



cutting through complexity

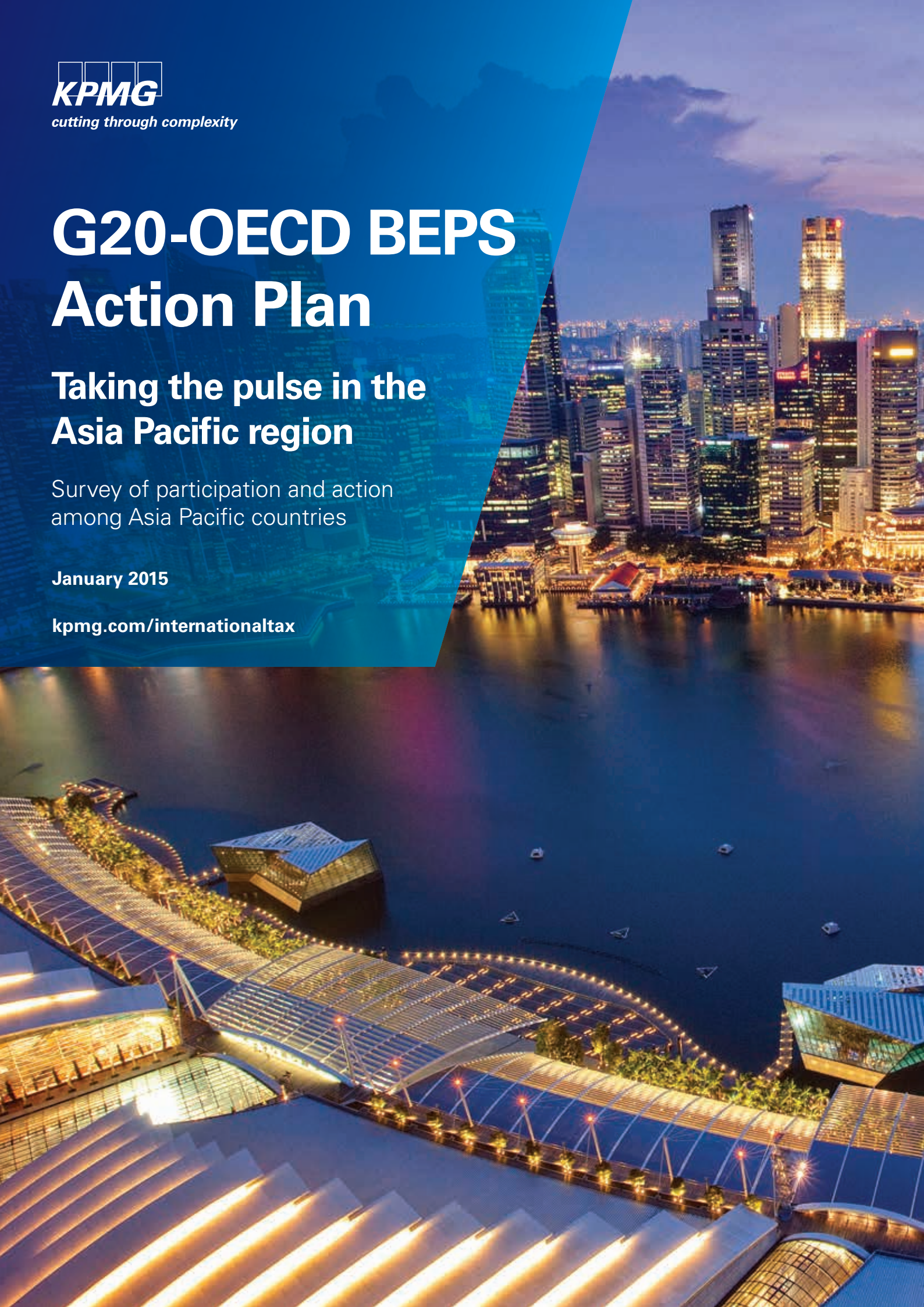
G20-OECD BEPS Action Plan

Taking the pulse in the Asia Pacific region

Survey of participation and action
among Asia Pacific countries

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Introduction

The global movement to curb tax base erosion and profit shifting has built a full head of steam over the past year, and we are starting to see the first wave of concrete results. From the Organisation for Economic Co-operation and Development's (OECD) proposals on tax transparency and transfer pricing to the European Union's country-by-country tax reporting rules, to unilateral legislative action by countries worldwide, these projects are advancing at a fast pace.

Globally, much of this activity centers on the G20-OECD BEPS Action Plan on Base Erosion and Profit Shifting (BEPS).¹ While countries in Europe and North America may appear to have the strongest voices in the debate, many countries in the Asia Pacific region (ASPAC) are influencing – and being influenced by – the profound international taxation changes that are under review.

How is BEPS-related tax policy evolving in this diverse region? At the mid-point in the G20-OECD BEPS Action Plan's 2-year mandate, KPMG International polled senior tax policy specialists in 23 KPMG member firms across ASPAC to take stock of trends and developments in these countries. In particular, we asked:

- How are ASPAC governments responding to the G20-OECD BEPS Action Plan currently in progress?
- Which ASPAC governments plan to adopt the new international tax guidelines that will be formulated?
- What unilateral actions to combat BEPS and aggressive tax avoidance are ASPAC governments taking outside of the OECD BEPS process?
- What are the implications for international companies doing business in the region?

Most importantly, we sought to answer if BEPS activities will ultimately improve taxation of cross-border transactions in ASPAC – or if companies will continue to weather inconsistency and uncertainty for years to come.

Our findings are set out in the following pages, starting with an overview of BEPS-related trends in the region as a whole, followed by an in-depth look at how events are unfolding in selected ASPAC countries. We conclude with strategic advice that tax directors of all international companies should consider now to guard against adverse change and thrive in ASPAC's new tax reality.



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¹ G20 Organisation for Economic Co-operation and Development (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing. <http://dx.doi.org/10.1787/9789264202719-en> (referred to herein as "G20-OECD BEPS Action Plan").

Contents

3

G20-OECD BEPS Action Plan: Taking the pulse in the Asia Pacific region

10

Countries in focus: Action or reaction?

Australia	12
China.....	14
India	16
Japan	18
Korea	20
Singapore.....	22

24

Bracing for BEPS: Are you ready?

26

Appendix: Unilateral BEPS legislative actions in ASPAC



A group of school children, seen from behind, are standing on a bridge or walkway, looking out over a wide river towards a dense urban skyline. The children are wearing white shirts and carrying various backpacks, including red and patterned ones. The skyline in the background features several prominent skyscrapers, including the Shanghai Tower with its distinctive twisted design. The sky is blue with some light clouds.

G20-OECD BEPS Action Plan: Taking the pulse in the Asia Pacific region

G20-OECD BEPS Action Plan: Taking the pulse in the Asia Pacific region

To date, Australia has perhaps been the most involved, given its presidency of the G20 for 2014 and its desire to demonstrate real progress on BEPS reforms during its tenure.

On 19 July 2013, the OECD released its Action Plan on Base Erosion and Profit Shifting (BEPS), identifying 15 specific actions that will give governments the domestic and international instruments to prevent corporations from paying little or no taxes. This plan was endorsed by the G20 at a Leaders Summit in Saint Petersburg in September 2013.

The Action Plan's rationale is that globalization of the world economy has resulted in multinational enterprises shifting from country-specific models to global models with integrated supply chains, centralization of service functions, location of activities that are distant from the physical location of customers and increasing delivery of service and digital products over the internet.

The OECD and G20 say these developments have opened opportunities for multinational enterprises to greatly reduce their tax burden, leading to heightened sensitivity on what paying one's fair share really means.

The OECD's goal is to achieve consensus on a coordinated

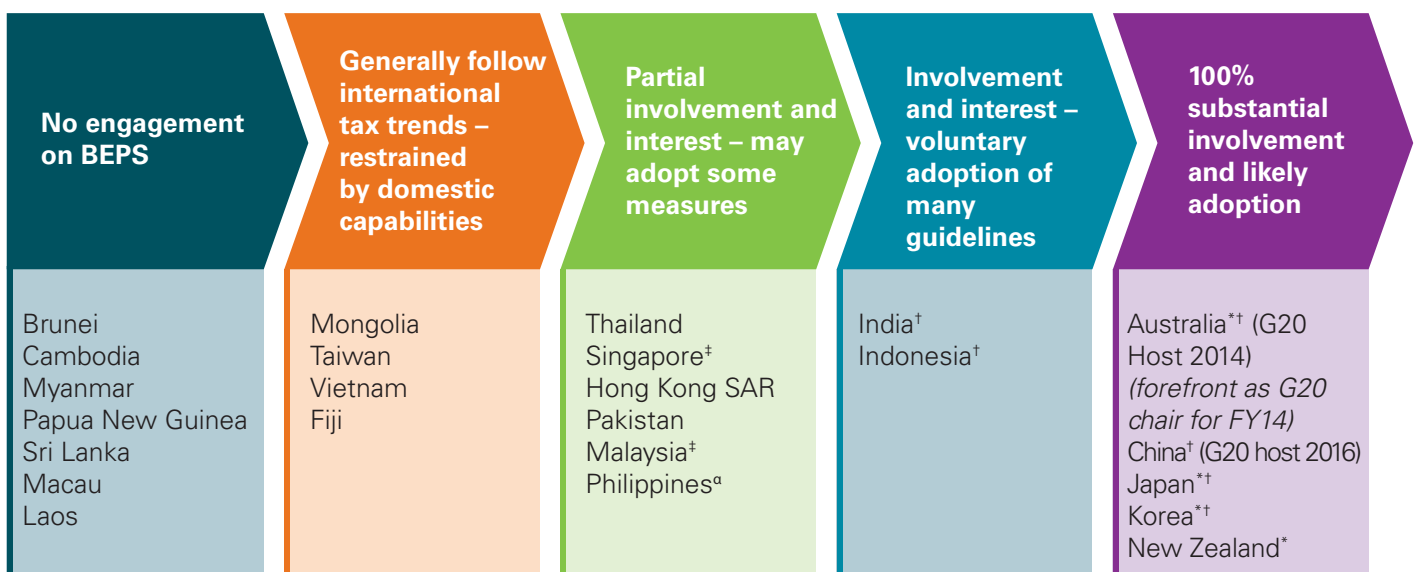
implementation of uniform international taxation principles for the modern age. While European and North American countries have been particularly vocal, a number of ASPAC countries have come to the fore and are exerting significant influence on the BEPS proposals as they take shape.

China has taken a particularly active and constructive role in the various Working Party meetings that are considering the Action Plan items. China is the host of the G20 in 2016, following Turkey. The significant interest China has taken in the Action Plan suggests that China may seek to keep tax on the G20 agenda during what will be the Action Plan's implementation phase.

Spectrum of engagement

In their engagement with the G20-OECD BEPS Action Plan, countries in ASPAC fall on a spectrum that runs from 100 percent participation and commitment to non-engagement. At one extreme, the OECD members in the region are highly

Spectrum of engagement: ASPAC jurisdictions



Source: KPMG International, 2014.

* OECD Member & Accession

† G20 non-OECD

‡ Action Plan Observer status

α Developing Country invitee to Action Plan from Nov 2014.

engaged and likely to adopt the full slate of BEPS proposals in accordance with the OECD guidelines. Australia has perhaps been most involved to date given its role as president of the G20 during the 2014 year and its desire to see real progress on BEPS during the period of its tenure. With a Japanese Ministry of Finance official currently in place as chair of the OECD Committee on Fiscal Affairs, Japan is also highly invested in the Action Plan's successful outcome.

At the other extreme, many of the region's developing countries show little interest in the OECD's project. With scant foreign direct investment, low international activity and less developed taxation systems, these countries do not perceive BEPS to be a significant problem. Further, many of these countries are members of the Association of Southeast Asian Nations (ASEAN), and their tax reforms are being driven by other priorities, including creation of the ASEAN Economic Community in 2015 (discussed below).

Along the middle of the spectrum countries such as India and Indonesia, which are engaging in the OECD discussions and will implement some aspects of the BEPS proposals that suit their domestic purposes. Other countries, like Singapore, are monitoring the debates and actively engaging with the OECD and will likely adjust certain aspects of their tax systems in response to any new international norms. Another group of countries, which includes Malaysia and Vietnam, also watch and follow international tax trends closely. Philippines

will take an increased interest in the Action Plan following its appointment as one of the seven additional developing countries invited to participate in the various discussions and negotiations.

Tight 2-year timetable

The G20-OECD BEPS Action Plan items are targeted to be complete by December 2015. However, many new developments and activities will certainly occur within and beyond this timeframe. The plan is ambitious, and it will be difficult to align the taxation approaches of so many countries, especially given their different economies and stages of development. The OECD's working groups should be applauded for keeping to their G20-OECD BEPS Action Plan timetable so far, and it seems likely that they will continue to deliver according to plan.

However, there are concerns that the plan is so complex and large in scope that the outcomes will lack sufficient depth and detail, opening opportunities for divergent interpretations as countries transpose the guidelines into domestic law. Further, the deliverables produced so far, in areas such as hybrid mismatches and transfer pricing for intangibles, cannot be considered as complete. More thinking needs to be done to integrate the Action Plan's 2014 deliverables with the items to be delivered in 2015.

// The OECD's working groups should be applauded for keeping to their G20-OECD BEPS Action Plan timetable so far, and it seems likely that they will continue to deliver according to plan. //



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Participation in G20-OECD BEPS Action Plan by region

	OECD Member & Accession	G20 non-OECD	Developing countries invitees	Total
ASPAC (n1)	4	3	1	8
North America	2			2
Europe	25	1	1	27
Rest of World	5	4	5	14
	36	8	7	51

Note: Singapore and Malaysia have observer status for the G20-OECD Action Plan

Source: KPMG International, 2014.

Nevertheless, contrary to the goal of consistent and coordinated implementation, some countries, like Australia, Mexico and France, have jumped ahead to enact legislation in some areas, despite pressure from businesses and other countries against unilateral activity. Such hasty and uncoordinated implementation in advance of the final proposals could disrupt the creation of a harmonized international tax system that the G20-OECD BEPS Action Plan aims to achieve.

Developed versus developing countries

The G20-OECD BEPS Action Plan builds on existing fundamental tax principles of residence-based taxation, with no discussion of potential alternatives, such as unitary or destination-based taxation. In fact, some argue that because the 'rich countries' club' of OECD members is leading the debate,

current thinking on BEPS is dominated by tax models that favor developed countries.

For example, as capital exporters, OECD countries like Korea and Japan have an interest in residence-based taxation, which allow them to tax a bigger share of repatriated profits earned offshore. As capital importers, emerging countries like Vietnam and the Philippines stand to benefit more from taxation based on source, so they can tax a larger share of income generated within their borders.



Similarly, in setting transfer prices, China and India reject income allocations purely based on OECD-style notions of functions, risk and value (e.g., based on the location of intellectual property holdings). Rather, these countries seek to allocate income based on other value drivers, such as labor pools and size of market. It is crucial for these non-OECD G20 members to have a strong voice in the BEPS project to avoid perceptions that the proposals tilt too far toward the benefit of developed, capital-exporting countries.

■ The ASEAN factor

In addition to BEPS, ASPAC's international tax landscape is being transformed by the move by The Association of Southeast Asian Nations (ASEAN) to create an ASEAN Economic Community (AEC) by 2015. The AEC will promote the free flow of goods, services, skilled workers and capital among ASEAN's 10 member countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam. These reforms hold the potential to dramatically accelerate the region's economic growth.

As with the G20-OECD BEPS Action Plan, the ASEAN countries have significant hurdles to overcome in a short timeframe. New laws to harmonize customs rules need to be adopted, for example, and there is no road map in place for harmonizing value-added taxes.

Further, since there are no plans to harmonize domestic corporate income tax systems, concerns over double taxation and tax competition are rising. Although corporate tax rates are going down and incentives are being widened, significant variations in tax rates still exist. For example, the Philippines' 30 percent rate is almost double Singapore's 17 percent rate, which is much more favorable to foreign direct investment.

As 2015 approaches, all ASEAN member countries are working to improve their tax competitiveness by providing more targeted tax policies and programs such as long-term tax holidays, specific (R&D) tax incentives, foreign direct investment promotion agencies, tax compliance programs and expansion of tax treaty networks. Thus, it seems likely that tax measures ASEAN nations are adopting to improve tax competitiveness could conflict with BEPS-related measures that OECD's ASPAC members may adopt.

■ Emboldened tax authorities

Within ASPAC governments and societies at large, the debate over tax transparency and tax morality has not reached anywhere near the degree of emotional intensity that it has in the West. Even still, with most tax authorities under pressure to raise revenue, it appears the global debate is giving them license to take a harder line in their tax collection and enforcement techniques. For example:

- For the past few years, India has attacked international structures that shift profits overseas in high profile cases such as *Vodafone* and *Shell India*. Increasingly, other ASPAC countries, including China, are following suit.
- In Vietnam, a global soft drink company faced a widespread boycott after a tax official commented that the company paid no tax in the country.
- Thailand, Indonesia and Malaysia, among others, have boosted their international tax audit resources, resulting in more detailed audits and more assessments.

Further, it appears that some ASPAC countries, like China and India, may be relying on the OECD's project to vindicate their introduction of strict unilateral tax measures, such as anti-treaty shopping rules, which they were inclined to pursue in any event. The global BEPS debate is providing support for these tax policies, along with new tax principles and tools to implement them.

■ Impact on tax planning

In Western economies, the global debate over aggressive tax planning and rise in tax audits and enforcement has caused international companies to take a more cautious approach to tax planning. In ASPAC, regionally headquartered companies of Western companies are growing similarly conservative.

For many ASPAC headquartered companies, the situation is different. Historically, many of them have not engaged in tax planning. While this is less true of companies headquartered in countries having a historical British influence such as Singapore, Hong Kong Special Administrative Region (SAR) and India, in most of ASPAC such practices are simply not part of the business culture. Thus, one might expect the global BEPS debate would have a more muted effect.

However, as discussed in the context of Japan later in this report, the focus on BEPS may be spurring an *increase* in tax planning. Facing high corporate income tax rates at home and rising tax scrutiny and challenges from tax authorities in emerging countries, some Japanese companies are taking more interest in planning to reduce their effective tax rates globally.

As with any tax reform, a surge in tax disputes is inevitable during the transitional period as taxpayers and tax authorities come to terms with the new rules.

G20-OECD BEPS Action Plan: Which items will succeed?

Changes arising from the OECD BEPS proposals will occur in a number of ways. Some countries will adopt OECD concepts in their domestic legislation. Others will make unilateral changes that follow OECD concepts to some extent but with local variations. More divergence could come as countries renegotiate bilateral tax treaties, develop multilateral instruments or go their own way entirely.

With ASPAC countries scattered across all points of the spectrum of engagement in BEPS-related activities, some G20-OECD BEPS Action Plan items appear to have better prospects for success in ASPAC than others in terms of consensus and consistency of implementation. Member firms of KPMG's global network in ASPAC rate these prospects as follows.

- **Hybrid mismatches:** There is widespread acceptance among ASPAC countries that tax planning based on hybrid mismatches should be curtailed. China's central tax authority has informally indicated a similar view, even though cross-border hybrid instruments are not commonly used in China due to regulatory restrictions. *(Action 2)*
- **Deductibility of interest:** The OECD-G20 are considering rules to cap interest deductions in a particular jurisdiction based on various methodologies. These may include caps based on worldwide gearing to prevent debt loading, which could have significant impact throughout the ASPAC region. *(Action 4)*
- **Preventing treaty abuse:** Many ASPAC countries have or plan to address tax treaty abuses, whether by introducing limitation of benefits clauses (e.g. India, Japan and Taiwan) or minimum shareholding periods (e.g. China) in new

treaties, or by cancelling treaties entirely (e.g. Mongolia). *(Action 6)*

- **Country-by-country tax reporting:** With a few exceptions (e.g. Japan), most countries are in favor of the increased transparency that country-by-country tax reporting would bring. However, there are fears that some tax authorities will use this data as a tool to target corporations for undertaking legally acceptable tax planning. *(Action 13)*
- **Transfer pricing reform:** Many countries in the region are taking steps to tighten their transfer pricing rules, some in step with changes to the OECD transfer pricing guidelines (Australia, Malaysia) but others through a different approach (e.g. China, India). With most ASPAC jurisdictions also increasing their transfer pricing enforcement (e.g. Taiwan, Sri Lanka), the risk of contradictory rules and double taxation is growing more acute. *(Actions 8–10)*
- **Addressing the digital economy:** Although Japan is actively studying digital economy tax issues, given the complexity of the issues and lack of consensus on potential solutions, it seems unlikely that significant global reforms in this area will proceed. *(Action 1)*
- **Dispute resolution:** To date, little attention has been paid to items 14 and 15 of the G20-OECD BEPS Action Plan, either in ASPAC or globally. These items call for more effective dispute resolution mechanisms and the development of a multilateral instrument to enable jurisdictions to implement BEPS measures and amend existing bilateral treaties. *(Actions 14–15)*

On this final point, the importance of effective dispute resolution to global businesses should not be overlooked. The world's international tax systems are about to undergo significant change. As with any tax reform, a surge in tax disputes is inevitable during the transitional period as taxpayers and tax

authorities come to terms with the new rules. If the G20-OECD BEPS Action Plan is to succeed, much more focus needs to be brought to bear on devising more effective means of addressing and resolving cross-border tax disputes.

See the Appendix for a table of specific measures adopted by ASPAC countries regarding each of the G20-OECD BEPS Action Plan's 15 points.

Preparing for uncertainty

As you will see in the individual country discussions that follow, even though the G20-OECD BEPS Action Plan seeks to instill more uniformity and certainty in the international tax system, there is a high risk of that its implementation

will be fragmented among regions and individual countries. Coupled with a lack of effective dispute resolution, international companies in ASPAC could experience more uncertainty and tax controversy in the coming years than ever before.

Tax health check: Top 5 items for review

What can tax directors in ASPAC do now to prepare for the coming wave of change? At the end of this report, you'll find general advice that all companies should think about, no matter where they operate. In examining their existing tax arrangements, companies in ASPAC should give high priority to five specific areas:

1. Consider threats to existing **hybrid entities and structures** and investigate potential alternatives.
2. Ensure there is sufficient **business substance** in offshore business structures, especially those involving low- or no-tax jurisdictions.
3. Review the extent and nature of your **business presence in foreign jurisdictions** in light of potential changes to existing permanent establishment concepts.
4. Develop a central approach to **transfer pricing** and prepare processes and tools to enable **country-by-country tax reporting**.
5. Prepare your **strategy for communicating your tax position** to your various stakeholders and decide what to communicate, to whom, where and when.

Above all, given the quick pace of the BEPS project, companies should closely **monitor developments** and their **potential impact** on their tax processes and planning arrangements. They should also **take a proactive role in BEPS consultations** to ensure practical business issues are raised and considered early in the process.

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Countries in focus: Action or reaction?



AUSTRALIA



As chair of the G20 for 2014 and an OECD member country, Australia shows one of the strongest commitments to carrying out the G20-OECD BEPS Action Plan among ASPAC countries. In fact, for over a decade, Australia has been a global leader in advocating for international tax reform, and the Australian Tax Office (ATO) has been a key member of the OECD's Forum of Tax Administrators since its inception.

At the political and social levels, the debate about tax transparency and ensuring global companies pay their fair share has resonated more in Australia than in most other ASPAC countries. Since the 2008 financial crisis, the Australian government has struggled with a string of budgetary deficits and a shrinking tax base, causing questions over the lack of Australian tax paid by some large foreign-controlled companies.

For many years, Australia has also been at the forefront of the global trend toward risk-based approach to tax audits based on the strength of a company's tax governance, risk management and controls. As a result, Australian companies tend to have greater board-level engagement in tax matters and have become relatively conservative in their approach to tax planning.

Despite Australia's commitment to driving the G20-OECD BEPS Action Plan forward, aspects of the plan

could be detrimental to Australian businesses. For example, proposals that address hybrid mismatches could dramatically increase the cost of capital for Australian subsidiaries with foreign parents, especially in light of Australia's tight thin capitalization rules. Further, given the high level of Australian business activity in China, for example, a move toward attributing profits based on an expanded definition of permanent establishment could cause more onerous tax payment and filing obligations.

Nevertheless, the Australian government has already announced or enacted laws to target the following items of the G20-OECD BEPS Action Plan:

- **Thin capitalization:** The Australian government has announced that for income years beginning on or after 1 July 2014, the thin capitalization safe harbor gearing limits will be reduced from a 75 percent gearing ratio to a 60 percent gearing ratio. (*Action 4*)

- **Transfer pricing:** Australia recently changed its transfer pricing rules to move away from an arm's length price model to a whole economic analysis model (embracing an arm's length profit allocation), consistent with OECD standards. While this change preceded the release of the G20-OECD BEPS Action Plan, it is consistent with the Australian government's increased focus on tax transparency and the use of OECD standards in Australian tax law. (*Actions 8–10*)
- **Documentation and transparency:** The former Australian government introduced rules that would require the Commissioner of Taxation to publish details of accounting profit, taxable income and tax payable for large corporate entities (those with annual revenue of greater than 100 million Australian dollars – AUD). While the new federal government (which was voted into office in September 2013) has indicated it intends to abolish these rules, it may lack parliamentary support to do so. (*Action 11*)

Disclosing foreign related-party transactions

As part of the Australian government's greater scrutiny of international corporate structures, the ATO established a project titled International Structuring and Profit Shifting (ISAPS). Under this project, the ATO will send out questionnaires to certain Australian companies with overseas related-party transactions requiring data be provided at a level similar to the country-by-country data requested under the G20-OECD BEPS Action Plan. The ATO will use this information to assign risk ratings to taxpayers and also determine whether to proceed to audit.

Given the ATO's underlying interest in the details of where value arises in international supply chains, global groups with Australian subsidiaries should monitor what information these subsidiaries are disclosing under the ISAPS new requirements. Even small

Australian subsidiaries may have to make these broad disclosures, and the ATO is known to be proactive in sharing relevant tax information with other jurisdictions. As a result, even groups with a minor business presence in Australia could find themselves subject to increased audit and enforcement activity in other countries as a result of the ATO's ISAPS project.

Jumping the gun?

As noted in the introduction, Australia's zeal in getting ahead of the game in adopting BEPS proposals could work against the goals of the OECD BEPS project. Until an integrated set of new tax principles is finalized for all 15 BEPS action items, countries that adopt early versions of this work in progress could complicate the global tax situation and hamper the implementation of commonly agreed and fully developed tax principles.



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CHINA



The Chinese government is monitoring the OECD's progress on BEPS closely and is part of the Bureau of the OECD's Committee of Fiscal Affairs, which is directing activities to carry out the Action Plan. China is also introducing new regulations corresponding to many G20-OECD BEPS Action Plan items that will have significant international tax and transfer pricing implications for international companies operating in China.

The Chinese government has indicated its firm support for the BEPS initiative. The State Administration of Taxation (SAT) Work Plan 2013-2016 already foresees the adoption of the 2014 BEPS deliverables into Chinese domestic law. However, many of the tax abuses targeted by BEPS do not apply to China because of limitations from non-tax regulations. Consequently, Western-style tax planning is often difficult in China. Much of the tax planning of multinational companies involving China has focused on the areas of transfer pricing and supply chain management (discussed later in this section).

External support for unilateral actions

While no explicitly BEPS-linked tax law changes have yet been made, the BEPS reports are viewed as support for recent Chinese tax law and administrative measures. Consider these examples:

- **Hybrid mismatches:** The G20-OECD BEPS Action Plan aims to neutralize the effects of hybrid mismatch arrangements. This supports the State Administration of Taxation's (SAT) recent informal policy guidance that, where characterization mismatches result in a payment from

China to overseas not being taxed overseas, then a Chinese corporate income tax deduction should be denied, and the SAT has indicated that it plans to introduce hybrid mismatch rules for 2015. (*Action 2*)

- **Accessing treaty rates for dividends:** The BEPS September 2014 Report on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances on preventing treaty abuse endorses the use of a minimum shareholding period for accessing lower dividend treaty withholding tax rates (WHT) for substantial shareholdings. This supports China's unilateral condition² requiring that equity interests in a Chinese company be held for at least 12 consecutive months before such a dividend is declared and paid. (*Action 6*)
- **Permanent establishments:** The OECD objective to prevent the artificial avoidance of permanent establishments supports measures³ taken by Chinese tax authorities to scrutinize onshore projects and service activities of international companies, including new obligations to submit disclosure filings regarding permanent establishment status and treaty claims. (*Action 7*)

² See Guoshuihan [2009] No. 81 (Circular 81).

³ See Circular 124 (2009) and Circular 19 (2013).

- **Focus on substance:** G20-OECD BEPS Action Plan emphasizes that existing bilateral treaty arrangements are strained by the insertion of third country shell companies that have little or no substance in terms of office space, tangible assets and employees. This lends support to the Chinese tax authorities' focus on the commercial and economic substance of offshore entities (rather than their business purpose) when applying China's measures on beneficial ownership⁴ and indirect offshore disposals.⁵

Transfer pricing and creation of value

China is similarly pointing to the BEPS work on transfer pricing, including the September 2014 Action 8 updated Transfer Pricing for Intangibles guidance, to justify its approach to transfer pricing. However, continuing differences between China's approach and the approaches of OECD countries may potentially still pose considerable risk of double taxation and controversy.

Under existing transfer pricing approaches, OECD countries have tended to consider value as being created through financial risk, strategic functions and intangible property holdings. China argues that this approach favors developed countries and that other value drivers justify a greater allocation of profit to Chinese operations of international companies. Thus, where the Chinese tax authorities believe that a transfer price does not reflect value creation by the Chinese entities relative to their foreign counterparts, China may consider adjusting the price based on a profit split or formulary profit allocation method.

China can now draw support for this approach from the September 2014 Action 8 revised guidance for Transfer Pricing for Intangibles which validates the concepts of location-specific advantages that the Chinese tax authorities have been applying to adjust transfer prices. Chinese tax authorities contend that unique characteristics of the Chinese market allow companies to reap more profits in China than in other countries. For example:

- Labor, infrastructure and other business operation costs are generally lower in China than in developed countries, creating location savings.
- Less competition in certain industries (e.g., automobiles, pharmaceutical, etc.) than more mature markets in the West and the purchasing power of China's rising middle class allow companies to demand higher prices in China, creating a market premium.

The SAT believes that at least a portion of such excess profits generated through location savings and market premiums should be subject to Chinese tax.

In addition, if a Chinese affiliate with limited functions and risks conducts significant marketing or R&D functions in China, the Chinese tax authorities may argue that the associated intangible assets at least partially belong to the Chinese affiliate, even though the intercompany agreements might indicate otherwise. This provides grounds for the Chinese tax authorities to determine the arm's length profits of the Chinese affiliates using methods akin to profit split rather than the traditional transactional net margin method (TNMM). The Chinese tax authorities may also seek to leverage

the BEPS outcomes to support such an approach.

Chinese tax officials are leveraging the BEPS focus on high-risk payments, particularly with their issuance in July 2014 of Directive 146, in order to examine head office expense allocations and deny tax deductions for these items on the grounds that they are equivalent to management fees under the Chinese corporate income tax law. When Chinese companies pay service fees or royalties to overseas affiliates, it is important to have documentation on hand to show that the payment is not stewardship in nature but instead produce direct, tangible value to the Chinese payor.

International companies should conduct a health check on their existing arrangements, identify potential weaknesses according to the G20-OECD BEPS Action Plan and take steps to mitigate tax risk. This includes realigning functions, assets and personnel within the group, developing legal, tax and transfer pricing documentation as support, and preparing internal controls and working guidelines to mitigate Chinese tax risks. With adequate preparations, international businesses in China can adapt to the new tax landscape created by BEPS without incurring excessive tax costs or business disruption during the transition.



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⁴ See Circular 601 (2009).

⁵ See Circular 698 (2009).

INDIA



India has been actively involved with other G20 member countries in pursuing the BEPS agenda and has emerged as leading voice in the process among emerging economies. India is also part of the Bureau of the Committee of Fiscal Affairs, which is coordinating and guiding the work under the Action Plan. It seems likely that India will seek to implement aspects of the OECD's BEPS-related guidelines.

New government, new investor-friendly approach

In the past several years, India has taken an aggressive approach to tax policy and audit practices, especially for its challenges of cross-border transactions and structures. As India sought to advance its tax system, frequent legislative changes, retrospective amendments, rising levels of tax disputes, and a protracted appeals and dispute resolution processes have led to significant uncertainties.

Under India's new government elected in May 2014, however, there are signs that this situation is set to change. The current government has expressed its commitment to stable, investor-friendly tax and business policies that promote economic development. As a result, future retrospective amendments are unlikely, and draft tax measures are under review and could be substantially modified or abandoned. In particular, these outstanding measures include the general anti-avoidance rule (currently deferred until 2015), controlled foreign company provisions and other changes proposed in the Direct Tax Code originally announced in 2009.

Taking action on BEPS

In terms of specific G20-OECD BEPS Action Plan items, the Indian government has announced or may be expected to address the following:

- **Transfer pricing:** Based on newspaper reports, the underlying tone of the Indian government seems to indicate that Companies should gear up to deal with the new rules on transfer pricing in wake of new global tax practices that are likely to be in force sooner rather than later. (*Actions 8–10*)
- **Transfer pricing documentation and country-by-country reporting:** The Indian Government is contemplating to formulate the 3 tier on transfer pricing documentation at the earliest possible opportunity. India has been an active contributor in raising the issues concerning tax avoidance and automatic exchange of information with a view to restrict loss of revenue to the exchequer. (*Action 13*)
- **Anti-treaty shopping:** India has been negotiating the inclusion of limitation on benefits clauses in its tax treaties, and such clauses are now included in the country's treaties with (among

others) Kuwait, Mexico, United Arab Emirates and the United Kingdom. A few Indian tax treaties, such as those with Luxembourg and Saudi Arabia, provide that domestic anti-abuse provisions may override the treaty. The India-Namibia tax treaty provides a unique LOB clause under which one state can tax income that is not taxable in the other state because it is foreign-source income in that other state. (Action 6)

- **Controlled foreign company rules:**

India's previous government proposed a controlled foreign company regime that would prevent Indian companies from accumulating profits in low-tax jurisdictions to avoid paying taxes in India on such income. The rules would tax undistributed profits of a CFC in the hands of the Indian shareholder. As noted, however, these and other Direct Tax Code proposals are under review by India's new government. (Action 3)

Creation of value and contract R&D

Like other non-OECD countries such as China, any OECD BEPS recommendations that India adopts are likely to be implemented in ways that reflect its status as a developing country. In terms of transfer pricing, for example, India may seek a greater allocation of profit to India based on how functions and risks assumed by related parties contribute to the creation of value.

For example, the Indian Revenue authorities have released two circulars with respect to Contract Research and Development Centers that align with the OECD's guideline on intangibles. The Indian Revenue may adopt a position that an Indian contract R&D service provider is entitled to cost-plus remuneration if the foreign principal has the necessary substance to conceptualize the R&D, monitor its progress, and fund the Indian researcher's operations.

However, if the foreign company has no substance and the Indian researcher carries out the strategic functions of conceptualizing and monitoring the R&D, then the intangible-related return would need to be attributed to the Indian R&D center using the appropriate method, even where the foreign company funded the R&D. The guidance not only seeks to identify what constitutes 'economically significant functions' in the creation of intangibles but also specifically provides that the conduct of the parties – and not the contractual terms – is the final determinant of who controls the risk.

More tax certainty on the horizon?

As noted, India's new government is expected to offer more stability and certainty in its tax system where foreign investors are concerned. But until the G20-OECD BEPS Action Plan is finalized and the Indian government announces what legislative reforms will proceed,

companies doing business in India will continue to operate in an uncertain tax environment.

In the near term, companies in India should expect the country's tax authorities to scrutinize their cross-border transactions and structures closely, especially in relation to:

- Direct and indirect transfers of shares of Indian companies where it is claimed that income arising on transfer of shares is not taxable in India
- Creation of permanent establishments by foreign companies with a taxable presence in India, such as subsidiaries, employee secondments or regular employee visits to clients' premises
- Recharacterization of royalty income from the provision of services and fees for technical services eligible for treaty relief as business income.

Companies in India should also consider securing more certainty over the tax treatment of their transactions by requesting advance tax rulings and making applications under India's new APA program. Above all, they should make every effort to document the economic substance of their cross-border transactions and business arrangements.



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JAPAN



Japan is highly engaged in the OECD's BEPS consultations due to its G20 and the OECD memberships. Tsugumasa Asakawa, Director General of the International Bureau of Japan's Ministry of Finance (MOF) for Policy Planning and Coordination, is the current chair of the OECD's Committee on Fiscal Affairs. The minister is not only leading the discussion of international tax matters at the OECD level, he and other MOF officials are actively working to garner support for the BEPS initiative domestically.

Japan currently has tax rules in place that specifically address three G20-OECD BEPS Action Plan items:

- **Limitation of deductibility:** Under Japan's 2012 tax reform, an earnings stripping regime was introduced to prevent companies from taking excess interest deduction. The regime limits the deductibility of interest, royalty, lease and other payments where the interest payments to foreign related parties are excessive in comparison with the company's income. *(Action 3)*
- **Anti-treaty shopping:** Under its tax treaty policy, Japan generally seeks to include limitation on benefits clauses in tax treaties. Japan's current tax treaties with Australia, France, the Netherlands, New Zealand, Switzerland the United States and the United Kingdom include such clauses. *(Action 6)*
- **Digital economy taxation:** In November 2013, the MOF submitted the report *Consumption Tax Treatment of Cross-Border Supplies of Services and Intangibles* to the International Taxation Discussion Group of the government's Tax Commission. The report discusses how cross-border supplies of services and intangibles should be treated for consumption tax purposes from the perspective of ensuring both tax neutrality and the taxing rights of Japan.

Although these issues are still under discussion, a relevant amendment is expected be made within the next few years. *(Action 1)*

Other anti-avoidance rules

Japanese tax law also includes a general anti-avoidance rule for closely held companies that allows the Japanese tax authorities to deny a transaction that, in their view, improperly decreases the company's tax burden due to improper or unique terms and conditions. Specific anti-avoidance provisions are in place for all companies related to corporate reorganization transactions and transactions. These rules give Japanese tax authorities similar rights as the general anti-avoidance provisions.

Rising interest in tax planning techniques

For international Japanese-headquartered companies, the current BEPS debate and BEPS-related actions by emerging countries is spurring an unexpected attitudinal change. Historically, Japanese companies have not undertaken tax planning. Rather, they have viewed their tax contributions as a source of pride. A shift is occurring

as Japanese companies contend with several factors:

- Despite recent corporate income tax rate reductions, Japan's current rate of 35.64 percent is relatively high.
- As Japan's economy has begun to improve, taxable profits of Japanese companies are rising, creating more incentive to take steps to reduce the effective tax rate.
- Despite their historical lack of tax planning, Japanese companies are finding longstanding international tax structures under increasing threat of double taxation from aggressive tax audit practices and BEPS-related measures of emerging economies such as India and China.

As beleaguered Japanese companies perceive their share of tax as increasing, many of them are showing more interest in ways to minimize their tax burden on a global basis.

Resisting different notions on allocation of profit

The stance of emerging economies toward allocations of profit is also driving many of Japan's positions as the G20-OECD BEPS Action Plan proceeds. For example, as emerging economies have increasingly sought to allocate profit for treaty purposes based on beneficial ownership (e.g., looking through holding companies in low-tax jurisdictions), Japan has become increasingly interested in preserving allocations based on legal ownership.

Similarly, it is in the interest of Japanese companies to maintain transfer pricing principles that, for example, attribute value creation to intangible asset holdings developed and held by the parent company rather than value drivers in emerging economies, such

as low-cost labor pools, extensive manufacturing operations and large consumer markets.

Japanese companies also have concerns that emerging countries will use data from detailed country-by-country tax reporting to further challenge the profit allocations among international groups.


However, even as Japan advocates for international tax principles best suited to global companies based in the country, Japan is expected to fully embrace the G20-OECD BEPS Action Plan's final outcomes.



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KOREA



As a member of both the G20 and the OECD, Korea is highly engaged in the BEPS consultations and appears likely to adopt many measures that the OECD ultimately recommends. While general attitudes in Korea toward international tax planning have hardened, most public criticism has been aimed at individuals rather than corporations. Nevertheless, Korea's tax policy makers and administrators are taking aim at abusive tax schemes of individuals and corporations alike.

In the BEPS consultations, Korea has taken up a leadership role within ASPAC. In February 2014, the OECD Korea Policy Centre hosted a meeting of 110 senior officials from 22 ASPAC countries, including Indonesia and the Philippines. The goal of this event was to encourage developing ASPAC countries to better understand and support on the G20-OECD BEPS Action Plan.

To date, Korea has introduced legislation on two G20-OECD BEPS Action Plan items:

- **Controlled foreign company rules on passive income:** To curb perceived tax avoidance through foreign retention, Korea is extending application of its controlled foreign company (CFC) rule to passive income as of 1 January 2015.



Obligations to submit CFC-related information have been strengthened, and a harsh new penalty of up to 100 million Korean won (KRW; about US\$92,000 US dollars of additional tax may be levied for not complying with these rules. (*Action 3*)

- **Exchange of information:** Korea has strengthened the inter-governmental exchange of information to prevent BEPS by entering agreements with more governments, including an agreement with the United States under the US Foreign Account Tax Compliance Act that took effect in July 2014. Korean exchange of information rules apply not only to non-resident and foreign entities but also to Korean residents and domestic companies. Financial institutions that fail to submit information as required face a new penalty of up to KRW30 million (about US\$27,000).

Other anti-avoidance measures

Korean tax law contains a substance-over-form rule that allows the tax authority to re-characterize a related-party transaction based on its substance where the tax burden of a company has been unjustly reduced. Thin capitalization and transfer pricing rules are also in place. In recent treaty negotiations, Korea has

worked to resolve treaty shopping problems by introducing limitation on benefits clause.

In addition, Korea's tax authorities have increased both the frequency and level of scrutiny of international tax audits, sharpening their focus on outbound investments, transfer pricing and foreign tax credit abuses in the past few years.

Tax skills in short supply

As in other OECD countries, Korea's tax authorities are also focusing on the governance of tax. Larger Korean companies are developing board-approved tax management strategies as a result, increasing their tax resources and strengthening their tax risk management controls and processes. They are also investing in training to equip internal tax professionals with more sophisticated international tax skills.

But due to a shortage of suitably qualified tax professionals in the country, small and medium-sized Korean companies are struggling to add substance and staff to their tax departments. Compared to companies in other countries, Korea-headquartered companies are more reluctant to outsource tax activities due to confidentiality concerns as many of them operate in the high technology sector.

As Korean companies seek to expand operations and compete in the global economy, they are showing interest in global structures that could help reduce their effective tax rates. However, the current climate and lack of international tax skills have combined to discourage them from implementing tax planning arrangements. For example, rather than developing a strategic approach to transfer pricing, Korean companies are more likely to devote resources to strengthening documentation to support transfer prices currently in place. By outsourcing more tax department activities, Korean companies could free some of their limited in-house tax resources to focus on more strategic tax planning activities.



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SINGAPORE



Singapore has a track record of setting competitive tax and other policies that attract global and regional headquarters companies. Similar to the G20 countries, Singapore is engaged in the development of the G20-OECD BEPS Action Plan. Singapore's government realizes the importance of the BEPS project and is interested in how the G20-OECD BEPS Action Plan is unfolding.

Further, as with companies from other developed ASPAC countries, Singaporean companies doing business in China and India are increasingly subject to aggressive tax investigations and adjustments in respect of their activities in these emerging countries. While the Singapore government has yet to introduce unilateral measures to counter BEPS, it may take steps in response to BEPS measures adopted by its neighbors and trading partners.

For example, Singapore is among the countries that endorsed the OECD declaration on 6 May 2014, committing them to implement a new single global standard on automatic exchange of information. This allows Singapore to share in this data exchange. Singapore has also signed an intergovernmental agreement with the United States on information exchange in connection with the US FATCA legislation.

Outside of the OECD BEPS process and as part of Singapore's efforts to encourage sound transfer pricing practices, the government regularly

conducts transfer pricing audits on taxpayers. Transfer pricing has been an area of significant activity in recent years, with the Inland Revenue Authority of Singapore (IRAS) now vigorously applying a series of guidelines and circulars issued from 2006-10. It is noteworthy that Singapore's new guidance relating to transfer pricing matters will be released in December 2014.

Focus on business substance

Singapore has an interest in being perceived internationally as a tax-friendly jurisdiction – but not as a tax haven. Thus Singapore's tax incentives and treaty benefits are generally only available to commercial arrangements with sufficient business substance. In fact, Singapore's Prime Minister is on record as saying, "Profits made by companies should be rightfully taxed in jurisdictions where there are substantive economic activities."⁷

⁷ "Improve Global Tax Rules," *Business Times*, 6 September 2013.



The arm's length principle is endorsed by IRAS and is set out in Section 34D of the Singapore Income Tax Act. According to Section 34D, where the pricing of related party transactions is not at arm's length and results in a reduced profit for the Singapore taxpayer, the Comptroller of Income Tax may adjust and tax the profit of the Singapore taxpayer. In addition to the arm's length principle, Singapore also has other general anti-avoidance provisions in its tax legislation.

In summary, as the G20-OECD BEPS Action Plan proceeds, Singapore is engaging with the OECD and carefully monitoring the international developments as well as weighing their implications to determine what, if any, unilateral legislative change may be needed to protect its tax base.



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Bracing for BEPS: Are you ready?



Given current global tax developments, all signs suggest that we will continue to see increased pressure for more scrutiny of international transactions and structures, more transparency between taxpayers and the tax authorities, and more disclosure by companies on how much and where they pay tax. No matter what tax changes result or where your company does business, you need to create a tax management strategy to drive how your company communicates about tax, governs its tax affairs and manages tax risk.

The following are key actions businesses must take seriously and address now, regardless of industry or location.

- **Stay informed:** Keep on top of developments as they occur locally and internationally. Consider how these developments could affect your tax positions and planning.
- **Get involved:** Engage in BEPS-related consultations to ensure your practical business issues are raised and considered. Effective, widely accepted solutions can only be forged through broad consultation with tax professionals in business, government and public practice.
- **Conduct a tax health check:** Review your existing tax transactions and structures immediately to identify potential weaknesses, and take measures to rectify these areas. Identify potential weaknesses according to the G20-OECD BEPS Action Plan and take steps to make improvements. This includes movement of functions, assets and personnel within the group, development of legal, tax and transfer pricing documentation as support, and preparation of internal controls and working guidelines to mitigate tax risks. With adequate preparations, multinational corporations will be able to adapt to the new tax landscape created by BEPS without causing unwarranted disruptions in business operation or incurring excessive amounts of tax costs during the transition.
- **Prepare for questions:** Be prepared to comment on your business and tax activity at any given moment (a particularly important capability in the era of social media). Ensure board members, C-Suite executives and the core tax team are aware of potential questions and challenges that could come from any number of stakeholders such as regulators, investors, media and the general public.
- **Think reputational risk:** Ensure that decisions around tax are made taking into account potential reputational risks and not simply whether your organization has complied with the tax laws in various jurisdictions.
- **Assess your company's relationship with tax authorities:** Ensure that there is appropriate, open and respectful relationships with local tax authorities in all countries in which you operate.

With adequate preparations, multinational corporations will be able to adapt to the new tax landscape created by BEPS without causing unwarranted disruptions in business operation or incurring excessive amounts of tax costs during the transition.

Appendix: Unilateral BEPS legislative actions in ASPAC



Even though we are only midway through the OECD's timeframe for developing proposals under the G20-OECD BEPS Action Plan and existing proposals are incomplete, many countries are already changing their tax legislation or administration in response. Below we summarize such actions taken so far by ASPAC jurisdictions regarding the Action Plan's 15 points.

G20-OECD BEPS Action Plan	Jurisdiction's unilateral responses to date
Action 1 – Address tax challenges of the digital economy	Japan – Ongoing discussion regarding consumption tax treatment in the digital economy
Action 2 – Neutralize effects of hybrid mismatch arrangements	Australia – Foreign dividend participation exemption rules amended China – May challenge Chinese corporate income tax deduction where characterization mismatches result in outbound payments from China not being taxed in the foreign jurisdiction. Plans to introduce anti-hybrid rules in 2015. New Zealand – Foreign deductible dividends already taxable. Ongoing review of hybrid instruments and entities. Increased use of anti-avoidance rules in cases of jurisdictional arbitrage
Action 3 – Strengthen controlled foreign company rules	China – Bolstering of CFC reporting rules effective from September 2014 with a view to increasing enforcement in the near future India – Proposed introduction of CFC rules Japan – Introduced earnings stripping rules 2012 Korea – Introduced CFC rules on passive income Taiwan – Proposed introduction of CFC rules
Action 4 – Limit base erosion via interest deductions and other financial payments	Australia – Introduction of thin capitalization rules Japan – Introduction of earnings stripping regime to prevent companies from taking excess interest deduction in 2012 (not directly linked to BEPS) Malaysia – Introduction of thin capitalization rules after December 2015 New Zealand – Further review of thin capitalization rules. Interest withholding tax rules also under review Taiwan – Introduced thin capitalization rules in 2011 (not directly linked to BEPS) Thailand – Introduction of thin capitalization rules under consideration
Action 5 – Counter harmful tax practices more effectively, taking into account transparency and substance	China – Strongly suspects and scrutinizes transactions between Chinese entities with haven jurisdictions, with Directive 146 launching a wide-ranging review of outbound service and royalty payments by foreign-invested companies to foreign related parties

G20-OECD BEPS Action Plan	Jurisdiction's unilateral responses to date
Action 6 – Prevent treaty abuse	<p>China – Introduced strict beneficial ownership rules under domestic law and introduced limitation on benefits concept in recent tax treaties</p> <p>India – Introduced or expanded limitation on benefits concept in recent tax treaties</p> <p>Japan – Some tax treaties include limitation on benefits clauses</p> <p>Mongolia – Cancellation of certain treaties due to abuse</p> <p>Taiwan – New treaties generally include limitation on benefits clauses</p>
Action 7 – Prevent artificial avoidance of permanent establishment status	<p>China – Increased scrutiny on onshore projects and service activities of international companies, focusing on dependent agency issues</p>
<p>Actions 8, 9, 10 – Assure transfer pricing outcomes are in line with value creation</p> <p><i>Action 8 – intangibles</i></p> <p><i>Action 9 – risks and capital</i></p> <p><i>Action 10 – other high-risk transactions</i></p>	<p>Australia – Change in transfer pricing rules from arm's length price model to whole economic analysis model</p> <p>China – Implemented transfer pricing adjustments related to location-specific advantages, market premium and intangible assets that are deemed to be developed locally</p> <p>India – Indian revenue authority deviates from OECD position on location savings – India views such savings as an intangible that would result in extra profit and thus needs to be attributed on related-party transactions. When planning for the cross-charge for services that involve intangibles, international companies need to ensure that transfer pricing outcomes are in line with value creation</p> <p>Malaysia – Transfer pricing guidelines in place (Tends to adopt OECD guidelines when finalized. Additional measures have been introduced in 2015 to tighten transfer pricing compliance)</p> <p>New Zealand – Tax authorities' compliance focus includes increased focus on transfer pricing</p> <p>Sri Lanka – Measures implemented to enforce transfer pricing</p> <p>Taiwan – Transfer pricing guidelines in place</p> <p>Thailand – Introduction of transfer pricing rules under consideration</p> <p>Vietnam – Aggressive transfer pricing audits</p>
Action 11 – Establish methodologies to collect and analyze data on BEPS and the actions to address it	<p>Australia – Set up dedicated unit to collect data from certain Australian companies with overseas related-party transactions</p>
Action 12 – Require taxpayers to disclose their aggressive tax planning arrangements	No unilateral action in ASPAC to date

G20-OECD BEPS Action Plan	Jurisdiction's unilateral responses to date
Action 13 – Re-examine transfer pricing documentation	<p>Australia – Introduced disclosure rules</p> <p>China – Supports country-by-country tax reporting to challenge beneficial ownership</p> <p>India – The Indian government may start formulating new rules on transfer pricing documentation at the earliest opportunity by seeking to implement OECD's recommendations on transfer pricing documentation</p> <p>Mongolia – Large taxpayers in Mongolia are required to disclose related-party information and transaction details</p>
Action 14 – Make dispute resolution mechanisms more effective	No unilateral action in ASPAC to date
Action 15 – Develop a multilateral instrument	No unilateral action in ASPAC to date

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