BEPS UPDATE

TAX MULTILATERALISM – PANACEA AGAINST TAX ABUSE? OR JUST A TAXPAYER COMPLIANCE NIGHTMARE! - SELECTED ASPECTS OF THE BEPS PROJECT

CO-CHAIRS: **JAMES RUSSELL SHORTER , JR. and SHIGEKI MINAMI**

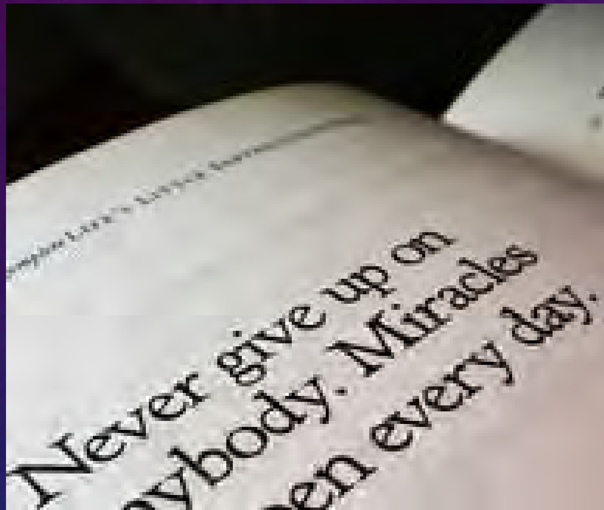
SPEAKERS:

MARIANA EGUIARTE MORETT

PERE M. PONS

MAKOTO SAKAI

AGENDA POINTS



- Introduction
- BEPS – The background
- Japan, Spain and EU, Mexico and U.S. Perspectives
- The Action Plans
  - AP 1 – The Digital Economy
  - AP 13 – Automatic sharing of data (CbC Reports)
  - AP 15 – “Multilateral treaty”

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BEPS – SOME BASICS

- Means "**Base Erosion Profit Shifting**"
- G20 – strongly influenced by aggressive media and local politicians
- OECD – ordered to quickly analyze and suggest actions against BEPS
- **15 Action Plans** – from the Digital Economy to Country by Country ("CbC") Reporting

General ideas

- taxes shall be levied and paid in the "right place"- means a focus on "**PE-issues**", "**intercompany-transactions**" and "**taxation where the value is created**"
- "**double non-taxation**" on income is not acceptable
- nor is tax deduction in more than one country of the same expense (i.e. ban double dip schemes)
- "tax arbitrage" shall be prohibited – i.e. so called "hybrid instruments" must be abolished

BEPS progress

116 members, representing 95% of global GDP

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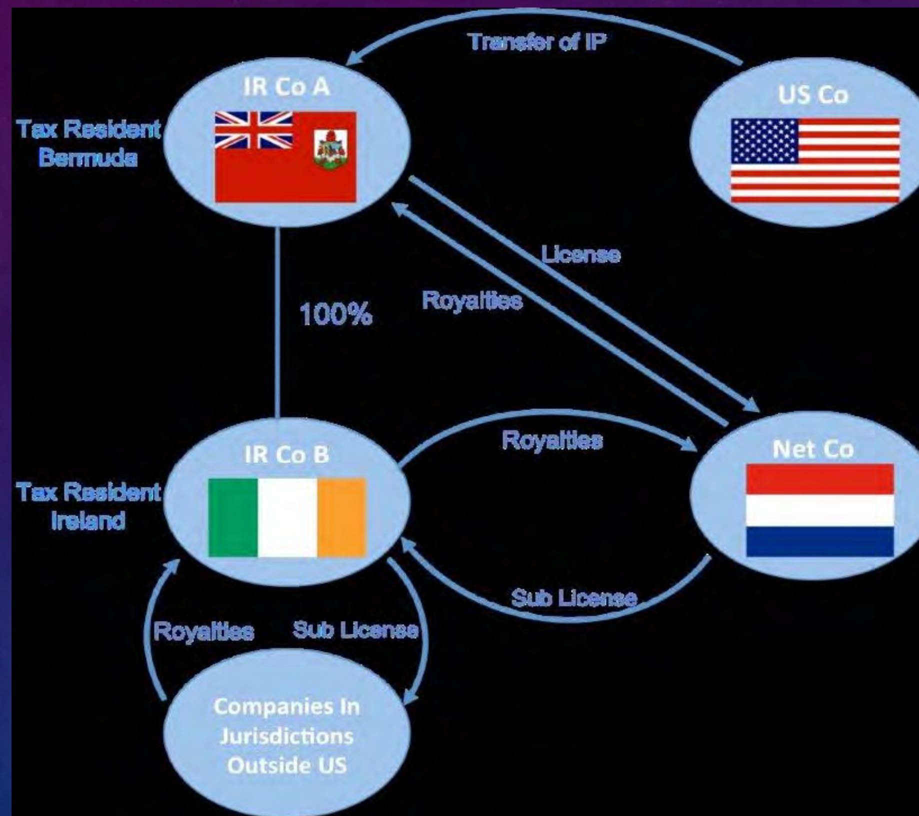
BEPS ISSUE – THE DIGITAL ECONOMY



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ACTION PLAN 1 – THE DIGITAL ECONOMY

- OECD Assertion - Current international rules do not give **fair** allocation of taxing rights
- Ability to sell in one country without creating a taxable presence
  - Use of data
  - Payments for services
- Fragmentation of business activities
  - Different locations and entities (MNEs can locate activities in low tax jurisdictions)
- Defining taxable presence (Permanent Establishment (“PE”))
  - Physical presence and dependent agent
  - New nexus / virtual PE
- Value creation chain: where to tax? (sales? IP rights? Risks and Functions?...) Is OECD approach driven by tax revenues?
  - “Market” countries feel they should be able to tax even if under traditional norms there is no PE

ACTION PLAN 1 – THE DIGITAL ECONOMY

- Initially, OECD deferred reaching conclusions on Action 1 - Addressing the Tax Challenges of the Digital Economy - because there was no consensus regarding whether special rules were appropriate
- However, many jurisdictions are hungry for tax revenue, and the temptation to tax the Amazon's, Googles, and Apples in the digital space, viewed as low hanging fruit and rich U.S. enterprises, has renewed interest in an OECD framework.
- In particular, France viewed the U.S. tech giants as paying "unfairly low taxes."
  - French President Macron has said that U.S. tech giants paid unfairly low taxes, were failing to contribute to the common good, and that taxing big tech more heavily is a matter of "social justice." Similar to the rhetoric of several U.S. politicians.

ACTION PLAN 1 – THE DIGITAL ECONOMY

- In the aftermath of BEPS, individualism is still as popular as ever:
- The EU considered a 3 percent digital service tax on gross revenues from activities in which users play a major role in value creation. However, this proposal was blocked in March 2019 by certain EU members.
- France adopted a 3% tax on large global tech companies (targeting U.S. tech giants in particular).
- The U.K., New Zealand, Spain and Italy are among countries considering their own digital taxes, which U.S. officials say could lead to companies being taxed multiple times on the same profits.
- The OECD and U.S. believe that countries considering their own version of a digital tax should instead participate in ongoing global talks with 134 countries through the OECD on how to tax tech companies.
- Implementation of such new rules under the OECD process will take time, because it likely entails a multilateral convention between the 134 countries that are members of the OECD's Inclusive Framework.
- Current OECD proposal is not limited to digital (i.e., tech) companies and includes expanding taxing jurisdiction of "market" countries and imposing a minimum tax on "under taxed" income.

ACTION PLAN 1 – THE DIGITAL ECONOMY

- On May 31, 2019 the OECD published a work program proposing a new set of international tax rules relating to, but not limited to, the digital economy. This OECD proposal is not limited to "digital" businesses.

- Focuses on resolving technical issues related to two main pillars:

  - Pillar One: Grant "Market" countries expanded jurisdiction to tax beyond traditional PE norms, under new nexus (PE) and profit allocation rules to apply to AP 1.

    - More taxing rights and profits would be allocated to the market jurisdiction where "value is created", without regard to whether there is physical presence or remote business participation in that jurisdiction.

  - Pillar Two: Adopt a "global minimum tax" by providing jurisdictions a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the profits are taxed at a low effective tax rate.

ACTION PLAN 1 – THE DIGITAL ECONOMY

- This Pillar Two global anti-base erosion tax would be designed to address cases where profits are shifted to zero or low taxed jurisdictions.
  - To apply "regardless of the type of income earned".
  - i.e., it would not be limited to intangible income, and is designed to ensure that all global businesses pay a minimum level of tax.
- This approach departs from the arm's length standard (the traditional standard strongly supported by the U.S.), and likely will result in "formulary apportionment".
  - As has been the case with U.S. State taxation, different jurisdictions are likely to develop formulas which maximize revenue based on their market circumstances.
  - However, in the U.S. there are constitutional limitations under the Due Process and Commerce Clauses of the U.S. Constitution regarding such formulas.

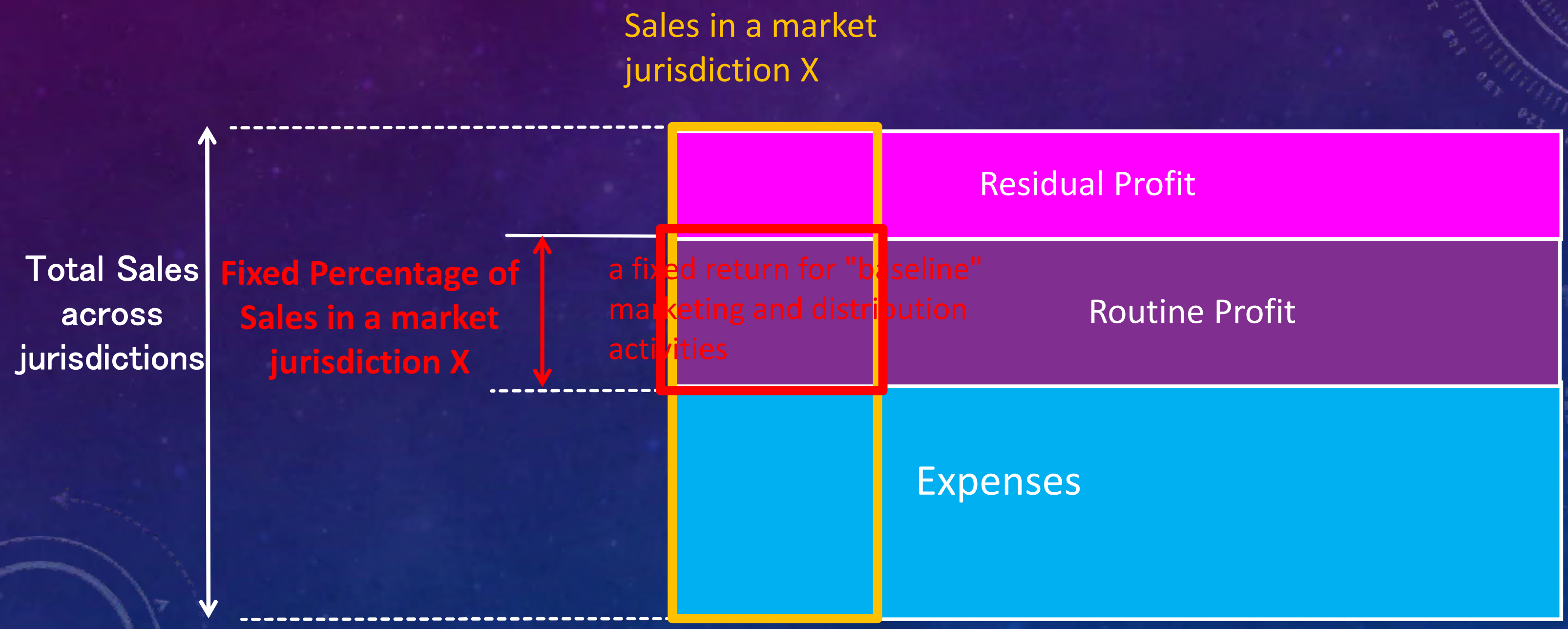
ACTION PLAN 1 – THE DIGITAL ECONOMY

- On October 9, 2019, the OECD published the Secretariat Proposal for a "Unified Approach" under Pillar One, subject to public consultation to be held in November 21-22 in Paris.

- The Unified Approach "unified" three proposals: (a) "user participation", (b) "marketing intangibles", and (c) "significant economic presence" proposals.
- Scope: It covers highly digital business models but goes wider - broadly focusing on consumer-facing businesses.
- New Nexus: It creates a new nexus, not dependent on physical presence but largely based on sales.
- New Profit Allocation Rule: It creates a new profit allocation rule, irrespective of whether the enterprise has an in-country marketing or distribution presence

  - Amount A - a share of deemed residual profits allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right;
  - Amount B - a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and
  - Amount C - binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

ACTION PLAN 1 – THE DIGITAL ECONOMY
➢ Amount A under "Unified Approach"
Deemed Residual Profit (Step 2)
10% of Deemed Residual Profit (Step 3)
To Market Countries
Total Sales: More than 750M euro
Operating Margin (10+a)%
a% of Total Sales
10% of Total Sales
Deemed Residual Profit (Step 2) Not from Markets
Country C
Country B
Country A
Deemed Routine Profit (Step 1)
Expenses
12


ACTION PLAN 1 – THE DIGITAL ECONOMY
Amount B under "Unified Approach"
Sales in a market jurisdiction X
Residual Profit
Total Sales across jurisdictions
Fixed Percentage of Sales in a market jurisdiction X
a fixed return for "baseline" marketing and distribution activities
Routine Profit
Expenses
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THE JAPANESE PERSPECTIVE (DIGITAL ECONOMY)

- Japan thus far has taken no unilateral action to tax digital activities or to expand the tax base to capture digital presence for the purpose of income taxation.
- Japan has maintained the traditional concept of permanent establishment e.g., computer server issue
- Nevertheless, the Japanese tax authority appears to be eager to capture digital presence for the purpose of income taxation.
  - For example, in 2009, the Japanese tax authority made adjustments on Japanese affiliates of Amazon US for the reason that such Japanese affiliates constituted PEs of Amazon US., most of which was cancelled through MAP.

THE JAPANESE PERSPECTIVE (DIGITAL ECONOMY)

- Also, in 2015, Japan introduced the EU-type Consumption Tax (VAT) regarding cross-border digital services. Applies to:
  - B2B services
  - B2C services, including e-books, online music and videos provided by non-Japan resident service providers.
  - Non-Japan B2C online providers are taxed in Japan through tax agents and B2B online providers are taxed in Japan under reverse charge mechanism.
- As for the new OECD Unified Approach, the Japanese government and industries may be concerned that tax revenues would be shift to market jurisdictions and that their business operations would be disrupted.
- It depends on percentages for "deemed routine profits" and for a portion allocated to market jurisdictions (currently, "10-over-10" is being discussed), because a relatively small number of Japanese companies have an operating margin over 10%.

THE SPANISH/EUROPEAN UNION PERSPECTIVE (DIGITAL ECONOMY)

- The current government has announced plans for the introduction of a digital companies tax in the next budget (if approved), at a rate of 3% of the turnover of any MLE which exceeds a worldwide turnover of EUR 750 million and EUR 3 million of Spanish turnover. It intends to cover online advertising, intermediation of services and sale of data from networks users. Inspired in European push for taxation of significant digital presence.
- Besides, certain amendments were introduced in year 2015 to implement the EU VAT Directive amendments on taxation of the digital economy to the Spanish VAT Law to ensure taxation of B2C supplies of electronic services at destination.

THE MEXICAN PERSPECTIVE (DIGITAL ECONOMY)

- A bill was submitted to consider that digital platforms are obliged to pay VAT for the services rendered to Mexican recipients. In a nutshell, if platforms do not comply with such obligations, they will be shut off from the Mexican web.
- For such purposes, digital intermediation services platforms must withhold 50% of the VAT in charge of the individual service providers (e.g. ride service hailing drivers and food deliverymen that use a digital platform to provide services).

THE U.S. PERSPECTIVE (DIGITAL ECONOMY)

- [~] Background – After enactment of the 2017 Tax Cuts & Jobs Act, U.S. and BEPS had different approaches to taxation of "stateless income" – BEPS would tax the Digital Income being paid from the source country; the U.S. Imposes a "minimum tax" on the Global Intangible Low Tax Income ("GILTI") received by the U.S. taxpayer.
- GILTI is the amount (if any) by which (i) a U.S. S/H's total CFC income exceeds (ii) a deemed 10% return on the average adjusted basis of its "Qualified Business Assets" (depreciable tangible property) ("QBA"). Thus, it taxes intangible income and "excess" QBA income as an extension of immediate taxation under the U.S. CFC-subpart F rules; it is included in the U.S. S/H's gross income in a manner similar to inclusions of subpart F income.
- Corporate U.S. S/Hs deduct 50% of GILTI; at the 21% CTR, the effective rate is intended to be 10.5% before Indirect FTCs. Tax on GILTI (grossed up to include the amount of foreign taxes paid) is offset by only 80 % of FTCs. Thus, at a foreign tax rate on such income of 13.125% or higher, no U.S. residual tax should be owed. If the foreign tax rate is 0%, the U.S. residual tax rate is 10.5 %. Therefore, as foreign tax rates range between 0 and 13.125 %, the total combined foreign and U.S. tax rate on GILTI should range between 10.5 and 13.125% , insuring a minimum tax on GILTI. No FTC carry back or carry forward is allowed - unused F.T.C.'s are lost.
- However, in practice the pre-existing rules for allocating expenses makes the U.S. tax rate higher than Congress intended.
- The combination of GILTI and a separate "transition tax" (deemed repatriation of post-1986 earnings of U.S.-multinationals' CFCs) at a 15.5% rate on cash and cash equivalents and 8% on noncash assets, eliminates the OECD & EU concern regarding non-taxation of "stateless income" which resulted from the prior U.S. CFC/Subpart F rules.

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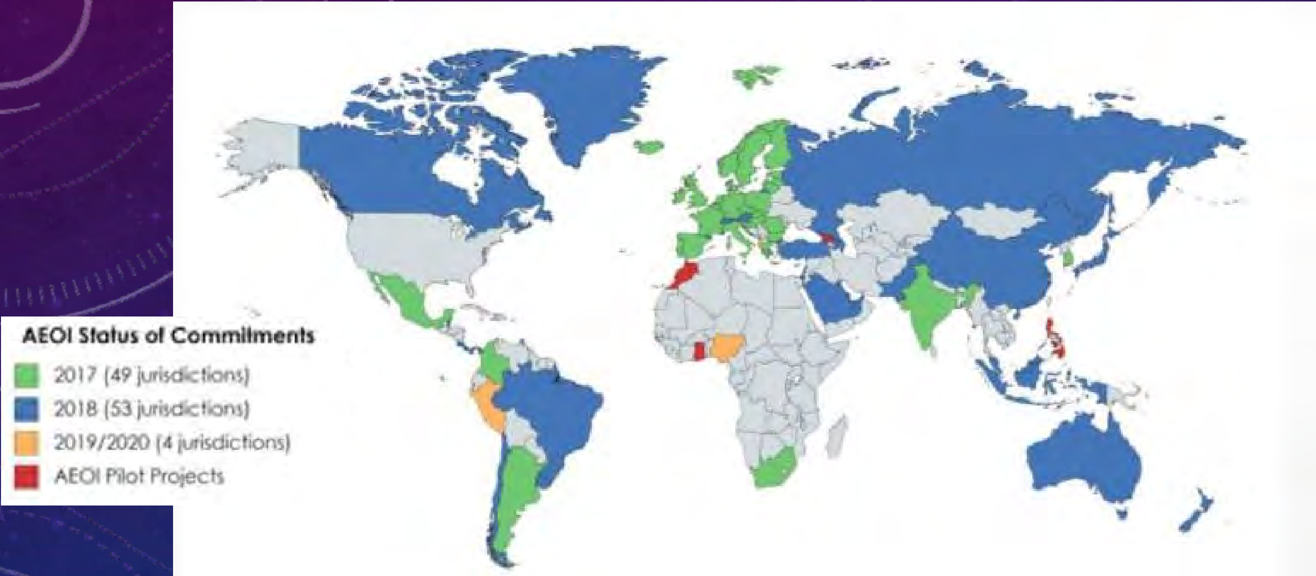
THE U.S. PERSPECTIVE (DIGITAL ECONOMY)

- Initially, U.S. viewed AP 1 as broadening the tax reach of "source country" taxing jurisdictions by expanding the traditional PE definition under the guise of moving to the digital age of business.
- AP 1 sought to re-write the rules in such a way to get more income from U.S. tech companies who had high revenues in those jurisdictions, and, ultimately, that would erode the U.S. tax base.
- Then, the EU and several countries proposed Digital Services taxes on gross revenues from activities in which users play a major role in value creation.
- France adopted a 3% tax on global tech companies with substantial global revenues and digital sales in France. French President Macron stated that U.S. tech giants paid “unfairly low taxes”, failing to contribute to the common good, and that taxing big tech more heavily is a matter of "social justice".
- The U.S. is considering retaliatory measures against France and other countries imposing digital services taxes.
- U.S. supports negotiations regarding how to tax tech companies. However, the U.S. approach is more limited in scope than the current OECD proposal.

ACTION 13 –TRANSFER PRICING DOCUMENTATION & COUNTRY-BY-COUNTRY (CBC) REPORTING

- Background:
- Provisions for exchange of information between tax authorities have existed for over a century. One of the earliest models prepared by the League of Nations in the 1920s provided for administrative cooperation between tax authorities.
- Since the late 1950s, the vast majority of tax treaties based upon the OECD Draft and Model and the UN Model have contained provisions for (i) exchange of information on request, (ii) spontaneous exchanges, and (iii) automatic exchanges of information.
- Substantial amounts of automatic exchange of certain categories of data have taken place for decades.
- On a broader scale, the Council of Europe/OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which now has over 90 signatories, contained equivalent provisions for exchange on request and automatically.
- Throughout the rapid development of systems for automatically exchanging financial information for tax purposes, inadequate attention has been paid to data protection rules for preserving privacy and confidentiality.
- Source: Philip Baker, "Privacy Rights in an Age of Transparency: A European Perspective", Tax Notes International, May 9, 2016, at 583.

ACTION 13 – Country by Country (“CbC”) status



100+ jurisdictions will be exchanging CbC information by the end of 2018

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THE JAPANESE PERSPECTIVE (CBC REPORTING)

- Japan signed the Multilateral Competent Authority Agreement ("MCAA") for the automatic exchange of CbC reports.
- Japan has introduced CbC reporting obligations for taxation years commencing on or after April 1, 2016 for Japanese MLEs with turnover JPY 100Billion, a rough equivalent of EUR 750M.
- The Japanese tax authority is expected to use CbC reports to identify unbalanced profits across jurisdictions so that they can make a transfer pricing assessment.
- In October 2018, Japan commenced the automatic exchange of information on CbC reports. So far, Japan provided information on the CBC reports to 39 jurisdictions for 609 MLE groups and received information on the CBC reports from 29 jurisdictions for 558 MLE groups as of October 31, 2018.
- Confidentiality: if a foreign tax jurisdiction fails to meet the standards for appropriate use set by OECD, Japan pauses exchanges of all reports with that tax jurisdiction (such as Bermuda Islands, Cayman Islands and Cyprus).

THE SPANISH/EUROPEAN UNION PERSPECTIVE (CBC REPORTING)

- Action 13 – CbC Reporting – Spain has introduced CbC reporting obligations for taxation years commencing on or after January 1, 2016 (turnover EUR 750M). EU automatic exchange of CbC is applicable since June 2017.
- Action 15 – MLI – Spain intends to ratify the MLI including a “baseball decision” arbitration.
- Actions 2, 3 and 4 - major developments under implementation of EU Directive ATAD I and ATAD II are expected across Europe

THE MEXICAN PERSPECTIVE (CBC REPORTING)

- Mexico's Tax Authority issued the Administrative Guidelines relative to the preparation and filing of the CbC Report, which was formally introduced into Mexican domestic legislation.
- 2017 was the first taxable year reported.
- It is of utmost importance that Multinational Enterprise (MNE) Groups understand the excessive burden of the Mexican CbC regulations, as the scope of the information and data reporting resembles that of a formal tax audit and exceeds the filing and reporting obligations of other countries.
- MNE Groups should implement strategies that allow the flow of legal, tax and financial information within their companies and verify the existence of proper legal documentation of all reportable transactions conducted by the MNE Group.

THE U.S. PERSPECTIVE (CBC REPORTING)

- Provisions for exchange of information have been included in tax treaties since the late 1930s, and they now are included in all U.S. tax treaties.
- CbC reports filed with the IRS and exchanged pursuant to Competent Authority Agreements ("CAAs") benefit from the confidentiality requirements, data safeguards, and appropriate use restrictions in the CAA.
  - The CbC report is treated as a tax return, and the information furnished to the IRS on the CbC report is return information subject to the confidentiality protections provided under IRC §6103. However, the important issue is how will foreign jurisdictions treat such information, and what can be done by the U.S. to encourage them to respect confidentiality.
  - IRS policy -- if a foreign tax jurisdiction fails to meet these requirements set forth in the CAA, the U.S. will pause exchanges of all reports with that tax jurisdiction.
- The U.S. Treasury Department has issued forms of bi-lateral CAAs that it proposes to enter into.
  - The IRS has signed CAAs to exchange CbC reports with Australia, Austria, Belgium, Bermuda, Brazil, Canada, Cayman Islands, Colombia, Croatia, the Czech Republic, Denmark, Estonia, Finland, Gibraltar, Greece, Guernsey, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Jamaica, Japan, Jersey, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Republic of Korea, Slovakia, Slovenia, South Africa, Spain, Sweden, and the UK.

ACTION 15 – MULTILATERAL INSTRUMENT (“MLI”) TO MODIFY BILATERAL TAX TREATIES

- The MLI modifies existing bilateral tax treaties between the parties to the MLI.
  - It does not directly amend the language of the underlying treaties, as an amending protocol would do, and the MLI thus co-exists with covered tax treaties and modifies their application.
- Under this approach it has been noted that tax publishers will have a difficult time and face the legal challenge of producing amended texts of more than 1,000 bilateral tax treaties when they incorporate changes made by the countries that signed the MLI instrument.
- Similarly, tax practitioners face the challenge of interpreting the treaties as modified, because the MLI layers rules on top of the text of the bilateral tax treaties, rather than amending the texts (which would not be possible).
  - Hence, the MLI doesn't specify the words that are being changed in the treaty; tax practitioners will have to interpret the operative language of the treaty, as modified by a layering provision that doesn't address the prior language of the treaty.
- A significant consequence of the adoption of the MLI is the provision which aimed at eliminating “treaty shopping.”
  - The MLI provides for use of the Principal Purpose Test ("PPT") or the limitation on benefits ("LOB") provision.
  - The LOB is an objective provision (favored by the U.S. in its treaties) applying factors which indicate substance of the enterprise's activities in the jurisdiction in which the profits are recognized.
  - The PPT is an overly subjective provision which will shift more power and potentially more revenue into the hands of tax authorities, resulting in significant uncertainty for companies trying to plan their tax liability.

THE JAPANESE PERSPECTIVE (MULTI LATERAL INSTRUMENT)

- MLI has entered into force with respect to Japan on January 1, 2019.
- As of October 1, 2019, the MLI took effect between Japan and a number of countries including the UK, France, Australia, the Netherlands, Singapore, India, and Israel.
- LOB clause: Japan did not adopt the limitation on benefit ("LOB") clauses as provided in the MLI. However, Japan introduced more-detailed LOB clauses in the treaty with US in 2003.
  - Subsequently Japan adopted fairly comprehensive LOB clauses in the treaties with Australia, France, New Zealand, Sweden, Switzerland and the UK.
- PPT clause: Japan was not proactive in adopting PPT clause in the past; under the MLI, however, PPT clause will apply to Japan's treaties with a number of countries.
- PE: Article 13 of the MLI – "Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions" will be incorporated into Japan's treaties with a number of countries; (a) Exemption requires the overall activity of the fixed place of business to be of a preparatory or auxiliary character; and (b) PE is recognized if the overall activity resulting from the combination of the activities carried on by closely related enterprises at the two places is not of a preparatory or auxiliary character.

THE SPANISH/EUROPEAN UNION PERSPECTIVE (MULTI LATERAL INSTRUMENT)

- MLI – Spain intends to ratify the MLI including a “baseball decision” arbitration.

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ACTION 15 – MULTI LATERAL INSTRUMENT

28 JURISDICTIONS HAVE OPTED FOR ARBITRATION AS OF TODAY. MORE TO COME ACCORDING TO OECD

Final offer ("baseball")	Independent opinion
Australia, Austria, Barbados, Belgium, Canada, Curacao, Fiji, Finland, France, Germany, Ireland, Italy, Liechtenstein, Luxembourg, Mauritius, Netherlands, New Zealand, Singapore, Spain, Switzerland and the UK.	Andorra, Greece, Japan, Malta, Portugal, Slovenia, Sweden

THE MEXICAN PERSPECTIVE (MULTI LATERAL INSTRUMENT)

- As of today, the MLI has not entered into force for Mexican tax purposes, although it is most likely that it will do so in the following year (2020), and this situation will present a number of challenges from the Mexican perspective.

- It is important to mention that the Executive Branch submitted a bill for amendments to several tax laws which are aligned with the BEPS actions. In this regard, the amendments are likely to pass in congress and we expect to have the MLI ratified shortly.

THE U.S. PERSPECTIVE (MULTI LATERAL INSTRUMENT)

- The U.S. has decided to not sign the MLI at this time because U.S. tax treaty policy is already consistent with most of the MLI measures, including savings clauses, taxation of transparent entities, and limiting benefits for investors in third countries (anti-treaty shopping).

- Further, Treasury has concerns with the BEPS Action 6 measures in the MLI on the PPT and LOB provisions. Also, there is substantial doubt that the U.S. Senate would ratify the MLI.

- In addition, U.S. State Department policy prefers bilateral treaties.

CLOSING COMMENTS -- CONCLUSIONS

- OECD focus in reality on global MNE´s only? Or just primarily?
- Regardless – it seems like total disregard of small and medium sized companies!
- Almost total disregard of professionals' comments on the Action Plans?
- The BEPS project will result in increased tax compliance (and costs of compliance) – regardless of what may happen!
- In some cases even without a change of local legislation – most of the action plans will end up in a revision of the OECD Guidelines
- Various countries will continue to offer tax benefits to attract investments!
- For Pillar Two of OECD's Digital Action Plan - the global anti-base erosion proposal (GloBE proposal), public consultation document is expected to be released in early November 2019.
- Spill-over effects (beyond the exact scope of BEPS) would be enormous.

ANY QUESTIONS?

James R. Shorter, Jr., E: jshorter@shorterlaw.net

Shigeki Minami, E: shigeki_minami@noandt.com

Mariana Eguiarte Morett, E: meguiarte@sanchezdevanny.com

Pere Pons , E: pere.pons@chevez.com

Makoto Sakai, E: makoto.sakai@mhm-global.com