Tax Training
10 August 2017

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Agenda

- Hard to value intangibles
- The Multilateral Instrument
- EU Tax Dispute Resolution Directive
- UK mandatory Disclusure of Tax Strategies

Transfer pricing – Hard To Value Intangibles

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BEPS action 8: Transfer pricing – intangibles

Four issues are analyzed:

1. Identifying intangibles
2. Ownership of intangibles
3. Transfer of intangibles
4. Arm’s length test of intangibles

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BEPS action 8: Transfer pricing – intangibles

Re 1) Identifying intangibles

- Broad, independent definition of intangibles only for TP purposes:
  1. Not a physical or financial asset,
  2. Cable of being owned or controlled,
  3. Used in commercial activities, and
  4. Use or transfer would be compensated in a transaction between independent parties
- Compare to: OECD Model Article 12 :
  - *"The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*
- IPR does not include market conditions, group synergies, assembled workforce and location savings etc.

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BEPS action 8: Transfer pricing – intangibles

Re 2) Ownership of intangibles

- Two separate issues: 1) ownership of intangibles and 2) joint development of intangibles.
- Identification of group members that are entitled to returns from the exploitation of intangibles:
  - A) legal owner test and B) arm's length principle.

- Re A) Legal owner test:
  - OECD now acknowledges that the legal owner is the owner of intangibles according to art. 9.
  - Thus, in principle all returns derived from the exploitation of the intangibles may initially accrue to the legal owner.

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Re 2) Ownership of intangibles (continued)

- Re B) Arm's length test:
  - Group members must be compensated for functions performed, assets used and risk assumed on an arm's length basis .
  - More focus on significant people functions than on risk and capital.
  - To receive the total return on intangibles the legal owner must:
    - Perform and control all functions, including important functions
    - Provide all assets, including funding
    - Bear and control all risks

BEPS action 8: Transfer pricing – intangibles

Re 3) Transfer and use of intangibles

- Transfer
  - The labels applied to transactions do not control the TP analysis.
  - Written contractual terms vs. actual conduct of the parties.
  - Transfer of combination of intangibles may be subject to a combined TP analysis.
    - Some intangibles are so intertwined that it is not possible to transfer one intangible without transferring the other
    - E.g. trademarks under a license agreement and goodwill

BEPS action 8: Transfer pricing – intangibles

Re 3) Transfer and use of intangibles (continued)

- Use
  - All intangibles used by group members must be identified for the purpose of:
    - 1) comparability analysis,
    - 2) choice of best method and
    - 3) choice of tested party

BEPS action 8: Transfer pricing – intangibles

Re 4) Arm’s length test

- Intangibles vs. other resources
- ***Residual income*** should not ***automatically*** be allocated to the legal owner
- ***Other factors*** have to be considered e.g.: i) risks, ii) market characteristics, iii) location, iv) business strategies and v) group synergies

- The profit split method
  - The preferred OECD method
- TNMM
  - Not a preferred method

Definition of HTVI

- BEPS action 8 mandated measures for HTVI
  - Implementation Guidance on HTVI (discussion draft 2017)
  - Guidance protects tax administration from the negative effects of information asymmetry.
  - Ensuring that ex post outcomes can be considered as presumptive evidence appropriateness of the ex-ante pricing.
    - Where for instance the actual cash flows are significantly higher.
    - What is known and what could have been anticipated also taking into consideration.
  - Should improve consistency and reduce the risk of economic double taxation.

Definition of HTVI

- Definition
  - In short 'HTVI' covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises,
    1. There is no reliable comparables, *and*
    2. Valuation assumptions are highly uncertain, making it difficult to predict the level of the ultimate success of the intangible at the time of the transfer.
  - HTVI *may* exhibit one or more of the following features:
    - Only partially developed,
    - Is not expected to be exploited commercially until several years,
    - Is integral to development or enhancement of other HTVIs,
    - Expected to be exploited in a manner that is novel and projection is highly uncertain,
    - The HTVI has been transferred to an associated enterprise for a lump sum payment,
    - Developed or used in connection with a CCA type arrangement.

Principles

- If HTVI approach applies, then ex post outcomes may be a **presumptive evidence**.
- When ex post evidence provides presumptive evidence, the **probability** of achieving such income at the time of transfer must be taken into account.
- Tax authorities should apply audit practices to ensure that presumptive evidence based on *ex post* outcomes is identified and **acted upon as early as possible**.
- If a HTVI has not been transferred at ALP tax authority may adjust by taken into account **contingent payments, adjustment clauses** etc.
- **Burden of proof** is shifted to the taxpayer if the HTVI approach applies.

Exemptions

- The taxpayer provides:
  1. Details of the ex ante projections used at the time of the transfer to determine the pricing arrangements, *and*
  2. Reliable evidence that any significant difference between the financial projections and actual outcomes is due to:
     a) Unforeseeable developments or events that could not have been anticipated at the time of the transaction, *or*
     b) That the probabilities of occurrence of foreseeable outcomes were not significantly overestimated or underestimated.
- The transfer of the HTVI is covered by an APA with the countries of the transferee and the transferor.
- Any significant difference as mentioned in 2.b) does not reduce or increase the compensation for the HTVI by more than 20%.
- A commercialization period of five years has passed since the HTVI first generated unrelated party revenues for the transferee *and* any significant difference between the financial projections and actual outcomes mentioned in 2. was not greater than 20%.

Comments

- Valuation of HTVI is always uncertain for both taxpayer and tax authority.
- Adjustment in the pricing of the HTVI may be at the discretion of the tax authority.
- Double taxation arising for taxpayers out of the adjusting authority having a longer statute of limitation than the corresponding adjusting authority.
- The 20% bandwidth is arbitrary.
- Timing issues:
  - Ex post outcomes may not even be available until years after the transaction and the audit window.
- Is profit potential an HTVI, or an attribute of HTVI or something beside tangibles and intangibles?
- Are the taxpayers themselves allowed to apply the ex post presumptive evidence to justify spontaneous adjustment?
- What documentation is required to prove the reasonable nature of the valuation ex ante?

The EU Tax Dispute Resolution Directive

EU Tax dispute resolution directive

- 2017 agreement on new directive – entry into force 1. January 2018.
- Based on the EU Arbitration Convention.
- Expanded from transfer pricing to income from business.
- Taxpayers – broadly defined.

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EU Tax dispute resolution directive

- Complaint:
  - 3 year deadline.
- Competent Authority must take a position to the complaint.
  - 6 months.
  - MAP.
  - If decided that not admissible – appeal to national court according to domestic law.
- Disagreement about the complaint.
  - Appeal to national courts.
  - Appointment of advisory commission (or Alternative Advisory Commission).
  - Advisory Commission delivers final opinion within 6 months.
  - Binding on competent authorities – although they can decide how to eliminate double taxation.

The Multilateral Instrument

- Culmination of the G20/OECD BEPS-project
- Published November 24th 2016
- Initial signing ceremony June 7th 2017 in Paris

OECD/G20 - MLI

BEPS Action 15

- Part of the action plan from 2013.
- Aim: To ease the implementation of BEPS-measures in tax treaties.
- Anticipated an increase in conflicts in the BEPS-era.

October 2015

- Publication of all BEPS Final Reports.
- Mandate granted to proceed with Action Plan 15.
- 20 countries willing to proceed with Mandatory Binding Arbitration.

OECD/G20 - MLI

- What's new?
  - Initially 68 signatory countries.
  - A further 9 countries have given official notice of their intent to sign.
  - 2 countries have signed since June 7th.

- Position Papers
  - In conjunction with signing the Instrument, signatories are required to submit position papers.
  - These stipulate to what extent signatory states wish to apply the instrument in their treaty law.

- System
  - Minimum standards vs. Opt-out mechanic.
  - Opt out available for articles "in their entirety".
  - Mandatory Binding Arbitration (Part IV) is a voluntary opt-in.

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OECD/G20 - MLI

- Entry into force?
  - 5 instruments of ratification must be deposited with OECD for the Instrument to enter into force.
  - OECD estimates this to be done by September 30th.
  - If accomplished by that date:
    - Withholding tax applicable from 1/1-2018.
    - Remaining instrument applicable from 1/7-2018.

- Who’s in?
  - 100 countries have participated in the process of creating the MLI.
  - 27 countries have been involved in working out Mandatory Binding Arbitration.
  - 25 countries elected to opt-in for the MBA.

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OECD/G20 - MLI

- How does it work?

  - Modifies the application of existing tax treaties.
  - Works alongside tax treaties.
  - NB: Does not replace or change existing tax treaties.
  - In practice the MLI adds an extra layer to treaty interpretation.
  - Each Signatory identifies which of their existing Double Tax Treaties are covered by the Instrument.
  - The technical term for these tax treaties are Covered Tax Agreements or CTA’s.
  - If both contracting parties to a DTA identify it as a CTA the instrument will be in effect for that DTA.
  - The Instrument works on a system of reciprocity.
  - For a given article to be applicable to a DTA, both parties must have identified it as a CTA and both parties must have chosen to apply a given article in the MLI – e.g. the Principal Purpose Test in article 7.

OECD/G20 - MLI

- How does it work?
  - Example: Canada and Sweden have both identified their DTA as a CTA.
    - Both parties have chosen to opt-in for Mandatory Binding Arbitration.
    - A taxpayer involved in a double tax dispute between Canada and Sweden therefore has the right to require arbitration as a means to resolve the dispute.

The intricacies of the MLI

What's in it?

- Action 2 – "Hybrid Mismatches".
  - Article 3-5.
- Action 6 – "Treaty Abuse".
  - Article 6-11 (PPT, limited LOB etc.).
- Action 7 – "Artificial Avoidance of PE-status".
  - Article 12-15.
- Action 14 – "Dispute Resolution".
  - Article 16-26 (Improvements to MAP and Mandatory Binding Arbitration).

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The Minimum Standard(s)

Certain provisions of the instrument provide the so-called "minimum standard", i.e. the parts of the instrument that have to be implemented in order to counter the risks identified in the BEPS-project.

- Action 6 – "Treaty Abuse".
  - Article 6 and 7 (Preamble, PPT, limited LOB etc.).
- Action 14 – "Dispute Resolution".
  - Article 16 and 17 (Improvements to MAP and corresponding adjustments).

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BEPS action 6: Treaty Abuse

What is the minimum standard?

- “Minimum level of protection against treaty shopping”.
  - This minimum level of protection is met by implementing:
    - A Principle Purpose Test (hereinafter PPT) – Art. 7(1).
    - Combination of PPT and LOB – Art. 7(1) and 7(6).
    - A bilaterally negotiated LOB-clause (e.g. US Tax Treaties).
- All current signatories choose the PPT; a minority in combination with the *limited LOB*-provision.
- *“Include an express statement that [the parties’] inten-tion is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance”.*
  - This is met via the inclusion of a preamble that will supersede the preamble of CTA’s, in cases where the preamble in a CTA does not meet this standard.

BEPS action 14: Improvements to MAP

What is the minimum standard?

- *"Countries should ensure that treaty obligations related to mutual agreements procedure are fully implemented in good faith and that MAP cases are resolved in a timely matter."*
  - This minimum level of protection is met by:
    - Implementing Art. 25(1-3) of the Model Convention.
    - Done through adoption of Art. 16 in the MLI
    - Aim: To bring all CTA's on par with the Model Convention.

- *Corresponding adjustments*
  - Applying Art. 17 in the MLI will implement Art. 9(2) of the Model Convention to CTA's.
  - Provide countries with a tool to unilaterally adjust income when/if deemed appropriate.

Mandatory Binding Arbitration

- Mandatory Binding Arbitration:
  - The MBA-provision requires countries to actively opt-in.
  - Differs from the remaining Instrument which requires countries to actively opt out of specific provisions.

- Certain relevant jurisdictions who have opted in: Germany, Belgium, Canada, Italy, Switzerland, Singapore, Australia, Luxembourg, Sweden.

- Similar in content and scope to the Arbitration Convention:
  - 2 year time limit – with the possibility of extending to 3.
  - Binding Arbitration – unless a settlement can be reached or the tax payer declines to accept the result.

Mandatory Binding Arbitration

- Base ball arbitration:
  - Each Contracting Jurisdiction submits one proposed monetary award before the Arbitration Tribunal.
  - After the arbitration process the Tribunal chooses one of the submitted proposals to award.

- The award is accepted at the tax payers discretion and is therefore binding for the Tax Authorities.

- It should be noted that for EU companies the upcoming Arbitration Directive provides better coverage of the Tax Payers rights.
  - The MBA is still a significant improvement in regards to disputes with non-EU jurisdictions.

What does the future hold for the MLI?

- More signatories:
  - As mentioned previously 9 further countries had given official notice of their intention to sign by June 7th.
  - 2 have since signed on: Mauritius and Cameroon.
  - 7 are still pending – Panama being the newest addition.

- The developing countries are preparing to join:
  - OECD have been engaged in assisting developing economies in preparing their internal systems for signing the MLI.
  - Depending on political willingness we could expect to cross the 100 Signatories threshold within the foreseeable future.

- The effect of the MLI remains to be seen:
  - Depending on how the national tax authorities choose to apply the tools in the MLI it could go either boom or bust.

UK Mandatory Disclosure of Tax Strategies

Royal Assent of Finance (No. 2) Bill 2016.

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Who needs to publish?

- Company, partnership, group or sub-group, which the previous tax year had a:
  - turnover above £200 million, *or*
  - balance sheet over £2 billion.
- The combined totals of all the relevant bodies for groups and sub-groups.
- This is separate to the OECD's CbCR.
  - A business not headed by a UK company, not meeting the threshold in its own right may still qualify if they satisfy the OECD's CbCR framework threshold of a global turnover of more than €750 million.

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What to include in the tax strategy

- Explanation of any tax arrangements relevant to UK tax and how tax affairs are managed.
  - Don’t need to include amounts of tax paid or commercially sensitive information.
- Tax risks linked to the size, complexity and any changes in the business.
  - Details on how business tax risk is managed.
  - A high level description of key roles and their responsibilities.
  - Information on the systems and controls in place to manage tax risk.
  - Details on the levels of oversight of the business’s board and its involvement.
  - Whether the business’s internal governance has rigid levels of acceptable tax risk.

What to include in the tax strategy?

- Attitude to tax planning:
  - Details of a code of conduct – if any.
  - Why external tax advice is used - if used.
  - Outline of tax planning motives and the importance of each to the tax strategy.
  - Group or sub-group should include the group's overall approach to structuring tax planning.
- The business's approach to working with HMRC:
  - How the business meets its requirement to work with HMRC
  - How the business work with HMRC on:
    - Current, future and past tax risks,
    - Tax events, and
    - Interpreting the law.

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Penalties

- Penalty will be imposed if:
  - The tax strategy is not published correctly (free of charge on the internet) and in time.
  - The tax strategy does not remain accessible free of charge until publication of the next strategy.

- Warning notice giving 30 days, however, any penalty will run from the first day the tax strategy was not published properly:
  - The first 6 months - up to £7,500.
  - 6 to 12 months - a further penalty of up to £7,500.
  - More than 12 months - £7,500 every additional month.
  - If your business is part of a group or sub-group the head will get the penalty.

Reaction?

- Timing: end of first financial year ending after 24 June 2016.
- How should companies react?

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