BY ABDUL RAZAK RAHMAN

ALIGNING TAX STRATEGIES WITH BEPS

JEROME STEPHANE VAN STADEN, INTERNATIONAL DIRECTOR, INTERNATIONAL TAX SERVICES, ERNST & YOUNG SOLUTIONS LLP SINGAPORE WAS SPEAKING ON ALIGNING TAX STRATEGIES WITH BEPS AT MIA'S BASE EROSION AND PROFIT SHIFTING (BEPS) SYMPOSIUM 2017.

THE 2013 Organisation for Economic Co-operation and Development (OECD) report Addressing Base Erosion and Profit Shifting concluded that no single tax rule on its own enables BEPS; it is rather the interplay among the different issues that makes it possible. Domestic laws and rules that are not co-ordinated across borders, international tax standards that have not always kept pace with the changing global environment and a pervasive lack of relevant information at the level of tax administrations and policymakers combine to facilitate taxpayers' BEPS strategies. The report also identified access to harmful tax practices as a key pressure area enabling BEPS.

Below, we outline Actions 1, 5, 12 and 14 of the OECD's BEPS project, which aim to align tax strategies with anti-BEPS initiatives.

ACTION 1 – TAX CHALLENGES OF THE DIGITAL ECONOMY

The Digital Economy (DE) has opened up a wide range of revenue models and the landscape is evolving rapidly. Whilst the DE by itself is not culpable for BEPS, its key features exacerbate BEPS risks. These include mobility in respect to intangibles and business functions, flexibility on the location of servers and resources, heavy reliance on 'big data', volatility due to low barriers to entry and rapidly evolving technology.

From the tax perspective, DE's nature of operating virtually, its ability to avoid source- or resident- based taxation and its heavy reliance on intangibles substantially increase its ability to shift profits to low tax jurisdictions. The OECD itself acknowledges that the present international taxation standards have limitations in addressing BEPS and the tax challenges raised by developments in DE.

When the OECD released its final report on tax challenges of DE in October 2015, it did not recommend any specific measures or special rules to address DE tax issues. Instead, the OECD recognises that DE is increasingly becoming an economy in itself, making it difficult to ring-fence

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DE from the rest of the economy. The report summarises the key features of evolving digital business models that the OECD considers relevant for BEPS analysis, and also identifies three main tax policy concerns which relates to Nexus, Data and Characterisation.

The report states that DE risks and tax challenges will be effectively addressed through other BEPS Actions. For example, Action 3 updates the Controlled Foreign Company rules to address challenges identified in the DE. Action 7 addressed the modification to the list of PE exceptions to ensure core activities involving preparatory and auxiliary functions cannot inappropriately benefit from the exception. Another area under Action 7 is the modification to the definition of PE to address artificial arrangements through 'conclusion of contracts' arrangements to avoid PE status. The updates to the OECD TP Guidelines under Actions 8, 9 and 10 will also address DE risks and tax challenges.

In addition, the OECD is considering the indirect tax treatment of digital transactions and recommendations have been put forward to apply the OECD's International Value Added Tax/Goods and Services Tax (VAT/GST) Guidelines. The OECD plans to develop a coordinated implementation mechanism for the International VAT/GST Guidelines and will continue working with a broad range of stakeholders for post-BEPS monitoring process.

ACTION 5: COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE

The concerns on harmful tax practices are primarily about preferential regimes that can be used for artificial profit shifting and lack of transparency in connection with certain rulings. It is important to note that Action 5 is not intended to promote harmonisation of income tax or tax structures within or outside the OECD, nor is it intended to dictate the appropriate level of tax rates. The OECD's objectives in

tackling harmful tax practices, amongst others, is to encourage an environment for free and fair tax competition to move to a 'level playing field' and to develop solutions more effectively, taking into account factors such as transparency and substance. Another objective is to develop measures to counter harmful tax practices with respect to geographically mobile and easy to shift activities from country to country. Ultimately, the aim is to secure the integrity of tax systems across the globe by addressing issues that unfairly erode tax bases of other countries, potentially distorting location of capital and services, causing undesired shift of tax burdens and increasing administrative and compliance burdens on tax authorities and taxpayers.

A regime is considered preferential if it offers tax preferences, either in the forms of reduced tax rates, preferential payment terms or repayment of taxes, in comparison with the general principles of taxation in that country. Action 5 only targets regimes which are potentially or actually harmful and it is important to point out that a preferential regime is not necessarily potential or actually harmful. A regime that is regarded as potentially harmful is obligated to exchange information in respect of rulings whereas a regime that is actually harmful is to be abolished or realigned to comply with the agreed minimum standards.

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In order to establish that a preferential regime has become potentially harmful, the OECD has outlined four key factors for consideration. The first is a primary or gateway/entrance criterion where there is no or nominal tax on the relevant income. The other three secondary key factors are ring-fencing from the domestic economy, lack of transparency of the regime or inadequate regulatory supervision, and lack of effective exchange of information. If the primary factor plus any one of the three secondary factors exist, then the regime is considered as potentially harmful.

In addition to the four key factors, the OECD also prescribes another eight supplementary factors for consideration in the potentially harmful regime test. They are artificial definition of tax base, failure to adhere to international transfer pricing (TP) principles, foreign source income exempted from residence country taxation, negotiable tax rates, existence of secrecy provisions, a wide network of tax treaties, promotion of the regime as a tax minimisation vehicle, and encouragement of operations that are purely tax driven with no substantial activities. The evaluation of these eight factors provides evidence to support existence of the four key factors and harmful impact.

The next step is to establish whether a potentially harmful regime is actually harmful. The OECD defines a potentially harmful regime as actually harmful if it creates harmful economic effects. The factors to consider are whether the tax regime is merely an attraction to shift activities from another country

rather than generating significant new activities, the preferential regime is the primary motivation for location of an activity, and lastly, the presence and level of activities in the host countries do not commensurate the amount of investment or income.

In order to improve transparency, BEPS Action 5 has also introduced compulsory spontaneous exchange of information covering rulings on the preferential regimes, unilateral advance pricing agreements or cross-border unilateral rulings in relation to TP, cross-border rulings providing for a downward adjustment of taxable profits, permanent establishment rulings and related party conduit rulings. This compulsory exchange of information is applicable to countries of residence of the related party with whom the taxpayer has transactions, as well as the immediate holding company and the ultimate parent company. In February 2017, the Peer Review and Monitoring Process was also released by the OECD covering four review areas which include: the information gathering process, the exchange of information, confidentiality of the information received and statistics on the number of rulings exchanged spontaneously.

ACTION 12 – MANDATORY DISCLOSURE RULE (MDR)

Aggressive tax planning (ATP) is a major risk to the revenue base of countries. The lack of timely, comprehensive and relevant information on ATP strategies is one of the main challenges faced by tax authorities worldwide. Timely access to the relevant information gives tax authorities improved accuracy in risk assessment, and faster and greater flexibility in responding to the tax risks, including changes in legislation, which are not sufficiently addressed through traditional audits. Action 12 on MDR is a disclosure initiative introduced by countries to receive timely information about ATP schemes. The aim is to obtain early information on tax avoidance schemes including the users and advisors of the schemes and to act as a deterrent to reduce the promotion of the schemes. Action 12 recommendations do not represent a minimum standard and countries are free to choose whether or not to introduce MDR. The recommendations mooted by Action 12 cover both the domestic and international schemes and outline the best practices in terms of information to be included, the timing of the reports as well as the consequences of disclosure and non-disclosure. It also sets out recommendations for the development and implementation of information exchange and co-operation between tax administrators.

AGGRESSIVE TAX PLANNING (ATP) IS A MAJOR RISK TO THE REVENUE BASE OF COUNTRIES. THE LACK OF TIMELY, COMPREHENSIVE AND RELEVANT INFORMATION ON ATP STRATEGIES IS ONE OF THE MAIN CHALLENGES FACED BY TAX AUTHORITIES WORLDWIDE.

ACTION 14 – MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE

The OECD recognises that the changes introduced by the BEPS project may lead to uncertainty, and could lead to double taxation and Mutual

Agreement Procedure (MAP) disputes in the short-term. The measures developed under Action 14 therefore aim to strengthen the effectiveness and efficiency of the MAP process by outlining minimum standards which have to be mandatorily implemented such as peer review, identifying best practices as recommendations and introducing mandatory arbitration for disputes not resolved through MAP. Under Action 14 there are three overarching principles which the OECD hopes to achieve as minimum standard principles. They are to ensure: that treaty obligations under MAP are fully implemented in good faith and resolved in a timely manner, the implementation of an administrative process that promotes the prevention and timely resolution of treaty-related disputes, and that taxpayers can access the MAP when eligible. In addition to the three overarching principles, the OECD also issued eleven best practices to improve the dispute resolution mechanisms. The best practices are recommendations based on the broad theme of the mandatory requirements but are not obligatory.

The MAP process is rather new to most Asian countries compared to the Europe or the USA. Japan is the most advanced and fulfils most of the three minimum standards and the eleven best practices recommended by the OECD under Action 14. Japan has also introduced arbitration in its national tax law and it is common practice for Japan to resolve disputes by arbitration. Singapore and Korea also have a working MAP process but have not implemented arbitration. Malaysia and Indonesia amended their MAP processes recently by issuing new guidance to improve the efficiency of the process. With regard to arbitration, there is no consensus amongst the countries for the adoption of mandatory arbitration as part of the three minimum standards or the eleven best practices. Only a group of countries, mainly in Europe and the USA, have committed to introduce mandatory binding arbitration as a way of dispute resolution, which could not be solved within a MAP process. Moving forward, mandatory binding MAP arbitration provision is to be developed as part of the multilateral instruments envisaged by Action 15 of BEPS Action Plan. ■

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Projek Lintasan Kota Holdings Sdn Bhd (331374-X) 12th Floor, Menara PNB, 201-A Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia