URÍA MENÉNDEZ

The OECD report on base erosion and profit shifting (BEPS) and EU measures against aggressive tax planning and tax fraud

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Background

Call for action

- Financial (and fiscal) crisis context
- Businesses facing pressure from media, politicians and general public
  - Growing concern: governments loose tax revenue due to planning aimed at eroding taxable base and/or shifting profits to more favorable locations

- June 2012, G-20 meeting final Declaration: BEPS must be prevented
- November 2012: G-20 welcomes OECD work on BEPS and looks forward to a report
  - U.K., Germany, and France issue joint statement calling for coordinated action to strengthen international tax standards and urging peers to support OECD measures to identify gaps in tax laws

- February 2013: issuance of the BEPS report

MNCs may be engaging in BEPS

- Current rules may allow for allocation of profits to locations different than those where valuable business takes place, using key and traditional principles (jurisdiction to tax, transfer pricing, etc).

- BEPS indicators:
  - Increased segregation between the location where actual business activities and investments take place and the location where taxable profits are reported.
  - Effective Tax Rate (not statutory rate) could be useful in determining whether BEPS is taking place
  - Foreign Direct Investment data shows potential lack of substance of certain investments

Key pressure areas

New businesses and digital era

- Global cross-border tax regime has not kept pace with changing business environment (global taxpayers, importance of movable IP)
  - Planning opportunities may now result in profits not being taxed in any jurisdiction

- The digital economy is putting increasing "pressure" on the well-established concept of permanent establishment.
  - Current technology permits nonresident taxpayers to derive substantial profits from transactions with customers located in another jurisdiction.

- OECD: questions arise as to whether or not current rules ensure fair allocation of taxing rights on business profits.

Pressure areas

1. International mismatches in entity and instrument characterization
2. Application of treaty concepts to profits derived from the delivery of digital goods and services
3. The tax treatment of related party debt-financing, captive insurance and other inter-group financing
4. Transfer pricing (shifting of risk and intangibles and ownership splitting)
5. The effectiveness of anti-avoidance measures (GAAR, CFC, thin cap, etc)
6. The availability of harmful preferential regimes.

Profit shifting examples

Examples and strategies

- "Common" practices of MNEs:
  - Moving profits to where they are taxed at lower rates, and expenses to where they are relieved at higher rates.
  - Make use of existing tax attributes (e.g. tax credits, loss carry forwards, etc).
  - Financing and licensing through low taxed branches
  - Use of hybrid entities (mismatch allowing no taxation of income)
  - Use of hybrid instruments (debt-equity mismatch, or similar effects through captive insurance, derivatives)
  - Conduit companies allowing treaty shopping
  - Use of derivatives (e.g. swaps) to avoid WTH and other taxes

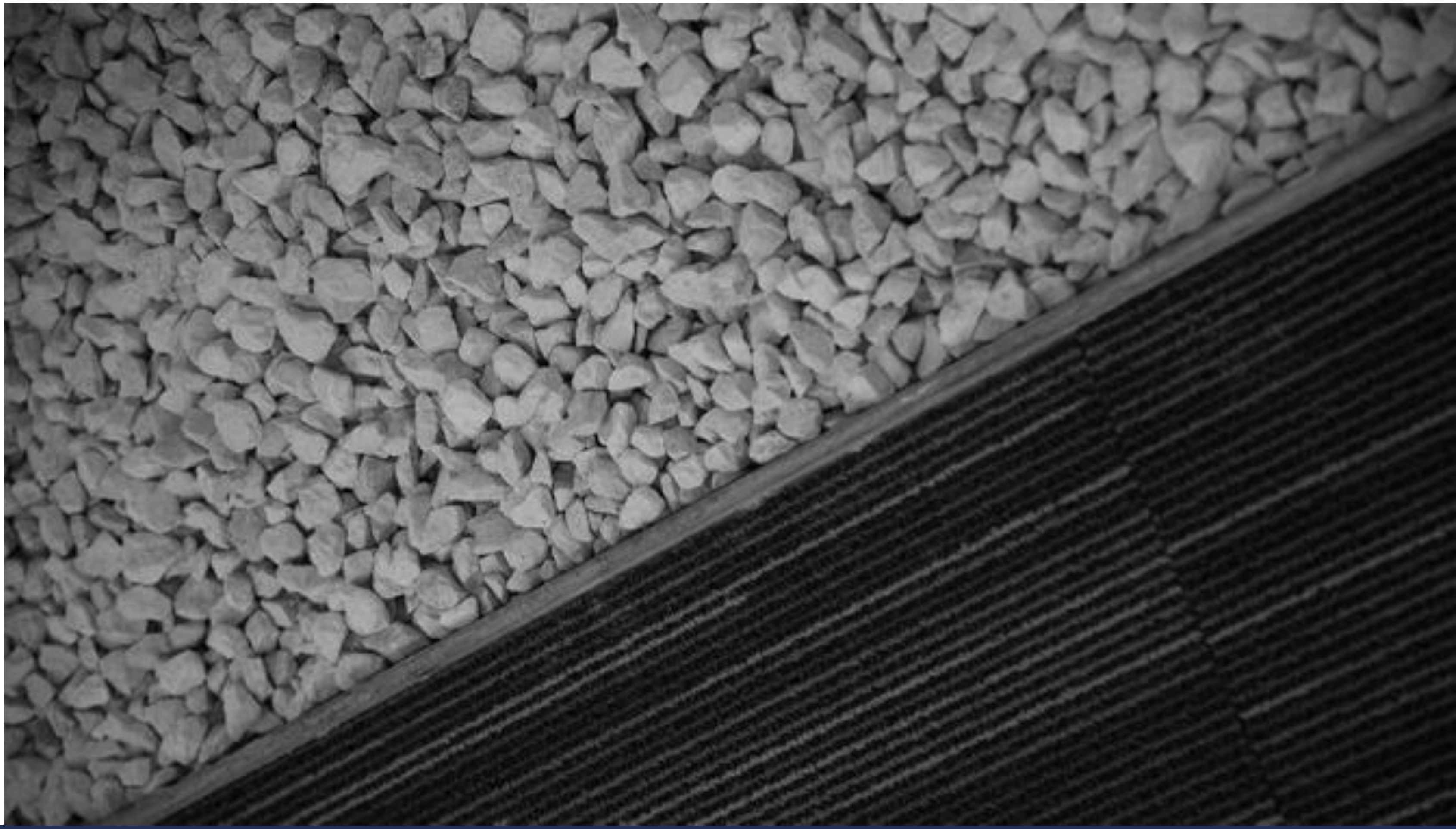
Examples and strategies

- Transfer pricing (risk allocation and IP):
  - Arm's-length principle assumes that the more extensive the functions/assets/risks of one party to transaction, the greater the expected remuneration.
    - Many corporations structure focus on allocating significant risks and hard-to-value intangibles to low-tax jurisdictions where their returns may benefit from a favorable tax regime. This may contribute to BEPS.
  - Transfer pricing rules regarding attribution risks of assets within a group are applied on an entity-by-entity basis, facilitating planning based on the isolation of risks at the level of particular members of the group.

Examples and strategies

- Domestic anti-avoidance rules may include GAARs, CFC, thin cap, Anti-hybrid rules, Anti-base erosion rules, lists of preferential tax regimes.
- Tax treaties may include similar rules and limitations on benefits clauses.
- In practice, strategies may have been used to circumvent application of anti-avoidance rules, e.g.:
  - channeling financing through independent third party (back-to-back loans, derivatives); or
  - "inversions" so that a nonresident company in a low or not ax jurisdiction with no CFC regime replaces the existing parent company at the top of the group; or
  - Hybrid instruments may also make income "disappear" (sic.) for tax purposes .

OECD's action plan



OECD’s current work areas

- OECD’s current work in this area includes, among others:
  - Report on hybrid mismatch arrangements (2012)
  - Report on tackling aggressive tax planning through improved transparency and disclosure (2011)
  - Projects conducted in conjunction with Global Forum on Transparency and Exchange of Information for Tax Purposes
  - A directory of aggressive planning schemes being used by government officials in several jurisdictions.

The OECD’s action plan

- International coordination is critical. Collaboration with private sector is desired. Modernization of tax regimes:
    1. Instruments to neutralize the effects of hybrid mismatch arrangements and arbitrage
    2. Improve and clarify transfer pricing rules
    3. Update solutions to the issues related to jurisdictions to tax, in particular in the area of digital goods/services
    4. More effective anti-avoidance measures
    5. New rules on the treatment of intra-group financial transactions
    6. Solutions to counter harmful regimes more effectively

- However, no specific measures are proposed.

A European perspective on BEPS

A European perspective on BEPS

EC Recommendations on aggressive tax planning

- In line with the OECD/BEPS report, the EC recognizes the lack of effectiveness of national measures to tackle base erosion from legal tax planning and suggests:
  - New wording for income tax treaties and unilateral relief requiring taxation of income in at least one country
  - A general anti-abuse rule – "artificial arrangement" in place for the "essential purpose of avoiding taxation" shall be ignored
  - Stress in commercial substance, amount of tax paid, tax benefits obtained, consistency with spirit and law and reasonableness of business conduct.

A European perspective on BEPS

- Better use of existing EC measures:
  - New framework for administrative cooperation; Closing Savings taxation loopholes ; Implementing VAT fraud measures

- New EC measures
  - Measures on good governance (creation of a level playing field) and aggressive tax planning (as contrary to Corporate Social Responsibility)
  - EC work with the OECD on standards for e-commerce
  - Need for quick answer to harmful practices including mismatches and double non-taxation: EC ready to act
  - European TIN and standard forms for exchange of information

A European perspective on BEPS: Trends

- New case law:
  - Expansion of the concept of Permanent Establishment
  - Anti-abuse provisions against certain debt-push down structures

- New legislation:
  - Limitation on the deductibility of financial expenses
  - Implementation of new anti-abuse rules
  - New contents of recent tax treaties (LoB for triangular structures, measures against tax havens)

- Added complexity for the request of certain rulings

Unilateral action to be avoided

Roche Vitamins (Spain). 2012 Supreme Court case

- Tax treatment of activities performed by a Spanish subsidiary engaged in limited risk manufacturing and promotion of products of a Swiss related entity in the pharmaceutical sector
- Issue: Potential existence of a PE of the parent company in Spain. Inclusion of manufacturing and sales profits as taxable income
- Facts: Signature of agreements entail change from importer, manufacturer and distributor to limited risk manufacturer and marketer

Roche Vitamins case (Spain)

The judgment: Existence of a PE in Spain

- The agreements entered into evidence that manufacturing and sales activities are organized by the Swiss parent company
- The parent company decides how human and material resources are to be used in Spain (they are at its entire disposal)
- Roche Spain is not assuming economic risks. It is merely managing the parent's manufacturing activity
- The parent company decides all economic conditions and merely reimburses costs to Spain (the mark up is a "consideration for the financial costs of manufacturing")

Q&A

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