Monday, August 28

Plenary Session Subject 1: Assessing BEPS : Origins, Standards and Responses

General Reporters: Stephen Shay (USA) and Allison Christians (Canada)

Chair: Robert Danon (Switzerland)

Panel Speakers: Marienne Coutinho (Brazil), Sjoerd Douma (Netherlands), Akhilesh Ranjan (India), Pascal Saint-Amans (OECD), Sam Sim (Singapore)

Secretary: Jacob Heyka (USA)

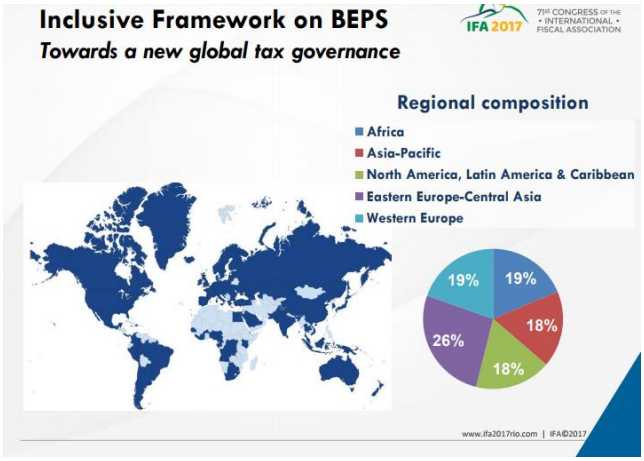
IFA President Porus Kaka mentioned during his inaugural address that Rio 2017 is the first IFA Congress wherein BEPS would be discussed as a full scientific topic. The first plenary session for the IFA Congress began on Monday with the topic of "**Assessing BEPS: Origins, Standards and Responses".** The session began by succinctly providing a recap on the origins of BEPS which can be traced to the political attention garnered during the period 2008-2010, when there were widespread campaigns on "tax havens" and tax avoidance by MNCs. **Ms. Allison Christians** explained the evolution of the BEPS Project from 2010 till date, touching upon important events like release of BEPS reports, launch of the Inclusive Framework & signing of the Multilateral Instrument, pointing out that this timeline was also dotted with a slew of controversies like the Offshore Leaks, Lux Leaks, Panama Papers, Apple, Ireland State Aid etc.

Thereafter, OECD Tax Policy Director **Mr. Pascal Saint Amans** emphasized once again about the 3 pillars which are the touchstone of the BEPS Project – coherence, substance & transparency and elaborated on the 4 minimum standards viz. Countering harmful tax practices (Action 5), Treaty shopping (Action 6), CbC Reporting (Action 13) & Dispute Resolution (Action 14) under the BEPS Project. He categorised the remaining BEPS Action Plans into reinforced standards (BEPS Action Plan 7 and 8-10), common approaches and best practices and lastly, the analytical reports (BEPS Action Plan 11 and 15).

Ms. Christians stated that the 4 top priority areas highlighted by the IFA branch reporters are CbC Reporting, Transfer Pricing, Treaty Abuse & Harmful Tax Practices while drawing further attention to the Reporters' assessment of relationships to BEPS & counter measures. **Ms Christians** noted that 23% of the responders from the IFA branch reporters felt that the negative

press led OECD to develop the BEPS Project, while 13% felt that their country is likely to go beyond the BEPS requirements. She also explained that some of the issues not addressed during the BEPS process included impact on trade & investment, insufficient capacity/resources, inconsistent application & growing compliance burden.

BEPS coverage



Regarding BEPS coverage, **Mr. Amans** explained that as of now, the Inclusive Framework members encompass most of the countries with 19% located in Africa, 18% located in Asia-Pacific, 18% located in North America, Latin America & Caribbean, 26% located in Eastern Europe-Central Asia and 19% in Western Europe.

BEPS Implementation Status

Regarding BEPS implementation, **Mr. Amans** highlighted that:

- Under BEPS Action Plan 5 'Counter harmful tax practices', around 125 preferential regimes have been identified and more than 12 harmful IP regimes have been abolished or amended. Further, information on more than 6,000 rulings has already exchanged.
- Under BEPS Action Plan 6 'Prevent treaty abuse', all 70 jurisdictions covered by the MLI have adopted the Principal Purposes Test (PPT) and soon, more than 1100 treaties will include a PPT.
- Under Action Plan 13 'TP documentation', 55 countries have taken steps to implement CbC filing obligation with more than 65 signatories to the CbC MCAA.
- Under Action Plan 14 'Dispute Resolution', more than 60 peer reviews have been scheduled with 6 jurisdictions already positively reviewed. He also acknowledged that some of the larger countries want the review be done after 2 years so that they are ready.
- Also, 26 jurisdictions have agreed to implement MAP arbitration through the MLI.

Mr. Amans thereafter, stated that the G20 has given a mandate to further explore solutions on digital economy taxation (BEPS Action Plan 1) by 2020, and to produce an interim report by spring 2018 on the following:

- Expansion of the PE definition to tax digital presence (Significant economic presence);
- Revision of profits allocation based on markets;
- Explore options like turnover tax etc. as regards digital economy taxation.

EU perspective on BEPS

Mr. Sjoerd Douma then gave an EU perspective on the BEPS Project, *inter alia* highlighting that the public CbC Reporting will have an important role to play with respect to EU tax policy impacting global tax agenda.

Mr. Amans termed the European countries as a good example of "*schizophrenia"* - on the one hand, they don't want countries like India/China or Brazil to tax their own MNCs but at the same time, want to go all out to tax Google, Starbucks etc. He, therefore, suggested that a coherent approach be adopted by all the countries.

Regional BEPS implementation

Brazil

At the outset, **Ms. Marienne Coutinho** apprised the audience that the Brazilian President initiated the process for Brazil to join OECD 3 months ago, although the country is a member of the G20. Moreover, Brazil is likely to sign the Multilateral Instrument soon.

Thereafter, discussing a case study on e-commerce, **Ms. Coutinho** explained that there is no express reference to tax digital activity in the Brazilian law. Further, their income tax legislation is based on direct sales, agents and consignment.

India

Mr. Akhilesh Ranjan (Principal Chief Commissioner, International Tax & Transfer Pricing, Indian IRS) stressed that India has extensively participated in the BEPS Project and is keen & willing to implement as many options as possible. This is evident from the fact that India has signed the Multilateral Instrument covering all its tax treaties. Highlighting that Action Plan 1 (Digital Economy) has always been a very high priority for India, **Mr. Ranjan** stated that domestic resource mobilization has been significantly impacted by inability to tax profits made by digital enterprises under the current physical presence based nexus rules. Further, unfair tax advantage to MNE digital enterprises violates principle of tax neutrality, he added. Remarking that *"In a market economy like India, we are not only concerned with base erosion but also source erosion",* **Mr. Ranjan** lamented that current rules are not geared up to tackle market value creation. He advocated that market jurisdictions which create value, particularly for digital services, must be remunerated. Further, he stressed on the point that the

value creation should be considered in the context of the market and demand forces as well. He quipped *"We knew BEPS project was not about source vs residence but we are confident that the final outcome will reflect that…"*

Mr. Ranjan then stated that in line with recommendations in Action Plan 1, India has adopted Equalization Levy to ensure tax neutrality, with minimal disruption and compliance costs, without multiple or excessive taxation for digital transactions. It is enacted as a self-contained code distinct from any other tax for specified services covering only Online Advertising till now. He, however, added that the scope of the levy can be extended. Consideration for specified (B2B) services received or receivable by a non-resident from a person resident in India and carrying on business or profession in India or a non-resident having PE in India is charged at 6% on the gross payment. According to **Mr. Ranjan**, *"India believes equalisation levy is not income tax, whether it is in the nature of income tax can be debated by treaty partners."*

Mr. Ranjan concluded by stating that India has emphasized the need for continuing the work of the Task Force on Digital Economy and urged an overhaul of PE definition under Article 5, especially the modification of nexus rules in tax treaties so as to recognize 'Significant Economic/Digital Presence' as sufficient nexus for taxing profits. He also added that OECD's authorized 'AoA' approach using FAR may not be sufficient for profit attribution and since demand side factors are important, some proxy for sales could be used. **Mr. Ranjan** also stated that India has urged for options in tax treaties for withholding tax, for ease of compliance and administration. Further, international consensus is paramount to obviate the need for unilateral actions by countries, he added. His final words – *"Digital economic practices and challenges must be addressed soon."*

USA

From a US outbound perspective, **Mr. Stephen Shay** stated that BEPS has dented source country but not so much the US avoidance planning. He added that *"BEPS adoption can be in form ... or in substance. A country can sign the MLI ... but take a minimalist approach to covering agreements or in agreeing to provisions (and to choices in mandatory provisions)".*

He cited the example of Mauritius not notifying Indian tax treaty, even though 60% FDI in India is routed through Mauritius. He also cited India's equalisation levy as an example of countries with early adopters of BEPS. Further, **Mr. Shay** stressed that *"Military defence, domestic security from terror attacks and a social safety net at home each must be paid for. Problems in other countries rapidly become our problems or our refugees."* He, therefore, suggested

that International cooperation in protecting revenue bases is the rational response, though it takes time and the progress is not in a straight line.

Asia

Mr. Sam Sim stated that the Asian countries are still digesting BEPS impact. He added that BEPS has helped in educating several stakeholders and uniformity brought by BEPS is welcome.

The panel at the end noted that the debate on 'source vs. residence' taxation has not been part of the scope of BEPS Project but it was agreed that the outcome of BEPS will lead to examining question thereon.

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DTS & Associates Take:

India has had a substantial role to play in the ongoing work on taxation of digital economy (BEPS Action Plan 1). India has shared its experience in taxing digital economy within the country through the Finance Act; but with OECD's interim report to be released in 2018 (as per G20 mandate), India may have to change its line of action.

As regards the debate over the nature of 'equalisation levy' in India (whether it is in the nature of income tax), the test is whether Indian authorities would give credit thereof in the event the Treaty partner country also introduces similar equalisation levy.

The definition of "Permanent Establishment" too requires an overhaul in view of the fact that a number of countries like Turkey have incorporated the change in their legislation in light of emerging digital economy. Even if digital economy is taken as PE, the de minimis rule and other issues will arise and hence, the only solution seems to be levy of VAT at appropriate level.

Seminar A: Fragmentation of contracts and taxation

Chair: Carmel Peters (New Zealand)

Panel Speakers: Jonathan Schwarz (UK) Liselott Kana (Chile), Mary Bennett (USA), Craig Elliffe (New Zealand)

Secretary: Lucas de Lima Carvalho (Brazil)

The panel analysed the international tax implications of fragmentation of contracts, especially taking into consideration BEPS recommendations, the impact of the Multilateral Instrument of Treaty Interpretation and changes in laws occurring in different countries.

The panelists explained the background of Article 5(4) appearing in Model Tax Convention dealing with the 'preparatory and auxiliary' services that carve out an exception to the definition of 'fixed place permanent establishment (PE)'. It was discussed that the intention behind creating this exception was to leave out the activities that are not significant and do not yield profits in the source jurisdiction. The intention was to not put burden on the taxpayers as well as the Governments with the compliance and audits. The panelists commented that in the pre-BEPS era, in the context of fragmentation of contracts, 'company-by-company' approach to the PE determination was an approach provided by the OECD.

The panel then discussed the BEPS changes on the new anti-fragmentation rule and noted the explanation from the OECD, which states that "*the purpose of paragraph 4.1 is to prevent an enterprise or a group of closely related enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.*" The panel noted the new anti-fragmentation rule - [clause (a) of Para 4.1] which reads that "*place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article*". The panel noted that this clause is very wide and has a flavour of "force of attraction" rule.

The panel also highlighted the likely issues from new anti-fragmentation rule. The two significant issues noted by the panel were –

- When does foreign enterprise have a fixed place of business at the location where the preparatory or auxiliary activity takes place?
- How to know when two activities constitute "complementary functions that are part of a cohesive business operation"?

The panel traced the actual implementation of the anti-fragmentation rules by the countries in the multilateral instrument signed by the countries. It was observed that the MLI signatories that have opted to make no changes to their treaties' specific activities exception rules include countries like Canada, China, Czech Republic, Denmark, Finland, Greece, Hong Kong, Hungary, Iceland, Korea, Latvia, Liechtenstein, Poland, Sweden, and Switzerland. Further, MLI signatories that have opted not to adopt the new anti-fragmentation rule include countries such as Austria, Germany, Luxembourg, and Singapore. Thus, the panel noted that results on actual adoption of new anti-fragmentation rules by the countries have been mixed.

The panel thereafter dealt with the overlap between the relationship of the principal purpose test (PPT) with existing Commentary on Article 1 and specific anti-avoidance rules relating to the PE Article (viz. Art 13 and 14 MLI and 2017 OECD Model changes). Referring this overlaps as 'substantial', the panel made a few important conclusions as follows:

- OECD's intention appears to be that PPT effectively introduces an anti-abuse principle which has been discussed in the OECD Commentary.
- With respect to contract splitting, it has been long regarded as potentially subject to anti-avoidance rules.
- OECD seems to concede that the anti-fragmentation rule in Article 13 of the MLI and paragraph 4.1 of the OECD Commentary on Article 5 operate prospectively.
- In addition to the above, provisions of the domestic GAAR may also apply.

At the end, discussed unilateral measures adopted by the countries such as UK, Australia, and New Zealand by the introduction of 'diverted profit tax rules', which seek to tax the activities in the source country by creating a deemed PE.

Ms. Marry Bannet, in the concluding remarks, explained the changed rules on the interpretation of preparatory & auxiliary services in the context of e-commerce companies having warehouses in source jurisdictions, which is now treated as a 'core activity'. She gave a corollary of a traditional fruit importer which has to keep fruits fresh in the warehouse until the customs clearance, which is regarded as preparatory in nature. She quipped that the flavour of the distinction between the treatment of e-commerce entity and the fruit vendor is not understood.

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DTS & Associates Take:

Companies have been splitting the contracts or allocating the activities among the group companies which would allow them to fall within the threshold of the PE definition under various tax treaties. This is sought to be checked through the BEPS Action Plan.

Though one may not get all the answers in the session, one can certainly get an overview of the challenges to be faced, whether the proposed amendments would have retrospective / prospective applicability and understand the interplay between different Rules viz. PPT Rules, GAAR provisions and Anti-fragmentation Rules. The Action Plan would have retrospective applicability when it comes to splitting of contracts, but in case of fragmentation activities, the view appears that same would be prosepective.

Seminar B: Automatic Exchange of Information: a New Standard?

Chair: Armando Lara Yaffar (Mexico/UN)

Panel Speakers: Monica Bhatia (OECD), Alexandra Kadet (Russia), Viktoria Wöhrer (Austria), Mark Matthews (USA), Xavier Oberson (Switzerland)

Secretary: Lucas de Lima Carvalho (Brazil)

OECD Global Forum's **Monica Bhatia** updated the audience on the progress of the work being done by the organization in relation to Automatic Exchange of Information (AEOI), emphasizing on the following parts:

1. Monitoring Implementation (102 of the 145 countries who are participating in the Global Forum, have signed up to the CRS, i.e. Common Reporting Standards)

2. Expert confidentiality assessments

3. Network partners

4. Legislative assessments

5. Compliance with technical exchange requirements

As regards the future work of the Global Forum, **Ms. Bhatia** made a mention of the following:

a) Monitoring and assessment of AEOI implementation.

b) Extending AEOI benefits to all jurisdictions

c) Importance of Compliance by Financial Institutions

d) Making an impact study of the compliance cost of AEOI

She stated as a matter of fact that, there is a huge pressure on countries to implement AEOI standards, which has led to several 'holdout' jurisdictions making commitments to implement the same. **Mr. Oberson** attributed this to the fear of their names figuring in the 'black list'.

The discussion then moved to an interesting sub-plot within AEOI - the fierce resistance of United States of America (USA) to implement the standards and their reluctance to join the CRS. **Mr. Mathews**, now in private practice but formerly with the US IRS, made some pertinent points in

relation to USA's stand as also the FATCA - CRS interplay. He ruled out the possibility of USA joining CRS in the near future and in a lighter vein, alluding to the US President Donald Trump's penchant to keep the front page headlines to himself, stated that EOI had largely gone below the radar in America. As regards the controversial US legislation FATCA, **Mr. Mathews** pulled no punches when he made the following points:

- FATCA is a problem area, as it imposes heavy costs and burdens on institutions.

- There were no detailed Senate Committee hearings, cost-benefit analysis done while legislating FATCA.

- There has so far been no evidence of audit activity by the IRS based on the FATCA data. **Mr. Mathews'** terse one liner - *"We don't have a system ready for prime time"*

- But in the same breath, he warned the audience that *"They (US IRS) will eventually get there... and when that 'tiger' is created and working, it will be "brutal" and there will be referrals to criminal investigations."*

Ms. Viktorial Wohrer explained to the delegates, the AEOI & Anti-Money Laundering (AML) interplay and the beneficial ownership definitions in AML legislation to identify controlling persons of passive non-financial entities. She referred to an EU directive that the tax authorities must get access to AML information.

f. He also referred to concerns over data encryption and data safety. He opined that different interpretations and case by case analysis vis-à-vis AEOI could present a threat to legal certainty. **Ms. Bhatia** was quick to clarify that Bitcoin operators would fall within CRS ambit as they are managing financial assets.

Ms. Wohrer then brought out the taxpayer fears on AEOI over the following aspects:

a) Communication of personal data to a public authority.

b) Collection & retention of data.

c) Is bulk transmission of financial data in line with the data protection safeguards?

d) To what extent is EOI necessary and proportional?

Panel Secretary **Lucas Carvalho** concurred, stating that the same fears existed in Brazil as well with big MNCs in the South American nation, not confident of the capabilities of the tax authorities to protect data received from Financial Institutions.

Ms. Alexandra Kadet, an IRS officer, informed the delegates that we are unlikely to see immediate action from tax authorities, with regards to usage of AEOI data, although she did concede that there will be some jurisdictions that will want to use the information immediately.

Ms. Bhatia allayed any concerns over lack of Model AEOI legislation, by stating that 102 countries adopted different models and hence there are lots of model legislations available. She also acknowledged concerns over technology preparedness of jurisdictions and termed as "valid concern" the fear that some of the 43 countries, which have not signed up to CRS, might become the new tax havens. Her concluding words -*"There are challenges but we are confident of a more uniformed implementation."*

DTS & Associates Take:

With 43 countries not signing up to the Common Reporting Standards, there could arise challenges with respect to the sanctions, eg. World Bank / IMF not granting them the loan or facilities. This would require a coherent action from the OECD Global Forum. The process of 'peer review' is also going to be a challenge in the future for the countries, especially with the fear of being 'black listed'.

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In light of India's Apex Court ruling on right to privacy being a fundamental right enshrined under the Constitution, protection of taxpayers' data will be of paramount importance. Data protection in India is currently not full proof and it may get a warning.