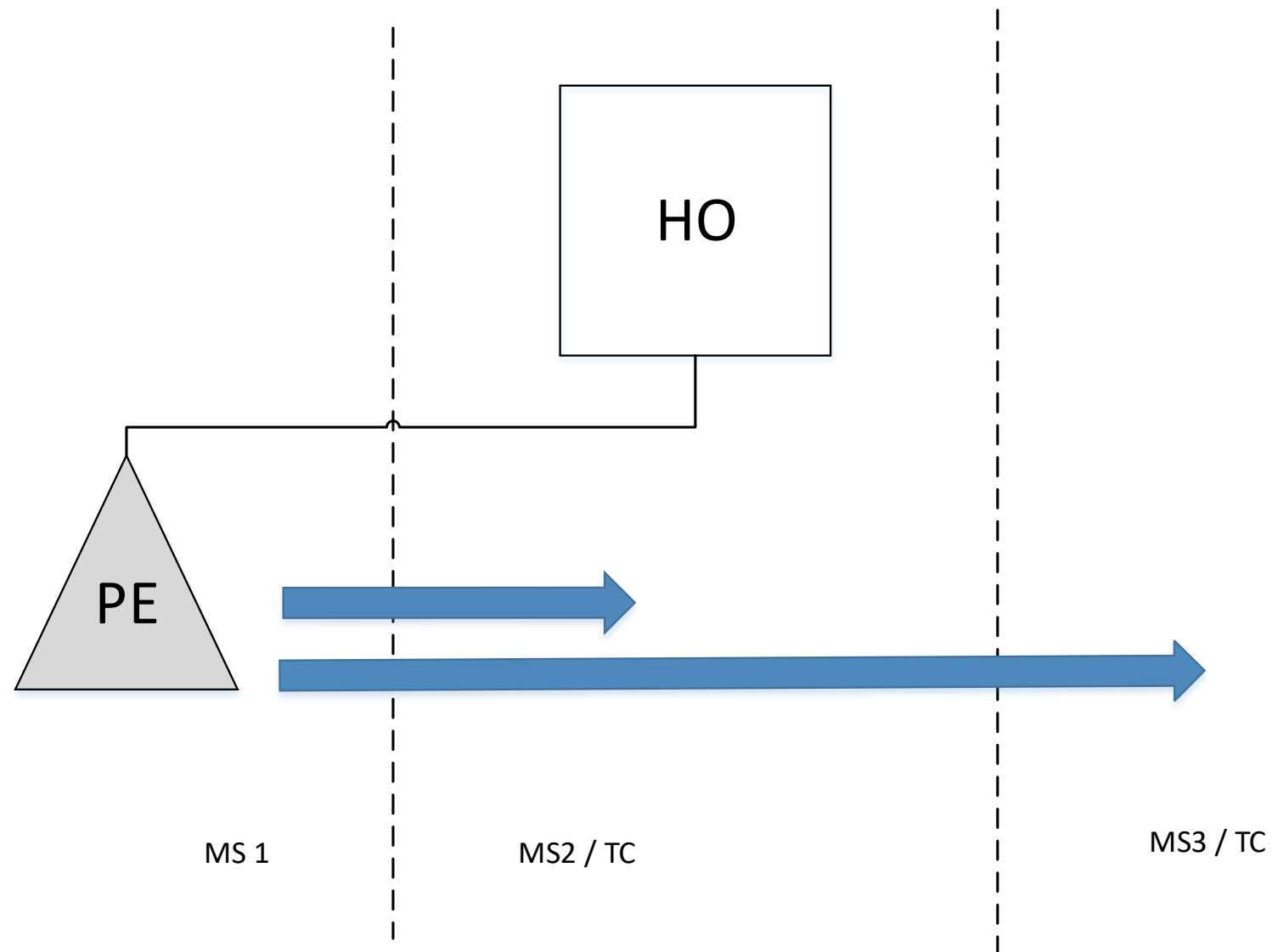
Exit Taxation

Transfer of residence (to EU or TC)



Exit Taxation

Transfer of a PE Business (to EU or TC).

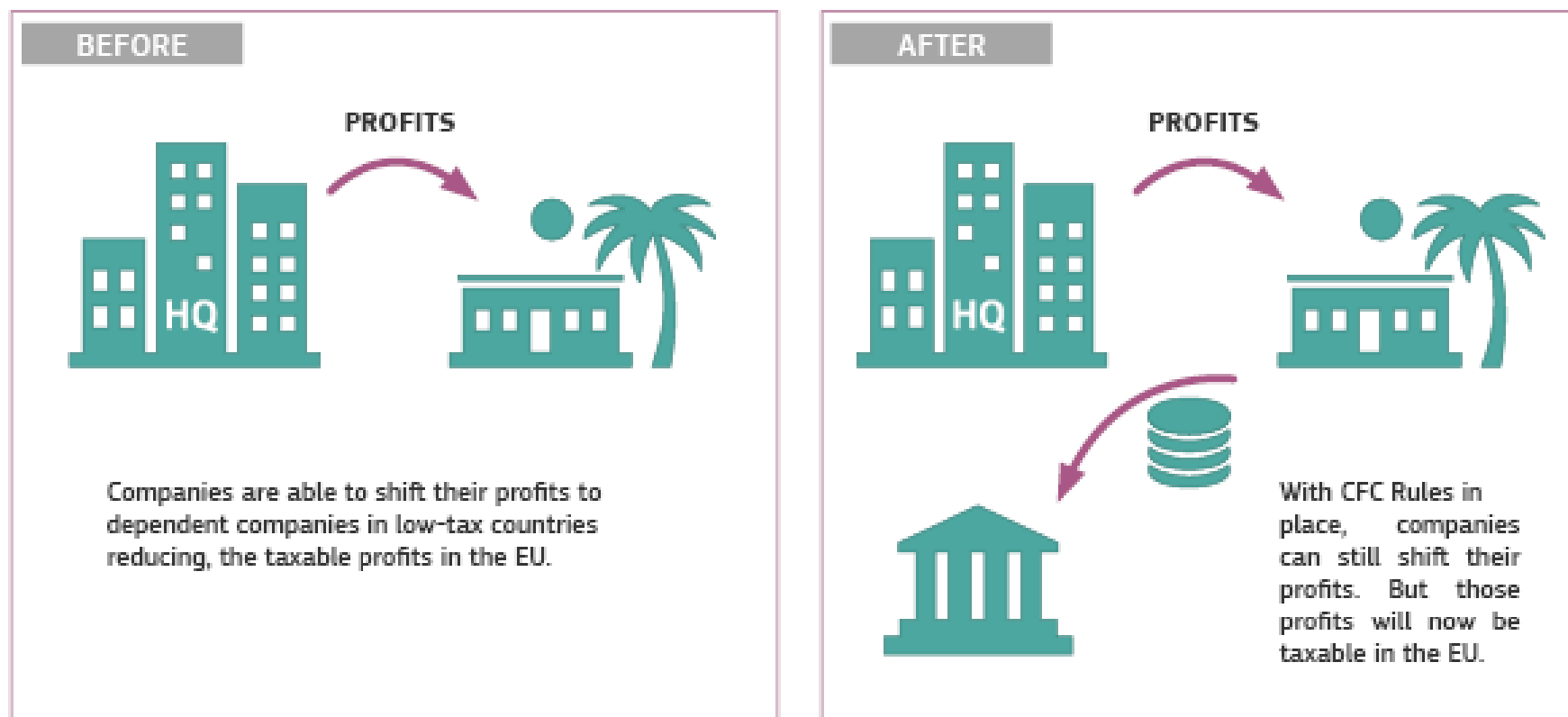


General Anti-Abuse Rule (GAAR)

- MS shall ignore an arrangement or series of, which have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law; or
- Are not genuine, that is, are not put in place for valid commercial reasons which reflect economic reality;
- In such cases, the tax liability shall be calculated in accordance with national law.

Controlled Foreign Company Rule (CFC)

THE CLASSIC PROFIT SHIFT: Controlled Foreign Companies (CFC) Rules



Controlled Foreign Company Rule (CFC)

- MS must tax the income of an entity or PE which is deemed a CFC

Controlled Foreign Company Rule (CFC)

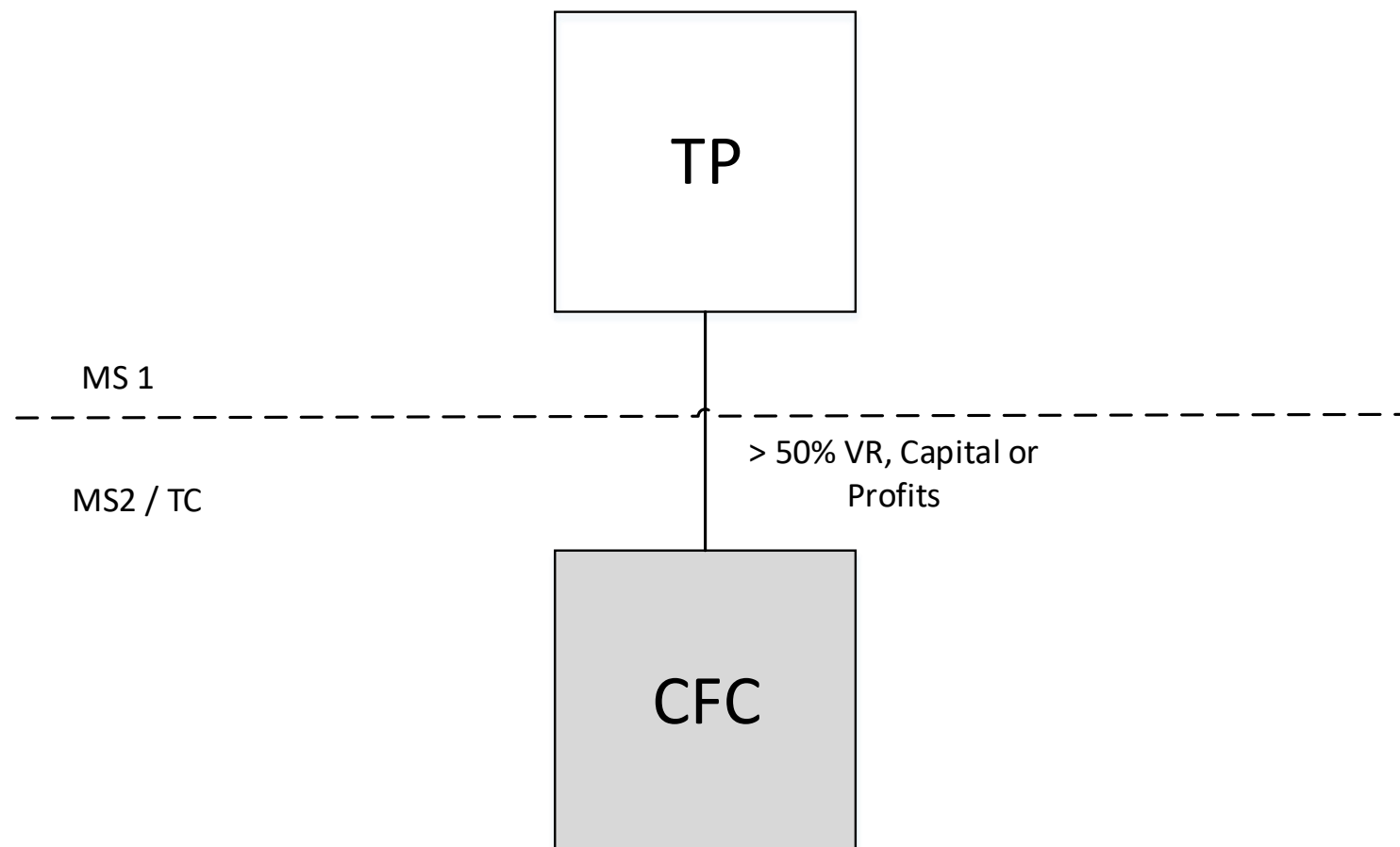
What is a CFC?

Where a TP (by itself, or together with its associated enterprises) holds a direct or indirect participation of more than 50% of:

- Voting Rights; or
- Capital; or
- Entitlement to profits.

‘Associate enterprises’ – connected as to 25% VR, Capital or Profits.

Controlled Foreign Company Rule (CFC)



Controlled Foreign Company Rule (CFC)

AND.....

- The actual corporate tax paid is lower than the difference between the corporate tax that would have been charged under the corporate tax system in the MS and the actual corporate tax paid.
- The income will not be taxed in the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises

Hybrid Mismatches

- To the extent that a hybrid mismatch results in a double deduction – the deduction shall be given only in the MS where such payment has its source;
- To the extent that a hybrid mismatch results in a deduction without inclusion, the MS of the payer shall deny the deduction.

Hybrid Mismatches – Proposed ATAD II

On 27 April 2017, the European Parliament adopted a legislative resolution amending ATAD to address hybrid mismatches involving 3rd countries:

- Hybrid entities;
- Hybrid PEs;
- Hybrid transfers;
- Imported mismatches;
- Dual resident mismatches.

Is the CCTB and the CCCTB the next step?

October 2016 – EU Proposal

CCTB – Common Corporate Tax Base – one set of rules to calculate taxable profit – 1 January 2019;

CCCTB – Common Consolidated Corporate Tax Base – Allocation of profits based on labour, assets, turnover – 1 January 2021

Concluding Remarks

- BEPS implementation via the MLI;
- Exit tax rule compatibility with EU freedoms is questionable;
- ATAD Contains principle based rules and leaves the details of their implementation to the MS – could this create an issue with harmonization?;
- Whilst being EU's response to the BEPS Project – some APs are not implemented in the Directive (1, 8, 9, 10 and 12) and the exit tax article is not mentioned in the BEPS' APs;
- Differences between what is proposed at OECD and EU level – how will this work?



**“The limits of the possible can only be defined
by going beyond them into the impossible”
Arthur C. Clarke**



Thank you

A|R|Q Group

Tower Business Centre,
Level 1,
Tower Street,
Birkirkara BKR 4013,
Malta

ARQGROUP.COM

GOING BEYOND