The October 2015 BEPS Deliverables

KPMG Commentary
5 October 2015

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Introduction

On 5 October 2015, the OECD published its final proposals under its Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Action Plan includes 15 Actions to address BEPS in a comprehensive manner and represents one of the most significant changes to the international corporate tax landscape since the League of Nations proposed the first bilateral tax treaty in 1928.

The conclusions and recommendations of the BEPS project come at a time when perceived tax avoidance by multinationals is high profile: indeed, the OECD estimates that global revenue losses from BEPS are between USD 100 billion and USD 240 billion annually, and it hopes that these proposals will go some way to closing the tax gap.

Multinationals will need to fundamentally rethink how they view taxes in a post-BEPS world, and governments will have to think about how they balance their ambition to attract business activity through offering an attractive corporate tax system against the need to keep a more level global playing field.

For the majority of Actions, the October Deliverables mark the end of the discussion and recommendation phase of the project and the start of the implementation and practical delivery phase. This implementation phase includes a mandate for monitoring and supporting implementation.

Whilst the implementation phase will be largely driven by activity at a domestic level, other stakeholders will be influential. For example, here in the UK we are closely following the initiatives launched by the EU which sit in parallel to the BEPS Action Plan. For the majority of the BEPS Actions there is at least one corresponding EU Committee, Review or Code of Conduct Group. Depending on the conclusions of these EU workstreams, these have the possibility of either clarifying the action required by Member States to meet the BEPS standard, or they may of course simply add further complexity and red tape.

The purpose of this document is to provide a UK commentary of the October 2015 BEPS Deliverables. It sits alongside our KPMG Global publication which provides a further, more comprehensive analysis of the Actions at a multi-jurisdictional level. We hope that you find our UK insights helpful as you start to assess the implications of the BEPS recommendations on your business.

Should you wish to discuss the impact of any of the Actions on your business in further detail, please do not hesitate to contact your usual KPMG contact or a member of the KPMG BEPS team.

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Action 1
Digital Economy

This Action is intended to address the difficulties posed by the digital economy for existing tax rules, covering both direct and indirect taxes.

In summary, the key recommendations set out by the OECD are:

- The impact of digitalisation of the global economy is a fast moving area and needs to be frequently revisited, however it is accepted that it is not possible to ring-fence a separate digital economy;
- For direct tax, no specific new digital taxes or permanent establishment (PE) rules are recommended, and it is recognised that the changes proposed under Actions 3 (CFCs), 7 (PE avoidance) and 8-10 (Transfer Pricing) will address the BEPS issues currently identified with the digital economy. The OECD expects digital economy to be tackled by other Actions but leaves the door open to countries to implement domestic rules if they consider them inadequate or creating a time lag. Monitoring will continue with a further report in 2020, with an exact mandate for further work to be discussed in 2016;
- It is recommended that indirect taxes move to a "consumption tax" model, i.e. international services, including digital, to be taxed in the place of consumption regardless of the local presence of the supplier. For B2B this generally means a recharge or self-assessment. For B2C services, remote suppliers of digital services will need to register and account for VAT in the country of residence of their customer;
- Finally, a new "Low Value Imports Report" provides options for tax authorities to tax more low value e-commerce goods transactions by shifting VAT obligations to the vendor/intermediary, again collecting VAT in the jurisdiction of consumption.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

In Action 1 the OECD and G20 confirm and endorse the OECD's new International VAT/GST Guidelines as the primary way to manage VAT challenges in the digital economy, including removing the incentive to deliver services from low/no VAT jurisdictions, by recommending that VAT should accrue in the country of consumption. For exempt businesses or branches this will generally mean a VAT recharge or self-assessment. For B2C digital supplies, the recommendation is for the remote seller to be required to register for and collect VAT in the country in which the consumer is resident. The OECD stresses that a VAT registration is not linked to and does not determine whether there is a PE for direct tax purposes, which has been problematic in the past in some countries.

The UK has already implemented this tax policy for VAT with effect from 1 January 2015 in line with the other EU member states. However, UK exporters of B2C services should expect to see more countries around the world adopting these rules, so face an increasing registration and compliance burden including increasingly complex accounting system requirements.

The Action 1 deliverable also contains a new "Low Value Imports Report" by the OECD, which recognises the massive growth in e-commerce and gives countries options to remove the VAT threshold for low value goods, which is in place because of the administrative cost to the tax authorities of collecting low VAT amounts. Authorities could transfer responsibility and cost of VAT collection to non-resident vendors, or an intermediary such as the internet platform in future: this would benefit domestic suppliers who have been lobbying for a more level playing field where VAT makes them uncompetitive, but international suppliers of low value goods would face additional costs of both VAT and related compliance costs.

The changes to indirect tax represent a fundamental policy shift and will have profound impacts for any retailer operating in the e-commerce space. It is our view that taxing B2C supplies of both digital services and low value e-commerce in the country of residence of the consumer will place a greater compliance burden on vendors in the global digital economy and potentially increase the cost to consumers. All affected clients need to act now to understand the implications of the proposals on their business model and systems, including monitoring tax rule changes in any country their customers are resident.

On the corporate tax side, the conclusions and recommendations of the OECD in relation to Action

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1 recognise that the changes proposed in the work on CFC rules (Action 3), addressing the artificial avoidance of PE (Action 7) and transfer pricing (Actions 8-10) will substantially address the BEPS issues identified with the digital economy.

It is clear from the report that substantial work has been undertaken and the Task Force for the Digital Economy (TFDE) consider (albeit not unanimously) that three areas of policy challenge for direct taxation remain outstanding: Nexus, Data and Characterisation. The report identifies three possible actions to address these concerns: a new nexus based on the concept of significant economic presence, a withholding tax on digital transactions and the introduction of an "equalisation levy". The report concludes that none of these three options explored by the TFDE are recommended for adoption at this stage and that further calibration would be required prior to any adoption or implementation.

It is therefore extremely disappointing that the final bullet point in the conclusions (listed in para 383 on page 148 of the report) effectively encourages countries to implement the options on a unilateral basis, albeit noting the need to respect existing treaty obligations. It is our established view that tax policy should be dictated by sound economic principles, and an approach such as that suggested here will lead only to a confused and complex patchwork of taxation options, which during this interim period will result in significant uncertainty for our businesses which operate across various jurisdictions.

Finally, the report recommends that developments in this area should be monitored and further work undertaken, however it is unclear what the remit for this work would be.

Who is affected?

The conclusions and recommendations of this Action will be of interest to all multinational corporations which either buy or supply digital services. In particular those that supply digital services or engage in e-commerce cross border will need to understand where their customers are resident before making their supply, collecting new data, making different taxing decisions and managing VAT registrations and compliance in multiple countries in which they often have no physical presence.

What are the expected next steps?

We understand that the UK Government is proposing to call together the digital tax stakeholder group to discuss the conclusions of the Action 1 working group and discuss the UK's approach to the continued work of the TFDE. It is not expected that the UK will look to implement any of the suggested digital tax options in the short to medium term, which we consider to be the correct approach given the overall uncertainty of the digital tax landscape.

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Action 2
Hybrid mismatch arrangements

This Action is aimed at developing model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect of hybrid instruments and entities.

In summary, the key recommendations set out by the OECD are:

- The introduction of domestic hybrid mismatch rules applying to arrangements involving a hybrid instrument or entity that cause a mismatch in tax outcomes. The rules operate to deny a tax deduction for payments made under such arrangements that are also deductible in another jurisdiction, prevent exemption for payments that are deductible for the payer and deny a deduction for a payment that is not included in ordinary income of the recipient;
- Other recommended domestic provisions include the denial of a dividend exemption for payments that are tax deductible for the payer and measures to prevent hybrid transfers being used to duplicate withholding tax credits (which the UK already has in place), as well as measures to treat reverse hybrids as resident taxpayers where income is not brought into charge to tax in the investor jurisdiction;
- There is a proposed change to the OECD model treaty to ensure hybrid entities are not used to obtain treaty benefits unduly. This is a provision that is already included in a number of US tax treaties, including that with the UK.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The final recommendations in relation to Action 2 are in line with the interim OECD report that was published in September 2014, although at that time there were a number of outstanding areas which required further work. This included the application of the hybrid mismatch rules to hybrid regulatory capital instruments that are issued intra-group. It has now been decided that countries will be free to decide in their policy choices as to whether to apply the rules to neutralise mismatches in respect of intra-group hybrid regulatory capital.

The UK government has already announced its intention to introduce domestic rules to give effect to the OECD's recommendations on hybrid mismatch arrangements, with a consultation document published in December 2014. The new hybrid mismatch rules, unlike the existing arbitrage rules, are expected to be within self-assessment and apply automatically. The government has previously announced that it will also consider the introduction of rules restricting the tax transparency of reverse hybrids, specifically identifying UK LLPs in this regard. In relation to the application of the hybrid mismatch rules to intra-group hybrid regulatory capital, the government has also stated that the rules should not apply to the extent that intra-group hybrid regulatory capital originates from an external issuance at the top holding company. The consultation document included a number of possible options in this regard. The new provisions are currently expected to apply to payments made on or after 1 January 2017, with no grandfathering of existing arrangements contemplated.

Who is affected?

The recommendations of this Action will be of interest to all multinational companies which currently use hybrid instruments or entities, particularly as part of intra-group financing arrangements.

What are the expected next steps?

Following the publication of the final Action 2 recommendations, it is expected that the UK Government will publish a response, together with draft legislation covering the new rules, at or around the time of this year's Autumn Statement.

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Action 3
CFC rules

This Action is aimed at developing recommendations regarding the design of CFC rules.

In summary, the key recommendations set out by the OECD are:

- The final report, in line with the earlier discussion draft, considers the constituent elements of CFC rules and breaks them into the "building blocks" necessary for the design of effective CFC rules. The six building blocks include the definition of a CFC and of CFC income and the attribution of CFC income;
- The recommendations are not minimum standards, but they are designed to ensure that countries which choose to implement them will have CFC rules that effectively prevent taxpayers from shifting income into foreign subsidiaries;
- The final report allows countries to decide on their rules for defining CFC income and sets out a non-exhaustive list of approaches, including a substance analysis and excess profits analysis, which could be used on their own, or in combination, for such a definition.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The OECD has recognised the recommendations in this area need to be flexible and not overly prescriptive, as the design of CFC rules in different countries reflects differing policy objectives, in particular, depending on whether they have a worldwide or territorial tax system and whether they are EU members. The definition of CFC income, which is one of the key building blocks, is an area where there are clearly differing views amongst OECD members and the final report sets out a number of approaches to accommodate those differing views.

The UK Government commented at the time of last year's Budget that, having completed its own major reform, it did not anticipate that the UK's CFC rules would require further substantive changes. We are not aware of that view having changed. Certainly, the UK rules seem to fit within the recommendations set out in the final report.

Who is affected?

The recommendations under this Action will be of interest to all multinational corporations, although more from the perspective of whether countries other than the UK amend their existing CFC rules or introduce new CFC rules in response to the OECD's recommendations.

What are the expected next steps?

We will need to wait for the UK Government's response, but based on previous comments it is not expected that any substantive changes will be made to the existing CFC rules as a result of the OECD's recommendations in this area.

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Action 4
Interest Deductions

This Action is intended to recommend best practice in the design of rules to limit deductibility of interest (or financial payments economically equivalent to interest).

In summary, the key recommendations set out by the OECD are:

- Recommendation of a Fixed Ratio Rule (FRR) of tax relief for net interest of 10% to 30% of EBITDA, applied to net (including third party) interest at an entity level;
- A Group Ratio Rule (GRR), in addition to the FRR, which would enable groups that are more highly leveraged with third party debt to apply the worldwide ratio rather than the country's FRR (with a possible uplift of up to 10% to the group's net third party interest expense to prevent double taxation);
- Alternatives to the GRR include an "equity escape" rule (comparing an entity's level of equity and assets to those held by its group), or no GRR provided the FRR is applied equally to both multinational and domestic groups;
- Suggested further options: a de minimis threshold, public benefit exemption, carry forward of disallowed interest expense and/or unused interest capacity, and other targeted anti-avoidance rules.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The recommendations set out by the OECD are in line with our expectations, and we welcome the opportunity and provide for local jurisdictions to implement the recommendations with a certain level of flexibility. We expect that most countries, the UK included, will select a FRR in the range of 20% to 30% of EBITDA. The recommendations provide for jurisdictions to implement a range of exclusions and it remains to be seen what exclusions the UK allows and the impact these will have on UK business – for example, the GRR is expected to be of significant benefit to largely domestic groups.

The implementation phase will be critical in whether the objectives of this Action will be successfully met. We expect that some countries which already have restrictions on interest deductions may be reluctant or take time to change these if they believe they are already effective in preventing abuse.

The UK arguably falls into this category of countries with an already well-established and largely well received policy around interest deductibility. The UK will need to balance implementing the recommendations of the BEPS initiative with potentially unsettling a policy that is largely seen as beneficial to the UK's competitiveness.

The existing domestic legislation in relation to tax deductibility is now well-established and largely understood by large UK corporates and multinationals – for example, the arm's length approach to amount and pricing of debt, the worldwide debt cap restriction, and the remit of the "unallowable purpose" rule in a debt funding scenario. It is also noted that the UK has a well-regarded practical approach to the implementation of these rules in practice, with advance clearance and published guidelines for tax inspectors on many aspects of the legislation. As we move into the consultation and implementation phase, business will be looking for reassurances from the UK Government that alignment with the BEPS recommendations will not adversely affect the stability and competitiveness of the UK tax regime.

Who is affected?

This Action will affect all international investors, with some more acutely affected e.g. Infrastructure, Private Equity, Real Estate and other "highly leveraged" groups. Banking and Insurance sectors must wait for further, more specific work to be completed in 2016.

What are the expected next steps?

Following the publication of these Action 4 deliverables, it is expected that the UK will launch a wide ranging policy discussion, with a consultation document issued this year around the time of the Autumn Statement. The consultation is expected to be technically complex, with changes to the UK regime expected in 2017/18 at the earliest.

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HM Treasury and HMRC have already set up a number of meetings with stakeholders in the coming weeks which we expect will set the scene for the consultation period ahead of us.

We expect that such a consultation will seek views on how the rules may be designed to prevent tax abuse but that avoid damaging business and the competitiveness of the UK. We understand the government is aware that some industries (such as Infrastructure) support high levels of gearing commercially, and the impact on these heavily affected sectors will be taken into account during the consultation phase.

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Action 5
Harmful tax practices

This Action is intended to encourage transparency, including in relation to preferential regimes, and provide an updated framework for identifying harmful regimes going forward.

In summary, the key recommendations set out by the OECD are:

- Introduction of the Nexus principle to link benefits under preferential IP "Box" regimes to a claimant's proportionate contribution to R&D activities underpinning the income, with all IP regimes requiring change to reflect the Nexus principle;
- New Nexus-based regimes to be introduced from July 2016 with use of current regimes permitted in certain circumstances until June 2021, under grandfathering provisions;
- Other non-IP preferential regimes to also require benefits to be linked to core income-generating activities undertaken by the taxpayer;
- Core activities that need to be undertaken for the purposes of a specific regime being considered will vary, with the OECD identifying types of activities that might be required for the purpose of the following non-IP preferential tax regimes: (i) headquarters regimes, (ii) distribution and service centre regimes, (iii) financing and leasing regimes, (iv) fund management regimes, (v) banking and insurance regimes, (vi) shipping regimes and (vii) holding company regimes (e.g. denial of treaty benefits to companies that lack substance necessary to engage in holding and managing equity participations);
- Introduction of compulsory spontaneous exchange of information on rulings which can give rise to BEPS concerns from April 2016, including (i) rulings in relation to preferential regimes, (ii) unilateral advance pricing arrangements (APAs) or other cross-border unilateral rulings in respect of transfer pricing, (iii) cross-border rulings providing for a downward adjustment of taxable profits, (iv) permanent establishment (PE) rulings and (v) related party conduit rulings;
- The obligation to exchange information applies to past rulings that have been issued on or after January 2010 and were still in effect as from January 2014, and to the names of new entrants to IP boxes post February 2015.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The Nexus principle will introduce considerable complexity to IP Box regimes and, for many taxpayers, is likely to restrict overall benefits, particularly those groups operating multiple R&D centres on a global basis.

Under the Nexus principle, taxpayers will be required to identify a proportion of qualifying expenditure from overall expenditure on research and development activities that resulted in the IP benefitting from the Patent Box regime. This proportion will need to be applied to the income benefitting from the regime to determine the overall benefit that remains available as below:

$$\text{Qualifying expenditure incurred to develop the IP asset x overall income} \times \text{Overall income from the IP asset} = \text{Income receiving tax benefits}$$

Qualifying expenditure will include a) expenditure on R&D activities that the company carries out itself or b) outsources to an unrelated third party (subject to a maximum 30% uplift in certain circumstances), but does not include c) the costs of acquiring IP or d) outsourcing R&D activities to related parties. So that the Nexus fraction is applied as follows:

$$\frac{a + b\ (+\text{ up to }30\%\text{ uplift})}{a + b + c + d} \times \text{Overall income from the IP asset} = \text{Income receiving tax benefits}$$

Those groups that have acquired IP or that outsource R&D to global R&D centres are likely to have the benefits currently available from Patent Box restricted.

Applying the Nexus principle will require significant "tracking and tracing" of R&D expenditure. The level at which this will need to be undertaken (product, product group or IP asset) will depend on the basis on which the claimant group's R&D activities are organised and the level at which income can be identified. The approach taken will need to be agreed with HMRC and supported by documentation.

For those taxpayers with at least 25% qualifying expenditure, but for whom Nexus produces a result which is not commensurate with the level of R&D activity undertaken, a rebuttable presumption

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may be used in exceptional circumstances. The UK Government will need to define what those circumstances are.

Groups that meet the qualifying conditions, including those with pending patents at 30 June 2016, should be able to benefit from grandfathering arrangements which allow them to claim under the current regime until 30 June 2021.

Taxpayers should be aware that information will be exchanged spontaneously in relation to certain rulings including on preferential regimes, unilateral transfer pricing and PEs.

Who is affected?

The conclusions and recommendations of this Action will be of interest to UK-headed groups and international groups with a UK presence who have benefitted, or are looking to benefit, from preferential regimes, for example, the UK's Patent Box regime.

Where a ruling for a preferential tax regime relates to a non-UK resident entity whose ultimate parent company or immediate parent company is resident in the UK, relevant information (including past rulings) will also need to be exchanged with the UK tax authorities.

Countries that have preferential regimes that have not yet been reviewed by the OECD need to self-assess and take a view on whether they still need to spontaneously exchange information as the obligation arises immediately. From a UK perspective, this is relevant where such a preferential regime is relied upon by a group company and the ultimate parent company or immediate parent company is resident in the UK, or where the UK resident may be party to a cross-border ruling.

What are the expected next steps?

Following the publication of these Action 5 Deliverables, HM Treasury is expected to issue a consultation document next week. This will set out how the UK government intends to implement the Nexus principles into the future Patent Box regime.

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Action 6
Treaty abuse

This Action is intended to enhance anti-treaty abuse protections and identify tax policy considerations that countries should review before deciding to enter into a tax treaty.

In summary, the key recommendations set out by the OECD are:

- That countries entering into a tax treaty include a clear statement in that tax treaty that they intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements;
- To counter treaty shopping, as a minimum standard, countries should adopt one of the following approaches:
  - a combined approach of both a Principal Purposes Test (PPT) and Limitation on Benefits (LOB) rule in tax treaties;
  - a PPT rule alone in tax treaties; or
  - a LOB rule in tax treaties, supplemented by anti-conduit financing rules adopted into domestic legislation;
- Recommended specific anti-abuse rules dealing with: transactions seeking to prevent source taxation of immovable property; low taxed permanent establishments (PEs); holding periods for short term dividend transfer transactions; and dual resident companies;
- The following key issues are still to be finalised in early 2016: firstly, the recommended wording for the LOB clause (pending the finalisation of the US new model tax treaty), and secondly the approach for treaty entitlement of non-CIVs (Collective Investment Vehicles).

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The impact of the proposed recommendations on UK groups will largely depend on the approach of the UK Government in implementing the OECD's proposals, together with that taken by the UK's bilateral treaty partners.

Historically, the UK and its European tax treaty partners have been viewed as preferring the PPT as the means by which access to treaty benefits is protected. It will be interesting to see whether this preference is reaffirmed by the government later this year. The use of a PPT rule by the UK and its European treaty partners would align the treaty position with an anti "EU Directive shopping" general anti-avoidance rule (GAAR) due to be introduced from 1 January 2016.

For those UK groups with activities located in jurisdictions which would prefer to implement the LOB (such as the US and Japan, in keeping with their existing bilateral treaties with the UK), there will remain a degree of uncertainty as to how this LOB will operate until the formulation of the revised US model treaty is finalised in early 2016.

Who is affected?

The conclusions and recommendations of Action 6 will be of interest to all UK groups with multi-national operations and international groups with a UK presence. These are discussed below:

- UK headed groups

The impact of the proposed PPT provisions on UK headed groups will need to be reviewed on a case by case basis (although where a group undertakes genuine business activity in the UK there is unlikely to be a restriction on the availability of treaty benefits).

The proposals for the LOB, if adopted by the UK, are unlikely to restrict the ability of UK listed entities to claim treaty benefits due to the exemption for publicly listed entities. For non-listed entities it will be necessary to look to the application of the derivative benefits test and active trade or business exemptions.

UK headed groups will need to review their outbound investment structures to assess whether the LOB or PPT would restrict the availability of treaty benefits within non-UK intermediate sub-holding companies.

- International groups with UK presence

Under both the proposed LOB and PPT alternatives it will be necessary for groups to review their group structure and the future accessibility of treaty benefits.

Structures where the UK is used as a through-bound investment platform (but with very limited business presence in the UK) to make non-UK investments will need to be assessed in terms of potential impact, although there will usually be many more purposes for establishing a holding company in the UK other than access to the UK's treaty network. Such structures will also need to

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be reviewed in the context of the anti-EU directive shopping GAAR to be introduced in 2016.

- CIVs/Non-CIVs

In respect of the LOB, and as expected, the report has confirmed that treaty access for CIV funds should be built around the Treaty Relief and Compliance Enhancement (TRACE) report of 2010. Work will continue into the first part of 2016 to develop suitable accommodation, perhaps in the form of a derivative benefits test, for non-CIV funds. It is positive that the OECD has recognised the differences between CIV and non-CIV funds, and has made this commitment to further work.

It remains to be seen whether the commentary will include fund specific examples in respect of the PPT. If included these would provide the clarity which respondents to the various consultation rounds have requested, with a view to improving the current position where significant inconsistency between jurisdictions exists. If not, then there is a risk that those businesses operating in jurisdictions choosing to meet the minimum standard via the PPT will merely be swapping one form of inconsistency and subjectivity for another.

What are the expected next steps?

We expect to receive further information on the UK Government's response to Action 6 in the Autumn Statement.

We also expect confirmation of the finalised LOB, formulation of the simplified LOB and confirmation of the application of Action 6 to non-CIVs to be issued in the first part of 2016. This timeline is critical in order for these elements to be relevant for the negotiation of the multilateral instrument.

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Action 7
Definition of Permanent Establishment

This Action is intended to update the definition of permanent establishment (PE) to prevent BEPS and will result in a significant extension to the PE definition.

In summary, the key recommendations set out by the OECD are:

- The circumstances in which a "dependent agent" PE can be created will be significantly widened and will, for example, extend to situations where a person "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise";
- The list of excluded activities in article 5(4) of the model treaty will be subject to an overriding precondition that they be "preparatory or auxiliary" in nature;
- Also for the purpose of applying article 5(4), a new anti-fragmentation rule will be introduced. This will apply where complementary functions that are part of a cohesive business operation are carried on by the same or a closely related enterprise;
- Perceived abuse of the 12 month threshold for triggering a PE in respect of a construction site will be addressed through the "Principal Purposes Test" under Action 6, with associated changes to the OECD commentary to Article 5 (PE) of the model treaty;
- The treaty changes are to take effect through the multilateral instrument (Action 15) coming into effect and associated changes to the OECD commentary to the model tax convention.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The recommendations set out by the OECD are broadly in line with the previous discussion draft, although the scope of some of the changes in particular relating to "dependent agents" has been slightly narrowed compared to earlier proposals.

The final proposals remain far reaching, and will need to be considered by every multinational business. In particular, it is our view that the revised definition will inevitably lead to greater uncertainty for businesses operating across multiple jurisdictions, and will also result in a marked increase in disputes with tax authorities.

For example, many overseas companies with UK activities that would previously have been automatically exempt from triggering a PE, such as purchasing, storage of goods etc. will now have to carefully consider whether such activities are of a "preparatory or auxiliary" nature in the context of the overall activities of the enterprise, and whether they fall to be aggregated with those of other group companies (including any UK subsidiaries).

The changes to the circumstances in which a "dependent agent" may trigger a PE are expected to result in "commissionaire" structures giving rise to a PE. In contrast, proposed amendments to the OECD commentary to the new model treaty will make clear that limited risk distributors (which sell to customers on their own behalf, and are more commonly seen in the UK) will typically not give rise to a PE of another enterprise from whom they obtain goods and services.

In the UK, we have already seen the introduction of the Diverted Profits Tax (DPT) legislation (effective 1 April 2015), which includes provision to address concerns around perceived avoidance of triggering UK PEs by foreign enterprises. There has been no suggestion to date from the government that the Action 7 proposals will make the "avoided PE" provisions in section 86 Finance Act 2015 redundant, and it is our expectation that both the DPT regime and the adoption of the revised PE definition will run in parallel, in the short term at least.

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Who is affected?

The conclusions and recommendations of this Action will be of interest to all multinational groups with cross-border operations or activities.

What are the expected next steps?

Following the publication of these Action 7 Deliverables, it is expected that changes to tax treaties will be made through the multilateral instrument.

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Action 8-10
IP and transfer pricing outcomes

These Actions deliver major changes to the OECD Transfer Pricing Guidelines including:

- Comprehensive guidance on the pricing of transactions involving intangibles, including specific rules that define and deal with hard to value intangibles (Action 8);
- Guidance on the arm's length allocation of profits relating to risks and capital, based on the principle of aligning returns with value creation (Action 9);
- Updated guidance on cost contribution arrangements (CCAs) to bring it in line with the major changes to intangibles and risks (Action 8);
- Additional guidance setting out how the comparable uncontrolled price (CUP) method should be applied to commodity transactions (Action 10);
- Updated guidance simplifying the pricing of low value services (Action 10).

In summary, the key recommendations set out by the OECD are:

- Legal ownership of an intangible asset does not of itself provide a right to all (or even any) of the returns derived from the exploitation of that asset. Those returns accrue to the parties which carry out the important functions relating to the development, enhancement, management, protection and exploitation of the assets - the DEMPE functions;
- Special rules for hard to value intangibles allow tax administrations to revisit the pricing of intangibles where the ex post results differ significantly from the expected results at the time the transaction took place;
- Transactions should be carefully and specifically identified and the conduct of the parties will replace the contractual arrangements where those arrangements do not reflect the actual conduct of the parties. Transactions can be disregarded for transfer pricing purposes where they lack commercial reality;
- Returns derived from the assumption of risks will be allocated to the parties which control those risks and have the financial capacity to assume them. Passive entities which do no more than provide funding will be entitled to no more than a risk free return;
- Revised guidance on CCAs aligns the rules with the changes on intangibles and risk so that leaking of value through a CCA is no longer possible. Specifically, contributions should be based on value rather than cost;
- Recommendation of a safe harbour for low value-adding services, with a light touch benefits test and prescribed net cost plus margin of 5%.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

There is little significant change from the previous discussion drafts and the recommendations are consistent with the overall evolution of the treatment of intangibles, risks and capital.

Whilst there is some greater, initial, recognition of contractual terms and of the reward accruing to entities which have the financial capacity to assume risk, the key principles set out in the earlier draft are largely unchanged. The recommendations cement the importance of rewarding underlying substance and value creation over legal ownership and funding. The need to specifically delineate transactions, compare conduct to contractual terms through a thorough functional analysis and then look to price the actual transaction based on where value is created is fundamental.

We welcome the specific clarifications on transfer pricing approaches where these have been provided in the OECD deliverable (for example, on the recommended safe harbour for low value adding services).

However, overall, we consider that many of the recommendations will, at least in the short to medium term, result in greater uncertainty for business as they, and tax administrations, grapple with the application of new guidelines. The revised guidance on CCAs raises particular concerns about their continuing use by business. We therefore expect there to be an increase in disputes which will be time-consuming and costly for multinational groups.

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Who is affected?

The conclusions and recommendations of this Action will be of interest to all multinational corporations.

Certain sectors will be particularly affected, for example, those groups with significant intangibles and complex intra-group arrangements. Companies within the financial services sector will be interested in the recommendations of Action 9 (risks and capital).

What are the expected next steps?

It is expected that the UK will adopt the recommendations of the OECD in full.

In the UK, domestic transfer pricing law is tied to the current version of the OECD Guidelines and it only requires secondary legislation in the form of a Treasury Order to incorporate an updated version. Whilst that may have to await republication of the complete Guidelines the changes should apply immediately to the application of Article 9 in the UK's bilateral treaties and will impact HMRC's position in Mutual Agreement Procedure (MAP) negotiations and bilateral Advance Pricing Agreements (APAs).

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Action 11
BEPS data

This Action is intended to develop indicators to assess the scale and economic impact of BEPS.

In summary, the key conclusions and recommendations set out by the OECD are:

- The OECD should work with all willing governments to publish a new Corporate Tax Statistical publication containing data and analysis of BEPS, presented in an internationally consistent format, including new data available under Country by Country reporting (CbCR);
- Suggestions are put forward for a range of other proposals for the OECD and governments, creating new ways to measure BEPS and the impact of BEPS counteraction measures;
- The OECD has found that six indicators it has studied point to BEPS activity costing governments between USD 100 billion and USD 240 billion a year in lost tax revenues.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The conclusions and recommendations of the OECD in relation to Action 11 are broadly in line with our expectations. It is encouraging that the recommendations focus on the need for governments to make better use of existing data, rather than imposing new data obligations on taxpayers.

Who is affected?

The conclusions and recommendations of this Action will be of interest to all corporations who are affected by the BEPS initiative.

What are the expected next steps?

Following the publication of these Action 11 Deliverables, it is expected that the UK will be one of the countries that works with the OECD to publish improved data. The UK Government is also likely to review its current approach to the publication of statistics and the access it allows to academics to ensure it comes into line with the OECD's recommendations as far as possible.

We expect to receive further information on the UK Government's response this year in the Autumn Statement.

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Action 12
Mandatory disclosure rules

This Action is intended to provide a framework for mandatory disclosure to provide early information to tax authorities on potentially abusive arrangements.

In summary, the key recommendations set out by the OECD are:

- Where a regime is implemented it should target features common to aggressive tax transactions but also areas of particular concern to the relevant authority;
- Any regime should include a mechanism to identify both promoters and users of disclosed schemes and a system of penalties to ensure compliance;
- The regime should include a focus on international schemes by targeting cross-border BEPS outcomes which cause concern;
- The report also includes some information on how mandatory disclosure could contribute towards enhanced transparency between tax administrations;
- The recommendations do not represent a minimum standard and countries are free to choose whether or not to introduce a mandatory disclosure regime.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The conclusions and recommendations of the OECD in relation to Action 12 are broadly in line with our expectations.

Key to any implementation will be clear and careful targeting of the rules to balance the harvesting of relevant information whilst not generating irrelevant and poor quality disclosures.

As with the discussion draft the recommendations appear to be heavily influenced by the UK disclosure system. The existing UK system is already expecting new and enhanced hallmarks. This latest development will inevitably raise questions about the reach of the existing disclosure regime and, in particular, how any extension of the regime to international transactions will interact with the accelerated payments regime.

On the face of it, the recommendations may be relatively simple to assimilate into the UK system but it is unclear how widely these recommendations will be adopted internationally and how they will translate into other tax systems. UK multinationals will need to keep up to date with the implementation of this Action in all territories in which they operate.

Who is affected?

The conclusions and recommendations of this Action will be of interest to all multinational corporations. At a bare minimum, these recommendations may result in multinationals having to assess all cross-border transactions which derive a tax benefit, whether in the UK or overseas, to ensure all compliance obligations in affected jurisdictions are identified and complied with.

As highlighted in the document, mandatory disclosure regimes can also be an effective deterrent and multinationals will need to consider the impact of implementing any disclosable transactions on their risk profile with tax authorities and wider stakeholder groups in affected jurisdictions.

What are the expected next steps?

It is possible that the UK will comment this year in the Autumn Statement on this deliverable.

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Action 13
Transfer pricing documentation and CbCR

This Action is intended to develop rules regarding transfer pricing documentation to enhance transparency for tax administrations. It introduces three key documentation requirements: the Master File, the Local File and the Country by Country Reporting (CbCR) template.

No further announcements in relation to this Action were provided in the October 2015 deliverables. However the three papers previously released have been consolidated to create the text of new Chapter V of the OECD Guidelines.

The UK perspective

The UK has supported the work of Action 13 from the outset. It is therefore no surprise the UK has confirmed it will adopt the recommendations in full, and to this end draft regulations for the implementation of CbCR were released for technical consultation on 5 October 2015 (please see link: https://www.gov.uk/government/publications/technical-consultation-country-by-country-reporting). The consultation is open until 16 November 2015.

Who is affected?

The UK implementation of the CbCR legislation will impact multinationals with a UK tax resident parent company, and that have consolidated group revenue in excess of £586 million (or equivalent) in the preceding year. It may also impact UK subsidiaries of multinationals parented in countries that do not implement CbCR, or where information exchange arrangements are not in place or are not effective, on a voluntary basis. The rules will impact accounting periods beginning on or after 1 January 2016.

Most multinationals will be affected by the changes to the transfer pricing documentation requirements. HMRC have confirmed their existing powers enable them to request the provision of the Master File and Local File. Many jurisdictions are amending their transfer pricing documentation requirements so that documentation, including the Master File, needs to be in place or submitted to the tax authority alongside the tax return. UK multinationals will need to monitor these compliance requirements.

Transfer pricing documentation is becoming part of the annual tax compliance cycle. Given the need for consistency between all three elements of Action 13, all multinationals need to be aware of how the documentation rules are changing. Establishing a documentation strategy and timetable for the preparation of documentation is key to making sure that they meet any new filing requirements in the countries in which they operate.

What are the expected next steps?

The UK has confirmed it will adopt the recommendations of the OECD in full.

Draft regulations to implement CbCR were released for technical consultation on 5 October 2015.

In the UK, domestic transfer pricing law is tied to the current version of the OECD Guidelines and it only requires secondary legislation in the form of a Treasury Order to incorporate the updated version issued on 5 October 2015. This is a very quick process and should be expected to take place shortly.

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Action 14
Dispute Resolution

This Action is intended to improve the effectiveness of treaty based dispute resolution through the Mutual Agreement Procedure (MAP), with the objective of providing certainty and predictability for business.

In summary, the conclusions and key recommendations set out by the OECD are:

- A strong political commitment to effective and timely resolution of disputes through MAP;
- The adoption by participating governments of a minimum standard to ensure that treaty obligations are implemented in good faith, that there are effective administrative processes for doing so and that there is universal access to the process by taxpayers;
- Implementation of the minimum standard to be monitored through the work of the Forum of Tax Administration (FTA) MAP Forum;
- The OECD has secured a commitment from 20 countries, including the UK, to introduce binding mandatory arbitration into bilateral treaties – potentially through the multilateral instrument (Action 15).

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The conclusions and recommendations of the OECD in relation to Action 14 are broadly in line with our expectations.

There is wide acceptance that the UK is already operating MAP correctly, and is one of the very few administrations setting the standard for others to follow. However there are significant improvements that need to be made by many of the UK's treaty partners to make the process work effectively. The OECD proposals should help to achieve this by pressurising tax administrations to deliver on their political commitments to properly resource the MAP process and to operate it in a principled manner.

The commitment to accelerate the introduction of binding mandatory arbitration is especially welcome. However it should be tempered by the limited success of the European Arbitration Convention which has been in place since 1995 and to which many of the 20 countries now committing to widening arbitration are signatories.

We consider the primary challenges to the OECD's objectives to be two-fold:

- Firstly, wide scale political commitment to change is fundamental to the success of the initiative. To date, the governments that have been most receptive to the proposals are those who generally do endeavour to operate the MAP process effectively. However most improvement is needed from those administrations who currently do not operate MAP effectively and it is at best unclear the extent to which those jurisdictions genuinely want to, or can, deliver change.
- Secondly, given the exponential increase in disputes which we have seen and expect to accelerate following some of the other BEPS changes, it is essential that governments commit sufficient skilled resources to the administration of MAP. Experience suggests that at best this will take a significant time to deliver and there will be little immediate improvement. The effectiveness of the monitoring process is key to continuing to deliver continuous improvement.

Who is affected?

The conclusions and recommendations of this Action will be of interest to all multinational corporations seeking to use MAP as a dispute resolution tool.

What are the expected next steps?

Following the publication of these Action 14 Deliverables, it is expected that the UK will sign up to increased arbitration via the multilateral instrument, which in practical terms will represent an acceleration of existing renegotiations of bilateral treaties. We also expect HMRC to take a leading role in the work of the FTA MAP forum.

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Action 15 Multilateral Instrument

This Action involves the creation of a multilateral instrument (MLI) to implement all the proposed changes required to existing double tax treaties. The MLI should remove the need to amend over 3,000 existing bilateral treaties.

In summary, the key conclusions and recommendations set out by the OECD are:

- No further announcements are provided in the October 2015 deliverables, the final report simply attaches the 2014 Report on the desirability and feasibility of a MLI and the mandate for an ad hoc group to develop it;
- The 2014 Report explains how the MLI can deal with issues of compatibility of new clauses with existing bilateral treaties, priority of rules, differences of interpretation and providing optionality;
- The ad hoc group began its work in May 2015 and a meeting is scheduled to be held on the 5 and 6 November 2015, to start the substantive work. This will include the establishment of the parameters for the MLI and determination of how best to apply the instrument across Contracting States. The group is open to any interested countries and so far 90 are participating. Participation does not entail an obligation to adopt the final MLI;
- Work will continue throughout 2016 with a view to concluding the MLI and opening it for signature by December 2016.

Please refer to our KPMG Global Special Edition Tax News Flash for further analysis.

The UK perspective

The conclusions and recommendations of the OECD in relation to Action 15 are in line with our expectations.

Unlike most of the other work streams, Action 15 is not about changing rules but about the procedure for implementing agreed changes. The 2014 Report noted there are a number of ways to include flexibility in the MLI. Parties can be given the option to exclude certain provisions, to choose between alternatives or to take on additional commitments through an optional protocol. How this will work in practice is yet to be defined. For example if, say, country A chooses to adopt the Limitation of Benefit (LOB) clause but country B chooses the Principle Purposes Test (PPT), it is unclear which of the new provisions would apply to an existing bilateral treaty between countries A and B, especially if that treaty currently contained no anti-treaty shopping provisions.

What is key now is that all states become involved in the process and reach agreement as quickly as possible on what clauses they intend to adopt. Companies require certainty and so will want to know, for example, whether or not a particular country is planning to adopt the new LOB Clause.

Who is affected?

The conclusions and recommendations of this Action will be of interest to governments and tax authorities as it defines how international agreements will be implemented as well as multinationals which rely on double tax treaties.

Groups who could be most affected by treaty changes will be watching this Action item closely. These include groups which are likely to have new permanent establishments under Action 7 and entities such as funds which will want to see if the eventual changes introduced under Action 6 will affect their access to treaties.

What are the expected next steps?

Following the publication of these Action 15 Deliverables, it is hoped that the UK Government will consult adequately where necessary over which of the optional clauses to adopt.

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