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International Tax Policy Developments

- 12. December 2019

Overview

- The current landscape – “The age of international taxation”
 - Tendency towards global uniformity and even harmonization (in principle)
 - Increased level of disputes and risks of double taxation.
 - More need than ever to view taxes from an international perspective.
 - Requires knowledge about global developments, international law and tendencies.
- Key tendencies
 - Responsible tax and strategic tax
 - Anti BEPS measures
 - Transparency (Mandatory disclosure, CBCR, Tax reporting standards, rulings etc.)
 - Market state taxation – digitalization issues



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Responsible tax and strategic tax

Responsible and strategic tax

- Tax matters are increasingly moving up the public agenda.
- International business has become increasingly exposed.
 - Severe reputational damages.
 - Lost public and private costumers.
 - Significant drops in share prices.
 - Top management can be held publicly accountable and be forced to explain in public.
- Responsible tax is now considered a standard requirement among investors.
 - May become parameter of competition.
 - New reporting initiatives (e.g. GRI 207).
 - Significantly increased interest in tax strategies and strategic thinking of tax matters – moving beyond uninformative public tax policies.
 - More and more MNEs and financial institutions are engaging in the tax policy discussions, in order to tell their side of the story and to impact the policy design of new legislation.



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The BEPS project – next phase



Where has BEPS taken us so far?

- BEPS was basically designed to combat aggressive tax planning relying on formalistic legal concepts.
 - “Value creation”, DEMPE, Commissionaire structures etc.
 - Push for new distribution structures, but seemingly not enough changes have been made?
 - Transparency measures
- BEPS introduced a lot more complexity (in an already complex system).



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New Taxing Right - Secretariat Proposal for a "Unified Approach" under Pillar One

Unified Approach

- Proposal is based on commonalities among the initial three proposals in Pillar One
 - To attract support from all members of the Inclusive Framework (but does not represent the consensus views)
 - The proposal is much broader than digital
 - Require further work
 - Require amendments in of articles 5 and 7/9 in tax treaties
 - Based on an assumption that the current ALP faces problems (significant dispute level) – in particular regarding marketing and distribution services
 - But works reasonably well for most routine functions.....

- New revenue-based nexus
 - Not per se dependent on physical presence

- Three new profit allocation rules → need to deliver the agreed quantum of profit to market jurisdictions
 - Amount A: Residual profit split and fractional proportion method
 - Only where new local revenue-based nexus is created
 - Amount B: Distribution-based method for marketing and distribution activities
 - Only where local sub or PE according to current rules
 - Amount C: If too low taxable revenue under Amount B (i.e. if Amount B ≠ ALP)
 - Only where local sub or PE according to current rules

New Revenue-based Nexus

- Scope:
 - Policy: *Focused on large consumer-facing businesses, broadly defined, e.g. businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element*
 - »Consumer« generally refers to individuals who acquire or use goods or services for personal purposes (B2C vs. B2B - i.e. outside the scope of a professional or business activity)
 - Not only create nexus for business models involving remote selling to consumers, but also business models where sale is done through un-/related distributors
 - Introduced as a standalone rule – on top of the PE rule – to limit any unintended spill-over effect on other existing rules
 - Technicalities
 - Definition of “consumer-facing business”?
 - Carve-outs (taking into account the tax policy rationale), e.g. extractive industries, commodities and financial services?
 - De minimis rules, e.g. size limitations, mEUR 750 revenue (from CbCR)?
 - How to deal with supply of consumer products or sales through un-/related intermediaries, the supply of component products and the use of franchise arrangements?

New Profit Allocation Rules

Amount A: A deemed residual profit representing the value created by non-routine function in a market jurisdiction

1. Determine total profit to be split

- Local GAAP or IRFS

2. Determine the deemed routine profit

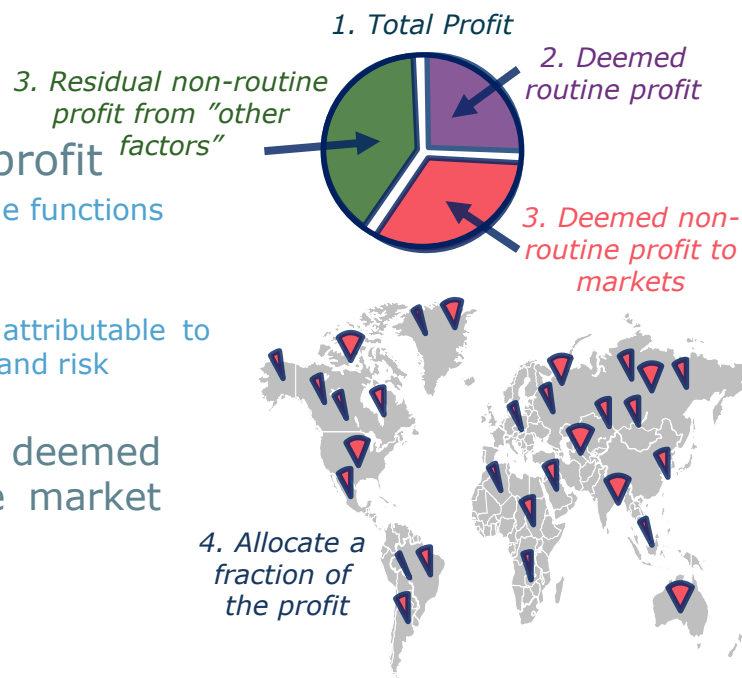
- Agreed level of profitability rewarding routine functions

3. Split of deemed non-routine profit

- Portion attributable to markets and portion attributable to "other factors", e.g. trade intangibles, capital and risk

4. Allocate the relevant portion of the deemed non-routine profit among the eligible market jurisdictions

- Based on agreed allocation key
 - E.g. sales?





New Profit Allocation Rules

- **Amount A (continued):**

1. The profit margin derived from the consolidated financial statements is **z%**
2. The portion that may be regarded as routine profits is **x%** should be ignored for the purposes of calculating the profits reallocated to market jurisdictions **z% - x% = y%** should be regarded as the MNE's deemed non-routine profit
3. The non-routine profits, **y%**, should be allocated between the profits attributable to market jurisdictions, **w%**, and the profits attributable to "other factors", **v%**
4. Allocation of the relevant portion of the deemed non-routine profit, **w%**, among the eligible market jurisdictions



New Profit Allocation Rules

- **Amount B:** A fixed return for certain baseline or routine marketing and distribution activities
 - Only applicable if there is a nexus following current rules (PE or subsidiary) and not in case of a new revenue-based nexus
 - Possibility of using fixed remuneration should be explored, reflecting an assumed baseline activity
 - Seek to reduce disputes
 - TP adjustments in home state to eliminate double taxation

New Profit Allocation Rules

- **Amount C:** An additional amount allocated to the market jurisdiction exceeding Amount B if in accordance with the ALP
 - If marketing and distribution activities go beyond the baseline level of functionality, *or*
 - E.g. where a local distribution company owns and controls all the risks for highly profitable marketing intangibles
 - If the MNE performs other business activities in the market jurisdiction unrelated to marketing and distribution activities
- Requires robust measures to resolve disputes and prevent double taxation
 - Mandatory and effective mechanisms



Concerns

- Amount of profits reallocated (modest)
- Ring fencing
- Challenges associated with the determination of the location of sales
- Defining in-scope activities, assets, return and expenses
- Determining allocation keys
- Business line or regional segmentation
- Interaction between amounts
- Treatment of losses
- Elimination of double taxation and disputes
- Enforcement and collection (WHT?)
- Implementation



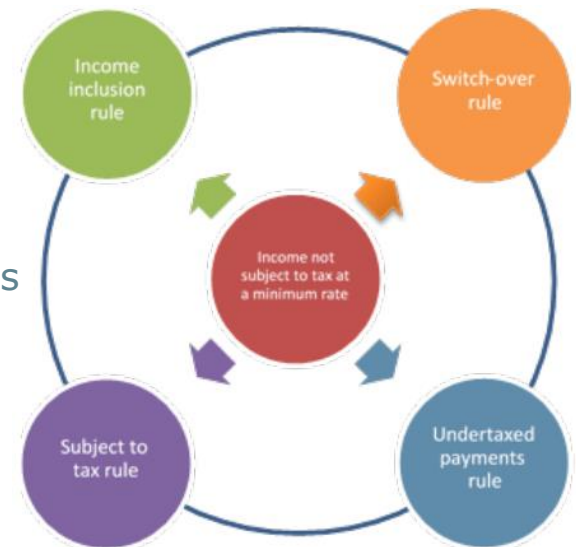
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Global Anti-Base Erosion Proposal (GloBE) – Pillar 2

Introduction

- Developing a long-term consensus-based co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.
- Pillar 2 – GloBE
 - Seeks to address remaining BEPS challenges by establishing a floor under CIT
 - I. Income inclusion rule
 - II. Switch-over rule
 - III. Undertaxed payments rule
 - IV. Subject to tax rule
 - Implemented in domestic law and tax treaties



Income inclusion rule – Basic design

- Income inclusion rule
 - **Idea:** To tax the income of a foreign controlled entity if that income has been subject to ETR below a fixed min. rate
 - **Operation:** Shareholders must include a proportionate share of the income of the entity if that income has not been subject to an ETR above a minimum rate. Should operate as a top-up (simplicity and reduced cliff-edge effect)
 - **Link to existing SAARs:** Considered a supplement – and not alternative – to existing CFC rules

- Comments
 - What is the min. tax rate? (expectation: fixed 0-12.5%)
 - The “top-up approach” distinguishes the income inclusion rule from traditional CFC rules (which typically entail taxation at the regular domestic rate). Moreover, the income inclusion rules is much broader in scope.
 - Scope not yet clear
 - Only controlling shareholdings? what is “control”?

Switch-over rule – Basic design

- Switch-over rule
 - **Idea:** To tax the income of a foreign PE or foreign immovable property if that income has been subject to ETR below a fixed min. rate
 - **Operation:** Allow the residence state of the HQ to apply the credit method instead of the exemption method
 - **Link to existing SAARs:** Similarities with existing broad CFC regimes.
- Comments
 - What is the min. tax rate? (expectation: fixed 0-12.5%)
 - Scope not yet clear
 - Only controlling shareholdings? what is “control”?

Undertaxed payments rule – Basic design

- Undertaxed payments rule
 - **Idea:** To allow the source state to protect itself from the risk of base eroding payments
 - **Operation:** Denial of deduction or imposing WHT on payments to related parties if the payment is not subject to tax at a min. rate in the recipient's country
 - **Link to existing SAARs:** Hybrid mismatch rules, WHT rules (beneficial ownership)

- Comments
 - Scope not yet clear
 - Only controlling shareholdings? what is “control”? which payments are within the scope?
 - What is the min. tax rate? What if recipient is loss making?
 - What if ETR is unknow at the time of payment?

Subject to tax rule – Basic design

- Subject to tax rule
 - **Idea:** To allow the source state to protect itself from the risk of base eroding payments (like the “undertaxed payments rule”)
 - **Operation:** Certain treaty benefits only granted if the payment is subject to tax at a min. rate in the recipient's jurisdiction
 - **Link to existing SAARs:** Subject to tax rules in MLI and OECD Model 2017

- Comments
 - Scope not yet clear
 - Only controlling shareholdings? what is “control”? which payments are within the scope?
 - What is the min. tax rate? What if recipient is loss making?
 - What if ETR is unknown at the time of payment?



Technical issues

- Tax base determination
 - In principle: Determine by CFC rules or CIT rules of shareholder
 - Each sub need to recalculate its income each year
 - Differences in calculation of tax base could impact ETR
 - Timing differences and the recognition of income and expenses
 - Alternative approach: Determine by financial accounting and adjust to align accounting income to a measure of taxable income
 - How to adjust for temporary differences?
- Blending income which is taxed differently
 - Worldwide blending
 - Jurisdictional blending
 - Entity blending

Technical issues

- **Carve-outs:**

- Compliance with BEPS Action 5 and other substance-based regimes
- Return on tangible assets
- Specific sectors or industries

- **Thresholds:**

- Turnover or other indications of the size of the group
- De minimis thresholds on profit or related party transactions

Concerns

- Broad scope – beyond BEPS
- Should the effects of the BEPS project be awaited?
- Simplification measure to reduce burdens through screening.
- Compatible with tax treaties as well as primary and secondary EU law?
- Co-ordination rule between the rules and between jurisdictions is needed
- NOL in tax base determination
- ETR as useful measure – inclusion of deferred tax.
- Interaction with pillar I
- Clear guidance and uniform interpretation is important
- Mandatory effective dispute resolution mechanism is necessary



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On the horizon



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Take-aways

Take aways

- Imperative to think strategically about taxes, including the communication hereof.
- Potential effects of current tendencies
 - Increased ETR
 - Compliance burdens
 - Risk of double taxation
 - Legal uncertainty
 - Poor quality in legislation
 - Reputational effects
- Handling tax in the 21th century
 - Technical analysis as the starting point.
 - GAAR assessment.
 - Reporting obligations (MDR).
 - Alignment with tax policy.
 - Assessment of civil society reactions.



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JAKOB BUNDGAARD

MANAGING DIRECTOR
HONORARY PROFESSOR, M.SC., PH.D.

CORIT ADVISORY P/S
LYNGBY HOVEDGADE 17, 2. SAL
2800 KONGENS LYNGBY
DENMARK

WWW.CORIT-ADVISORY.COM

P: +45 40 42 22 84
E: JB@CORIT.DK