frontiers in tax

People thinking beyond borders in financial services

September 2014

Featuring:

Automatic Exchange of Information
The emerging global Standard

BEPS
Time for action

Country-by-Country Reporting
What's your strategy?

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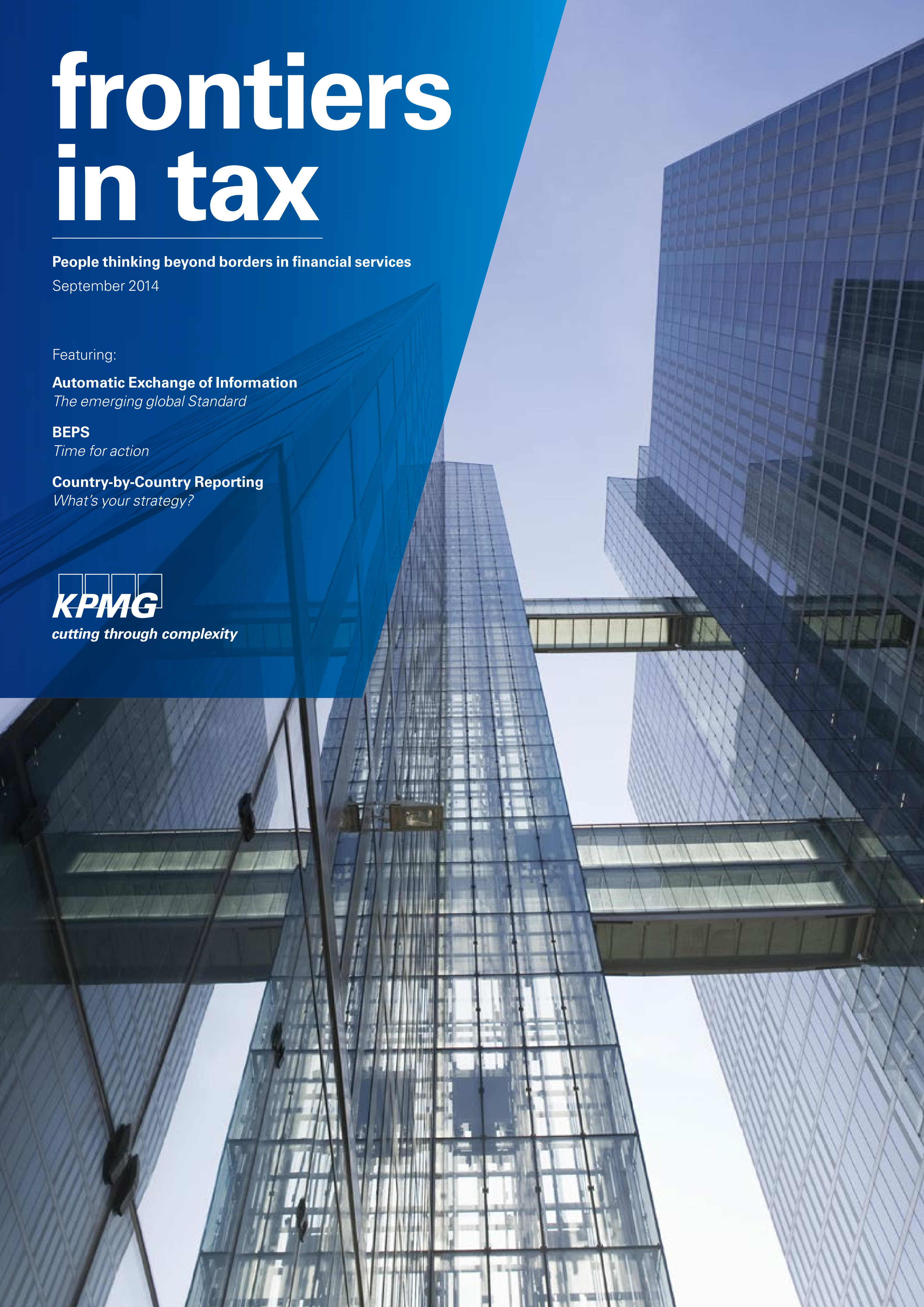
cutting through complexity



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Introduction:

Towards a new international consensus on tax?

"Cross-border tax evasion and avoidance undermine our public finances and our peoples' trust in the fairness of the tax system. Today, we endorsed plans to address these problems and committed to take steps to change our rules to tackle tax avoidance, harmful practices, and aggressive tax planning."

G20 Leaders' Declaration, Saint Petersburg Summit, 5–6 September 2013

In the wake of the financial crisis, political leaders and the electorates they represent have become increasingly concerned at the apparent ability of multinational corporations (MNCs) and high net worth individuals to escape their 'fair' share of tax responsibilities. Globalization has brought many benefits in terms of cross-border trade, efficiency, competition and the free movement of goods and labor. But it has also allowed MNCs much greater freedom to reconfigure the location of manufacturing, operations, sales and corporate services in ways which channel reported profits – and hence tax liabilities – to low-tax jurisdictions.

While such actions are legal, the view has developed rapidly in recent years that tax avoidance of this type is both unfair and potentially economically damaging. Apart from the alleged existence of a moral imperative to pay the 'right' amount of tax, it is argued that avoidance by some shifts the tax burden disproportionately onto those who are less able to take avoiding action; that it distorts economic incentives; and that it brings tax regimes in general into disrepute. The widespread and increasing adoption of general anti-avoidance rules (GAAR) is a measure of how international concern over aggressive tax avoidance has grown.

Since the crisis, this concern has been magnified dramatically. This is in part because virtually all developed countries, faced with the challenge of sustaining broadly current levels of government expenditure during a period of financial stringency and economic slowdown, have generally raised consumption taxes and personal income taxes and redoubled their efforts to collect tax wherever and whenever they can. It is also because their citizens, squeezed between declining purchasing power and higher taxation, increasingly resent others who seem to be 'getting away with it'. Across the world, we are seeing tougher legislation and regulation, more cooperation between tax authorities, and a media climate that, in some jurisdictions, is potentially hostile to business – and to financial multinationals especially.

As a consequence, there is now significant debate over whether long-standing fundamental elements of the global corporate tax environment need to be changed. Key drivers include:

- perceptions that MNCs are not paying enough tax compared to domestic companies
- questions over the suitability of the current global system for allocation of profits in the e-commerce age
- the growing tendency to put the burden of tax collection on the private sector.

The fact that governments want to increase tax revenues in times of austerity is not a surprise. Nor is the fact that the countries which feel disadvantaged by the current system are looking to change it for their own benefit. Ultimately, many developed nations in the G20 are determined to increase the total amount of taxes paid by MNCs; at the same time, developed countries want to ensure that more of that tax is retained in the developed countries where, they argue, most economic value – whether manufacturing, services or sales – is created.

The G20 has taken the lead in driving debate forward, as in many areas of post-crisis response, and has placed responsibility on the OECD, with its long history of promoting international tax cooperation, to develop concrete proposals. The results are likely to change significantly the context in which multinational financial institutions operate and constrain further their scope for effective tax planning.

Key drivers of the changes that may occur will be:

- The OECD's Base Erosion and Profit Shifting (BEPS) project, and in particular those actions designed to:
  - ensure that transfer pricing outcomes are in line with value creation
  - ensure that multinational companies provide all relevant governments with details of all operations, revenues and taxes paid according to a common template ('Country-by-Country Reporting')
- the move to Automatic Exchange of Information between governments and tax authorities on account holders with multiple or overseas residences.

New regulations are being introduced on potentially very tight timescales, and companies need to gear up to respond as a matter of urgency.

As multinational financial companies develop their responses to the new environment, the impact on tax functions will be profound. Transfer pricing decisions, information gathering, reporting and information exchange will all be extended and transformed. Against this background, it will be crucial that tax considerations are integrated effectively into overall business strategy and operational decisions.

In this issue of *frontiers in tax* we review each of the key areas noted above: BEPS, Country-by-Country Reporting and Automatic Exchange of Information. Some companies may think they can postpone action until the rules become clearer; others may remain sceptical about how radical the transformation promised by BEPS will be in practice. In our view, though, it is essential that financial institutions fully evaluate the potential impact of the BEPS project on their business as a matter of urgency. Even though many of the structures currently in place may not be the direct target of the steps being taken under the BEPS project, the law of unintended consequences could well apply. Active engagement and understanding of the potential implications is highly advisable, as lobbying and representations may be required to avoid adverse unintended consequences for sectors or business models.

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Hans-Jürgen A. Feyerabend
Chairman – Global Financial Services Tax

Automatic Exchange of Information: The emerging global Standard

"The next challenge regarding Automatic Exchange of Information is now to get all jurisdictions to commit to this Standard and put it into practice."

G20, September 2013[1]

In the previous issue of *frontiers in tax* we reported on the background to the development of Automatic Exchange of Information (AEoI) and explored the emerging framework of international tax transparency.[3] That article noted that at their St. Petersburg Meeting of September 2013, the G20 announced that they expected to begin Automatic Exchange of Information by the end of 2015.[4]

A key subsequent step was the OECD publication on 13 February 2014 of a multilateral Standard for automatic exchange of financial account information.[5] This Standard was developed in partnership between the OECD and the G20 countries, and in close co-operation with the EU. The document is in two parts: Part I contains the introduction to the Standard; Part II contains the text of a Model Competent Authority Agreement (CAA) and a Common Reporting and Due Diligence Standard (CRS). It defines a Standard for mutual exchange of information on account holders with foreign tax residence, account balances, income and gross proceeds from certain financial transactions.

The new Standard was endorsed in May 2014 during the OECD's annual Ministerial Council Meeting in Paris by all 34 member countries, along with Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Latvia, Lithuania, Malaysia, Saudi Arabia, Singapore and South Africa.[6] Forty-four countries and jurisdictions have committed to early adoption of the Standard and implementation by 2016 for exchange beginning in 2017.[7]

On 21 July 2014, the OECD released a detailed commentary on the standard to help ensure its consistent application.[8] The OECD also plans to provide information and guidance on the technical measures necessary to implement the processes of actual information exchange, including compatible transmission systems and a standard format for reporting and exchange. This latter component is scheduled to be presented in time for the G20 meeting of finance ministers in September 2014.

According to the current implementation timeline of the early adopters, the new regime will start in 2016 by obliging financial institutions to classify all new accounts from 1 January 2016 and all pre-existing accounts as of 31 December 2015.

"Tax fraud and tax evasion are not victimless crimes: they deprive governments of revenues needed to restore growth and jeopardize citizens' trust in the fairness and integrity of the tax system. Today's commitment by so many countries to implement the new global standard, and to do so quickly, is another major step towards ensuring that tax cheats have nowhere left to hide."

Angel Gurría,
Secretary-General OECD[2]
(Organisation for Economic Co-operation and Development)

1. Tax Annex to the St Petersburg G20 Leaders' Declaration, September 2013
2. Countries commit to Automatic Exchange of Information in tax matters, OECD, 6 May 2014
3. Automatic Exchange of Information: The emerging framework of international tax transparency, *frontiers in tax*, December 2013
4. "Calling on all other jurisdictions to join us by the earliest possible date, we are committed to Automatic Exchange of Information as the new global Standard, which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global Standard for Automatic Exchange of Information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015."
5. Standard for Automatic Exchange of Financial Account Information, OECD, 13 February 2014
6. Declaration on Automatic Exchange of Information in Tax Matters, adopted in Paris 6 May 2014 by the Meeting of the OECD Council at Ministerial Level.
7. Joint Statement by the Early Adopters Group, 19 March 2014, available at http://www.oecd.org/tax/transparency/AEOIjointstatement.pdf.
8. http://www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf

Much more than FATCA

In order to build on previous experience, the CRS has been built on the approach to inter-governmental information exchange developed in relation to the US Foreign Account Tax Compliance Act (FATCA). But it is somewhat misleading to view AEoI as simply FATCA 2.0 or GATCA ("Global FATCA"). It is likely that it will apply to many more financial institutions and result in many more reportable accounts. Additionally, in some respects solutions already being developed for FATCA may be inconsistent with those necessary for AEoI. Financial institutions therefore face the double challenge of responding to both sets of requirements.

On a functional level, the requirements on financial institutions from participating countries are similar to those under FATCA. However, the scope is not limited to US persons but potentially extends to all customers with tax residence outside the implementing jurisdiction. Similarly, all pre-existing individual accounts must be documented; *i.e.*, the threshold under FATCA does not apply. There is no exemption from financial account status for certain classes of traded instrument as there is under FATCA. Certain exemptions for financial institutions under FATCA do not apply under the CRS, and the treatment of some investment vehicles in non-participating jurisdictions also differs. All in all, this means that AEoI presents institutions with a much larger population to report on, covering a larger range of financial accounts.

Institutions in jurisdictions with Model 2 inter-governmental FATCA agreements (IGAs) (or in jurisdictions that do not have an IGA) may face even greater challenges than institutions in Model 1 IGA jurisdictions. This is because institutions in Model 1 IGA jurisdictions have had to develop domestic reporting systems to report financial account information, while institutions in other jurisdictions may not yet have developed such systems.

It is clear that AEoI requires a wholesale review, and a potentially substantial reconstruction of, solutions developed so far to respond to FATCA. In particular, processes for customer acceptance, know-your-customer (KYC) and customer documentation will need to be reviewed and extended, and new systems for reporting relevant data to the tax authorities built. Governance requirements for AEoI processes could be significantly greater than under FATCA, and need to be designed accordingly.

The major operational challenge which financial institutions will face will be to develop and implement efficient and effective processes and IT solutions. These solutions must be sustainable and scalable as more countries participate in the AEoI regime over the months and years ahead. All of this has to be undertaken while institutions are still working to achieve FATCA compliance: the consequence could be the inevitable disruption of systems and processes that have just been established for FATCA. In addition, to the extent that operating models have been defined in part to avoid or minimize operational burdens from such tax reporting requirements, these decisions will need to be re-evaluated in the light of the global scale of AEoI.

Action now?

Once again, the pace of regulatory change challenges the ability of financial services companies to develop the necessary systems and processes to respond. And while the deadlines are short, the detail cannot be specified until the CRS is fully defined in the domestic legislation of implementing countries beginning towards the end of the year.[9] In addition, there are in certain cases legal limits to what can be pursued on an early timetable: in many jurisdictions, data protection laws prevent companies from collecting the necessary information on account holders in advance of the passage of domestic enabling legislation.

Nevertheless, there are a number of actions which can be mounted now, and which should yield benefits in any event. Examples include:

- review and overhaul existing customer acquisition systems, KYC processes, documentation standards
- review and streamline separate systems, and rationalize inconsistent policies and definitions
- review and overhaul governance arrangements to ensure clear lines of authority and responsibility for compliance
- ensure that policies and procedures to manage operational and reputational risk are geared up to capture AEoI issues.

These and similar actions should also feed into the final key priority: ensuring that where business imperatives substantially favor one AEoI implementation methodology rather than another, the argument is effectively captured in representations to governments. Financial institutions can still influence how AEoI will operate. But the window of opportunity is closing rapidly.

[9] The UK issued draft guidance notes for the CRS on 7 August 2014: https://www.gov.uk/government/consultations/implementing-agreements-under-the-global-standard-on-automatic-exchange-of-information

The major operational challenge which financial institutions will face will be to develop and implement efficient and effective processes and IT solutions. These solutions must be sustainable and scalable as more countries participate in the AEoI regime over the months and years ahead.

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BEPS: Time for action

Responding to the recent political demands that companies pay the 'right' amount of tax in the countries in which they operate, the OECD's Base Erosion and Profit Shifting (BEPS) initiative aims to create a framework to reduce the ability of companies to shift income to reduce their tax burden. Their proposals could impact substantially on financial services firms. Time is short, and the industry needs to respond now.

One of the significant consequences of the financial crisis has been the development of acute concern over whether corporations are paying the 'right' amount of tax. These concerns have been fed by a number of key factors. First has been the need of governments in the developed world to sustain and maximize their tax take in the face of continued commitment to government expenditure at a time of economic retrenchment. Second, there has been increasing political and public outrage – stimulated in part by the mass media – at some multinational corporations that have been revealed to pay relatively low levels of tax.

At the same time, globalization has steadily increased the opportunity for corporations to arrange their affairs so that taxable profits are reported in low-tax rather than high-tax jurisdictions. Globalization has made it much easier for businesses to locate productive activities in different geographic locations.

The resultant erosion of domestic tax bases ('base erosion') and the associated transfer of reported profits to low-tax jurisdictions ('profit shifting') has generated an increasing focus on 'unfair' tax avoidance. It is argued that this damages the tax revenues of individual states; distorts economic performance; and brings taxation systems generally into greater disrepute. In some cases financial institutions (mostly, but not exclusively banks) have been criticized for facilitating such strategies as well as undertaking them on their own account.

Prompted by policy developments at the G20, the OECD has taken an increasing interest in this issue of BEPS. The OECD has argued, that BEPS has a number of critical consequences:[1]

- Governments are harmed. Many governments have to cope with less revenue and a higher cost to ensure compliance. BEPS undermines the integrity of the tax system, as the public, the media and some taxpayers

1. OECD, Action Plan on Base Erosion and Profit Shifting, 2013. http://www.oecd.org/ctp/BEPSActionPlan.pdf

deem reported low corporate taxes to be unfair. In developing countries, the lack of tax revenue leads to critical under-funding of public investment that could help promote economic growth. Overall resource allocation, affected by tax-motivated behavior, is not optimal.

- Individual taxpayers are harmed. When tax rules permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers in that jurisdiction bear a greater share of the burden.
- Businesses are harmed. Multinational enterprises may face significant reputational risk if their effective tax rate is viewed as being too low. At the same time, different businesses may assess such risk differently, and failing to take advantage of legal opportunities to reduce an enterprise's tax burden can put them at a competitive disadvantage.

According to the OECD: 'it is an issue of fairness: when taxpayers (including ordinary individuals) see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers… Business cannot be faulted for using the rules that governments have put in place. It is therefore governments' responsibility to revise the rules or introduce new rules.'[2] The OECD is therefore developing as a matter of urgency a program to tackle BEPS through new regulatory frameworks as part of its overall program of modernizing tax regimes.[3]

So in July 2013, the OECD published its Action Plan to tackle BEPS.[4] The Action Plan sets out 15 actions, many directly focused on corporate structure and performance, to address BEPS issues in a coordinated and comprehensive manner (see Table). Work to refine and implement the deliverables on BEPS is now being undertaken at a rapid pace. Much has been written in the specialist press and elsewhere about the potential implications. But the key point is that companies in the financial services sector need to consider – as a matter of urgency – how to respond.

Major challenges

The current political focus on fairness in corporate tax matters raises two fundamental challenges for financial services firms. First is the risk of changes to the law that will result in greater tax burdens and greater compliance burdens. Already some countries, including Mexico, France, Germany, Australia and Austria, have begun to introduce domestic measures targeted at BEPS. Norbert Walter-Borjans, Finance Minister of North Rhine-Westphalia, has argued forcefully that Germany should act unilaterally to tackle BEPS if the OECD project has not made sufficient progress by the autumn of 2014.[5] Conversely in the UK, despite the government claiming it expects companies to "pay the tax they owe", the Chancellor of the Exchequer has announced his intention to "create the most competitive tax environment in the G20."[6]

Second, the question of fairness raises issues of politics, morality and corporate reputation, beyond technical matters of finance, tax and compliance.[7] It presents major challenges to senior executives, who are now having to balance their primary responsibility of maximizing returns to shareholders – and hence of minimizing avoidable costs – with that of being seen to behave in a responsible way in a broader context.

Defining fairness presents particularly acute problems, and translating it into a reliable basis for tax policy is even more difficult. The challenge has been faced on previous occasions. In Europe, the long-standing Code of Conduct for business taxation was first set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997, which gave guidance on how to identify potentially harmful tax practices. Key criteria included:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned
- tax benefits reserved for non-residents
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base
- granting of tax advantages even in the absence of any real economic activity
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD
- lack of transparency.

Increasingly, these criteria are being subsumed into a more overtly political framework. The G20 assert simply that "Profits should be taxed where economic activities [driving] the profits are performed and where value is created".[8]

2. http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm
3. OECD, Bringing the International Tax Rules into the 21st Century: Update on Base Erosion and Profit Shifting (BEPS), Exchange of Information, and the Tax and Development Programme, Report from the Meeting of the OECD Council at Ministerial Level Paris, 6-7 May 2014
4. OECD, Action Plan on Base Erosion and Profit Shifting, 2013. http://www.oecd.org/ctp/BEPSActionPlan.pdf
5. International Tax Review, 15 January 2014
6. Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting, HM Treasury, March 2014
7. A New Era in International Tax: Tax morality, transparency, base erosion and profit shifting, KPMG 2013
8. G20 Leaders' Declaration, Saint Petersburg Summit, 5–6 September 2013. The published and often-quoted text has the verb *deriving*, but this is clearly a mistake.

There is a danger that the superficially attractive concepts of fairness and justice are used to mask national protectionism, and to attempt to insulate high-tax, high-spend economies from international competition from more economically-efficient, low-tax jurisdictions. Algirdas Šemeta, European Commissioner for Taxation and Customs Union, made this link explicit earlier in 2014, when he said: "Why is fair tax competition so important? To put it simply, our social and economic model relies on it."[9] In a subsequent speech, he stated the Commission's intent to impose its interpretation of "fair" tax competition more widely:

> "Switzerland has agreed to remove a number of harmful tax regimes that were of concern to Member States… Our efforts to secure fair tax competition are bearing fruit, even beyond EU borders. Our sights are set on tackling unfair tax practices worldwide. If we continue to work as a union, with ambition and determination, I have great hopes that this can be achieved."[10]

This substantial overlay of politics and international competition onto what is already a set of challenging technical issues means that the timescale for BEPS implementation – with all actions complete by the end of 2015 – is extremely ambitious. There is an obvious risk of slippage. And against this background, there is the danger of unilateral action by countries determined to press ahead.

These challenges raise the spectre of the coordinated approach to tackling BEPS failing, with a growing likelihood of unilateral action leading to double taxation, double non-taxation and much increased uncertainty. In the global economic context, this could have significant detrimental impacts on investment and growth.

Action now

It is often tempting to delay formulating a response to new regulatory initiatives until the detail of new requirements is finalized. The temptation is understandably greater when financial services firms are already addressing a massive range of challenges, not only in the form of new regulation but also in the face of fundamental threats to core strategy, business models and operations. Prioritizing action can enable sensible planning, avoid wasted effort and reduce an overload of demands to manageability. In this case, however, targeted engagement with the process now is highly desirable.

The timetables are short. As the table of actions shows, the majority will impact directly on individual companies' organization and operating models. Many of them are due to be translated into formal recommendations within a few short months, in September 2014. While this target may slip a little, it is clear that by the end of this year companies will need to be formulating detailed plans for reaction. At a minimum, therefore, the actions targeted for early implementation need to be reviewed and analyzed for potential impact.

An additional reason for early action is that many of the actions will be able to be implemented immediately, without the need to wait for domestic legislative initiatives. The actions on transfer pricing, for example, may be automatically incorporated into the laws of some countries. Other issues, for example on permanent establishment (PE) status, will require specific rule changes, and have a later target date. But even here, the timescale is comparatively tight.

These considerations point to a further conclusion: it is urgent that the financial services industry makes its views known on specific proposals, both collectively and individually. The recent history of political and regulatory response to the financial crisis has shown that regulators are willing to engage constructively with representations which support the general thrust of policy but which seek to reduce unhelpful or harmful consequences. When an initiative is as broadly framed and widely targeted as is BEPS, there is an inevitable danger that individual sector concerns are overlooked. The financial services sector is already heavily regulated; but its interests are not currently held in high regard. It is therefore all the more important that the industry's voice and views are made known.

Finally, many of the changes which may flow from BEPS could require important reconfiguration of organization and structure. Where these involve realigning the location of profit reporting with the location where economic value is created, significant transfers or relocation of people and teams may be required. These actions are expensive and time-consuming. Planning needs to start now.

Prioritizing action can enable sensible planning, avoid wasted effort and reduce an overload of demands to manageability. In this case, however, targeted engagement with the process now is highly desirable.

9. Speech at the EU Competition Forum, Brussels, 11 February 2014
10. Speech, Brussels, 20 June 2014

The OECD action plan: Actions and target dates[11]

Action	Detail	Target date
1. Address the tax challenges of the digital economy	Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation.	September 2014
2. Neutralize the effects of hybrid mismatch arrangements	Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect (such as double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities.	September 2014
3. Strengthen CFC rules	Develop recommendations regarding the design of controlled foreign company rules.	September 2015
4. Limit base erosion via interest deductions and other financial payments	Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments.	September 2015
5. Counter harmful tax practices more effectively, taking into account transparency and substance	Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.	Review member country regimes: September 2014 Include non-OECD members: September 2015
6. Prevent treaty abuse	Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.	September 2014
7. Prevent the artificial avoidance of permanent establishment (PE) status	Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.	September 2015
8, 9 and 10. Assure that transfer pricing outcomes are in line with value creation: 8. Intangibles	Develop rules to prevent BEPS by moving intangibles among group members.	September 2014
9. Risks and capital	Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members.	September 2015
10. Other high-risk transactions	Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties.	September 2015
11. Establish methodologies to collect and analyze data on BEPS and the actions to address it	Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.	September 2015
12. Require taxpayers to disclose their aggressive tax planning arrangements	Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.	September 2015
13. Re-examine transfer pricing documentation	Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.	September 2014
14. Tax treaty measures to make dispute resolution mechanisms more effective	Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, inclu ding the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.	September 2015
15. Develop a multilateral instrument	Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.	September 2014

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11. Tax treaty changes to extend Actions 4, 5 and 15 are scheduled for December 2015; cf http://www.oecd.org/tax/beps-about.htm

Country-by-Country Reporting:
What’s your strategy?

Country-by-Country Reporting of financial data by multinational companies may seem a technical detailed issue to be left to tax and finance professionals. In fact, the implications go much wider. Companies need to address not just the operational challenge but also assess the strategic implications and opportunities.

As the reaction to the financial crisis has developed, a significant strand of attention has been focus on the tax strategies of multinational companies. There is increasing public and political concern that some companies are paying less than what is considered to be a “fair” amount of tax in jurisdictions where they have major operations or customer bases. The perception is that complex ownership structures and sophisticated corporation tax planning techniques can be combined to reduce tax liabilities. As such there is increasing focus on where and how a company earns its profits and whether it is paying tax in those countries.

The OECD (Organisation for Economic Co-operation and Development) was tasked with tackling these issues and in response launched its Base Erosion and Profit Shifting initiative (BEPS). As part of this effort the OECD is seeking to reform transfer pricing documentation and introduce a mandatory form of reporting to tax authorities to enhance transparency of revenues, profits, taxes and other measures of substance across the globe. Action 13 of the BEPS Action Plan sets out the aim of developing rules that:

The view appears to be that, armed with a full and clear picture of where companies’ profits are generated, how this aligns to where their activity takes place and where they pay taxes, national governments will be better able to bring pressure to bear on perceived aggressive tax avoidance or non-compliance with the rules.

The resulting Country-by-Country (CBC) Reporting requirements are likely to pose a compliance burden for multinational companies, as gathering and reporting the data in the required format will require a new compliance process, potentially requiring new technologies or system changes, but certainly involving commitment from resources across the organization. Financial services companies are likely to face particular challenges as they will have to address these CBC requirements as well as those imposed under the EU Capital Requirements Directive IV (CRD IV), which requires public reporting of revenues, profits, taxes, employee numbers and public subsidies for regulated entities within the EU.

Template

The OECD has outlined a three-tier approach to reporting: an overall '*master file*' containing information about the group including its organization structure, description of its business, intangibles, and financial and tax position; and a '*local file*' that is more akin to certain current local transfer pricing documentation requirements. The CBC template is likely to require the disclosure on a country-by-country basis of the following:

- revenues (split between related party and unrelated party)
- earnings before income tax
- income tax paid (including WHT)
- current income tax charge
- stated capital and accumulated earnings
- number of employees
- tangible assets other than cash and cash equivalents.

The second section of the CBC template will require a listing of every entity tax resident in each country identifying where they are incorporated, if different from residence, and selecting the most appropriate indicators of activity from a set list of options.

Financial services companies that fall within the requirements of CRD IV now have to publicly report on an annual basis for each in scope entity:

- nature of activities and geographical location
- turnover
- number of employees (on a full time equivalent basis)
- profit or loss before tax
- tax on profit or loss
- public subsidies received.

This needs to be reported on a country-by-country basis, and depending on group holding structures and the local government implementation of CRD IV, the disclosure can be complex.

Many financial services groups should by now have made their first public disclosure under the CRD IV rules. Unfortunately that does not mean the work is done; the OECD requirements are more extensive as they require more data points, but also cover every entity in the group rather than just certain regulated entities. The graphic [on 16 page] shows areas of overlap and areas where more work will need to be done for OECD CBC.

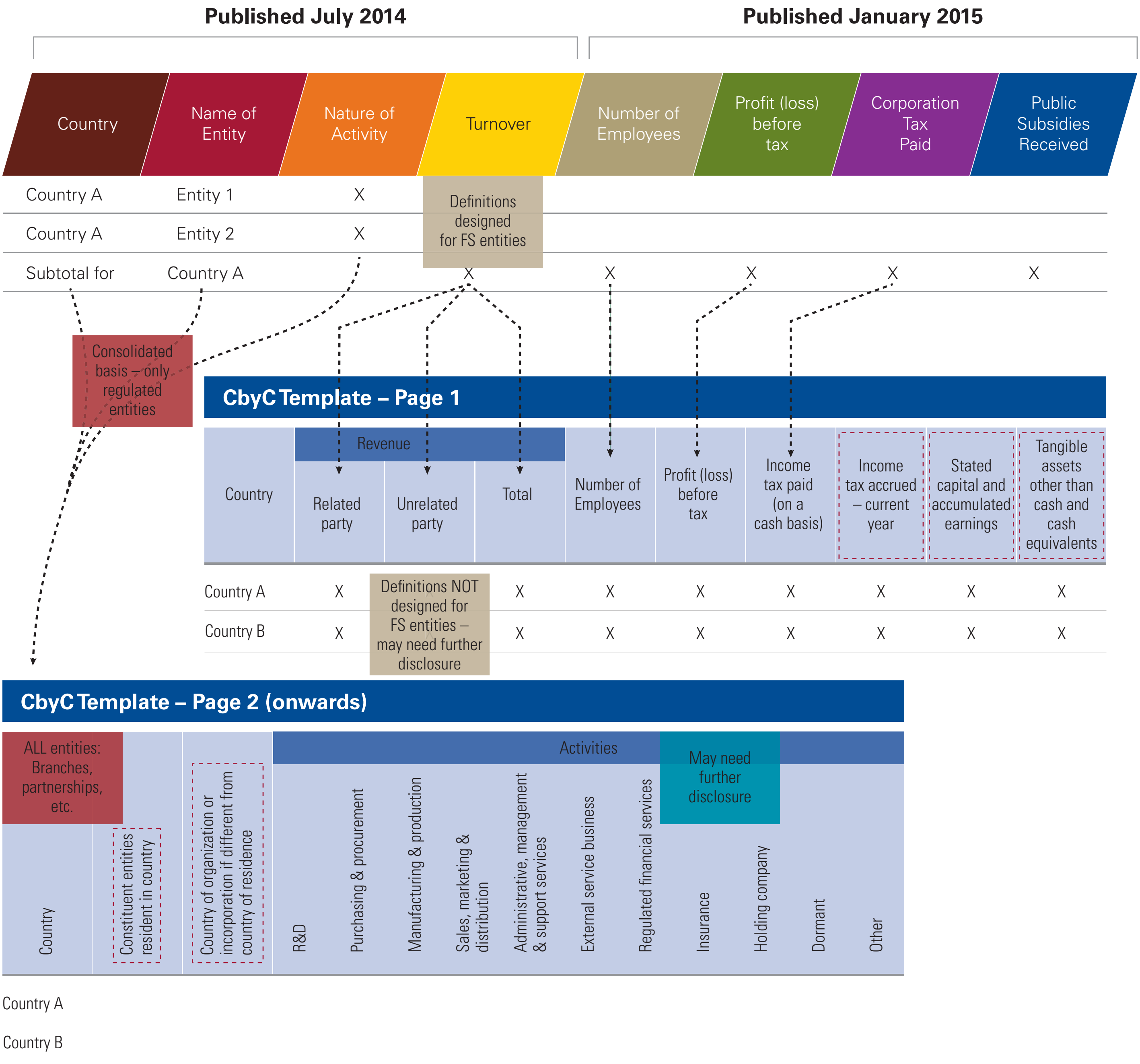
The OECD timetable is now well-advanced. The Committee on Fiscal Affairs approved a template in June 2014, and we understand this approved CBC template will be issued publicly around the time of the G20 Finance Ministers meeting in Australia in September 2014. Depending on how this is implemented companies may need to comply with this from 2015 onwards.

"will include a requirement that [multinational enterprises] provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template."[1]

1. Action Plan on Base Erosion and Profit Shifting, OECD, 2013 (http://www.oecd.org/ctp/BEPSActionPlan.pdf)


HONG KONG
CAPE TOW
NDON

CRD IV template compared to mock-up of CBC template



Comment	Notes
Consolidated basis – only regulated entities	– Under CRD IV, groups are allowed to report on a consolidated basis, and in practice many have reported only their regulated entities. This means that financial information from branches, funds, etc may not be disclosed in the country with which they are associated. – Under OECD CBC, ALL entities will have to be reported (though financial information will be consolidated on a country level). This includes companies, trusts, partnerships, and branches which are 'associated enterprises' (which is not always clear at first glance). And, there is nothing to stop local tax authorities from asking for the single figure reported for the local country to be broken down by entity.
Definitions designed for FS entities	– Under CRD IV, 'turnover' has been defined with FS entities in mind, thus the UK (for example) has said 'we would expect turnover to consist of total income before impairment and operating expenses, but after net interest, net commissions/fees income, investment and trading income and net insurance premiums.' – Under OECD CBC, revenues are defined more broadly as 'revenues from sales of inventory and properties, services, royalties, premiums, and any other amounts received' – in order to report an appropriate figure, Groups may need to supply additional disclosure to show how the revenue figure was derived and which elements of the financial statements it includes or excludes.
May need further disclosure	– CRD IV does not prescribe a list of activities from which to choose, so Groups are able to describe their activities in an appropriate way. – Under OECD CBC, Groups must determine the important business activities of each entity, and select from a list provided by the OECD. FS companies may find themselves frequently using the 'other' category, for which additional information must be disclosed. Even where a business activity falls under one of the listed categories, FS companies may feel that additional disclosure is necessary to aid understanding of the information supplied.
	– These categories of information are not covered by CRD IV, so Groups will need to build information gathering for these into their processes and consider whether further information may need to be disclosed to aid understanding- e.g. where current tax accruals are disclosed, should deferred tax accruals also be disclosed in order to present a complete picture?

Source: KPMG International - September 2014

Uncertainties

Significant uncertainties remain over the implementation process and timing. The OECD recognizes that if the standardization of transfer pricing documentation is to succeed, they need to try and deliver a coordinated implementation process with countries introducing the same template at the same time. However, the OECD cannot compel member governments to comply with their guidance, nor can they prevent countries from going it alone. And then of course there is the question of how the countries outside of the OECD approach this, given that not all of the G20 members who commissioned the BEPS project are members of the OECD. There seems little doubt that governments want to have access to this information and so we can expect to see a CBC template mandated more widely than in OECD countries. The question is whether there will be sufficient protections for companies to ensure that the data is treated confidentially and is appropriately used for risk assessment, and not audit or formulary apportionment. How tax authorities use the data and the questions and challenges they may raise, leads to the concerns about the potential additional, and perhaps more extensive, compliance burden for companies – who within a multinational is going to deal with all of the queries and challenges that will follow submission? And how will disputes be resolved particularly where there are no dispute resolution mechanisms in place between countries?

The OECD recognize these challenges and are going to do further work in the coming months to develop the implementation plan and sharing mechanism, with a view to making recommendations in January 2015.

The experience of implementing CRD IV across the EU could provide useful lessons; for example the need to ensure that the process is synchronized with the passage of the necessary domestic legislation in affected countries, and that legislation and guidance is in place and finalized well in advance of the first filing requirement. Since the OECD cannot directly impose its requirements, there is a danger that everything proceeds at the speed of the slowest participant; or conversely, that some governments decide to break ranks and press ahead unilaterally to gain domestic political advantage or simply to get early sight of the relevant data.

The attitude of global governments will be significant in this respect.

In the US, the view has been expressed by some that BEPS is designed to provide tax authorities outside the US with a weapon to attack US multinationals and extract more tax revenues from them in their own jurisdictions.[2] The Council for International Business has said it feared that information reported could be used to underpin arbitrary and formulaic tax demands on US multinationals; the National Foreign Trade Council has said that the potential risks "far outweigh any marginal benefit that would be derived by tax authorities from such information."[3]

The US Administration may find it difficult to secure the passage of necessary legislation through Congress: some officials have indicated they believe the relevant measures could be implemented administratively, without primary legislation, although others are more skeptical of whether this can be achieved.

Other countries have expressed concerns that the measures do not go far enough. For example, the French and Chinese delegates to the OECD have urged the OECD to consider requiring the parent company of a multinational group to automatically share the CBC template with its subsidiaries local tax authorities. In another example, a Chinese tax official recently noted that CBC 'will help', but does not allow a full assessment of a multinational group's transactions.[4]

2. http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=383338
3. 'OECD faces tough tax rules balancing act', Financial Times, 12 November 2013.
4. Bloomberg BNA Transfer Pricing report, 6 December 2014 Asia Pacific Rim

Any move towards unilateral development of tax and regulatory policy could be a significant stumbling block to coordinated international implementation. If the OECD is not able to lead a coordinated international initiative, countries may implement their own versions of CBC reporting, which could mean that multinational groups must comply with a patchwork of requirements around the world.

Compliance and beyond

Regardless of the precise implementation timetable, it seems inevitable that this will be implemented and multinationals should be considering how they will comply and how this process can be built to become a 'business as usual' compliance process alongside others. Our practical experience suggests some of the key challenges will include:

- gathering the data on a consistent global basis from multiple accounting systems
- gaining comfort regarding the accuracy and consistency of the data

- understanding and applying each country's implementation and interpretation of the regulations
- managing input from different parts of the business including finance, tax, HR and controlling, and ensuring sufficient resources can be made available to manage this additional compliance burden
- getting comfortable that a compliant CBC template is being submitted taking into account for example, the fact that judgments will have to be made around definitions and areas where full data cannot be accessed as envisaged by the OECD
- implementing technologies or making system changes to more accurately capture or report the data required.

However, the strategic view on this is also vital – what is the company's strategy around disclosure and transparency? Is there an opportunity to use some of this data to publicly articulate the company's position on tax? Is there a need or a desire to provide more narrative to the tax authorities to supplement the data and aid understanding? Would further narrative help to address up front some of the potential queries, thereby reducing the compliance burden down the line? Is the CBC template information what tax authorities are looking for and how does this fit with the information in the Master File?

Bringing all of this together goes beyond strict reporting compliance and involves many more functions than the tax department. This will require a consistent, coordinated response strategy, reflecting all key interests in the company and will need to be driven from a senior level.

This is not simply a question of how to comply most efficiently and cost-effectively with specific obligations. Leading banks – like major multinationals in other sectors – are realizing that an explicit strategic framework is necessary to guide the voluntary release and dissemination of financial, operating and tax information. This is increasingly an issue of corporate reputation management, requiring the development of a consistent communication strategy and a coherent narrative of corporate policy. Consistency of disclosure will also be critical to maintaining a sound public position, since data revealed to one agency may well be communicated to others; and any information shared with tax authorities could ultimately end up in the public domain. A compelling narrative should also act as a strong defense against information being misinterpreted.

Strategic challenge

The environment of global policy making, public expectation and information disclosure is changing rapidly. Tax strategies which may be legal are increasingly regarded as unacceptable; transfer pricing is perceived by some as a mechanism used by multinationals to artificially shift earnings to low tax jurisdictions, and supporting and defending business models will be tougher but ever more important in the future; the requirements around reporting and transparency will continue to increase.

The new requirements for disclosure, and for effective explanation, will bring significant operational challenges. But the strategic challenge is wider and more fundamental - can groups use disclosure as a way to restore public trust in corporations? How much should groups voluntarily disclose to stay ahead of the public debate? To meet this challenge, multinational financial services companies will need to develop a clear philosophy and vision, integrated with other expressions of corporate values, and ensure that all relevant functions, in all relevant jurisdictions, endorse it. The necessary thinking should be starting now.

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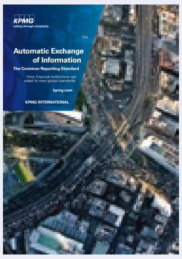
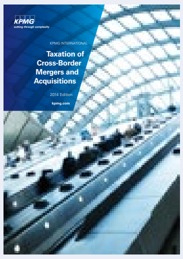


Automatic Exchange of Information - September 2014

This report looks at the impact of CRS and the influence these new Standards have upon financial institutions around the world.



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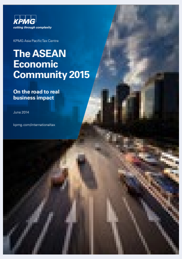
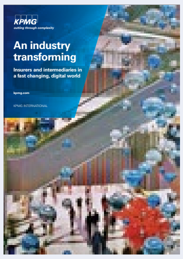


The ASEAN Economic Community 2015 - June 2014

The Association of Southeast Asian Nations (ASEAN), is rapidly approaching a new milestone; the implementation of the ASEAN Economic Community (AEC) at the end of 2015. This publication discusses the states of readiness of the member countries for regional integration and the implication to ASEAN businesses.



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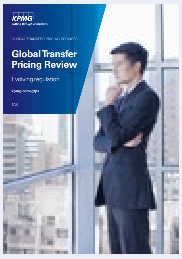

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This review provides a wealth of local country transfer pricing information, including documentation requirements, deadlines, transfer pricing methods, penalties, special considerations, advance pricing arrangements, and competent authority matters.

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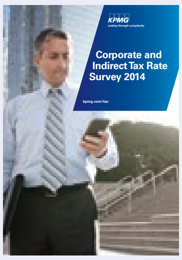

Corporate and indirect tax rate survey 2014 - April 2014

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Competitive Alternatives KMG's Guide to International Business Location Costs - March 2014

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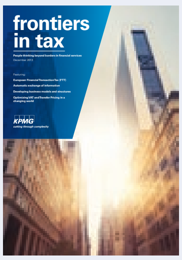
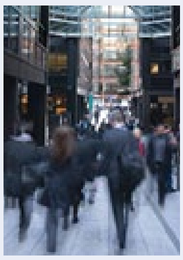


Frontiers in tax - December 2013

New regulatory developments are having a growing impact in the world of tax. In this issue of frontiers in tax, we look at the following:

- Continuing political debate over the introduction of a financial transaction tax (FTT) in the European Union (EU)
- How the increasing global drive for financial transparency and Automatic Exchange of Information is transforming the international tax environment
- The interaction with transfer pricing issues, business models and the specific impact on VAT.



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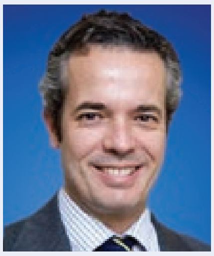

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