



Global Tax Reset – EC State Aid Decisions, BEPS & Corporate Expatriations

American Taxation Association 2016 Mid-Year Meeting

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Agenda

- Introduction
 - Transformational trends
- EC State Aid
 - Recent decisions
 - Anti-tax abuse proposal and common tax base
- BEPS
 - Implementation
- Corporate Expatriations
- Questions

Transformational Trends

What's driving the transformation?

- Press articles and public hearings on perception that corporations not paying tax (U.S. and in Europe)
- Government revenues down
 - European Commission State Aid initiative
 - OECD BEPS initiative
- Relatively high U.S. corporate tax rate with worldwide taxation
 - U.S. corporations expatriating

Expect Greater Transparency, Information Sharing
and the Push for a Common Tax Base in Europe

European Commission - Illegal Fiscal State Aid

What is State Aid?

- Dates back to 1957 and the first steps in creation of European Union. Part of the competition law, not the tax law. Law includes anti-trust and merger controls, and state aid controls.
- Guidance under the “Treaty on the Functioning of the European Union.”
 - Protection of the internal marketplace against distortions caused by member states.
 - Some distortions permitted, e.g., common interest or promoting social or regional cohesion
 - Other distortions not permitted, as we’ll discuss
- Arguably similar to intent as behind the U.S. commerce clause protection for interstate commerce

What is the legal framework for State Aid?

- Article 107 of the Treaty on the Functioning of the European Union (the "Treaty")

“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, shall in so far as it affects trade between Member States, be incompatible with the internal market.”

What are the procedures in respect of State Aid?

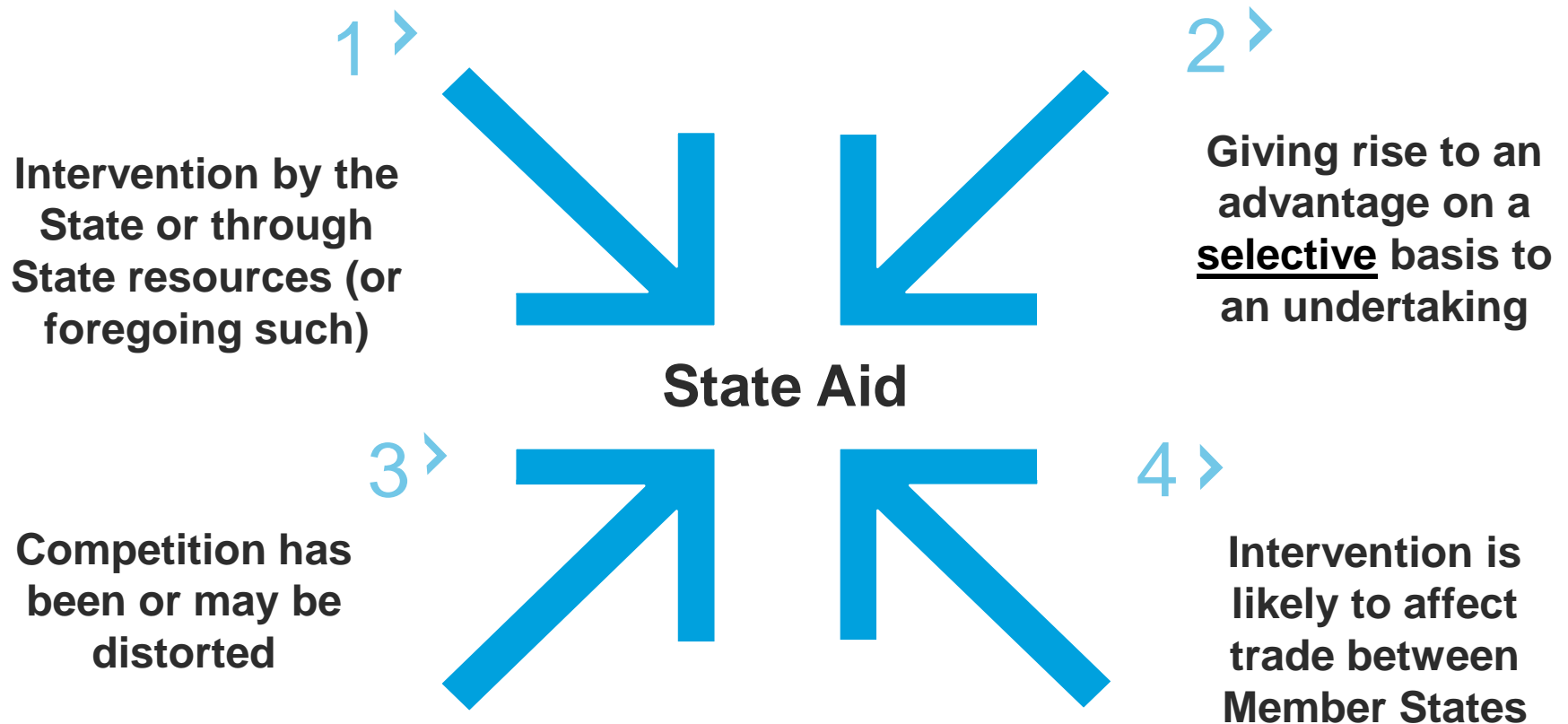
1. Member states notify European Commission (EC) of plan to provide aid. Aid includes direct or indirect subsidies (e.g., loans, guarantees, tax deductions).
2. Standstill required until EC approval received.
3. Approval provided or investigation commenced.
4. After any investigation, final decision may (i) approve, on finding that no aid exists; (ii) approve, on finding aid is permissible; or (iii) disapprove and enjoin implementation.
 - 300 to 500 EC decisions every year, but only a fraction of cases found to be improper state aid in any particular year, e.g., 20 to 40 on average over the last few years.*
5. Decisions appealable to General Court and European Court of Justice.

* Source: Karl Soukup, Director, Directorate General Competition, European Commission, Speech at Institute of International Economic Law of Georgetown University Law Center co-sponsored conference (Feb. 22, 2016).

What happens if EC not notified of aid?

- If a member state fails to notify the EC of aid prior to its granting, EC may open an investigation on whether the aid is illegal state aid at a later date.
- If the aid is found to be inappropriate, the EC will order the member state to recover the aid.
 - Recovery. The recovery is made from the beneficiary to the member state.
 - Legitimate Expectations Exception. If a prudent and discriminating trader would not have reasonably predicted that the aid was improper based on actions of the EC, then no recovery is warranted. Example: Although the Belgium Coordination Center benefit was found to be impermissible, no recovery required because of previous EC actions in support of the BCC.

State Aid concepts – four elements



State Resources / Selective Benefit/ Distorting
Competition / Affecting Trade

What is an advantage?

- Any benefit that relieves the beneficiaries of costs that are normally in their budgets. Not only positive benefits, such as subsidies, loans and public shareholdings, but also measures and interventions, in various forms, which are of similar character and effect.
- An advantage may include a “tax expenditure,” including those obtained through rulings.

When does the advantage provide a selective benefit?

- Comparison is made to a referenced regime or norm.
- Compare the regime/measure that confers the advantage with the common, generally applicable system (reference system).
- Examine whether a measure results in different treatment of companies in a similar legal and factual situation.
- No selective benefit if the different treatment arises from the nature or logic of the reference tax system.

When are tax measures not selective?

- General measures: tax measures open to all economic agents operating within a Member State.
 - Tax measures of a technical nature (e.g., tax rates, depreciation rules, loss carry-over rules, or provisions to prevent double taxation/tax avoidance).
 - Measures pursuing general economic policy objectives through a reduction of the tax burden related to the production of goods (e.g., R&D/environmental incentives).

EC has no authority over tax laws in member states

Can Tax Rulings be State Aid?

“175. Administrative rulings that merely contain an interpretation of the relevant tax provisions without deviating from the case law and administrative practice do not give rise to a presumption of aid. (...)

177. Advance administrative rulings involve selectivity in particular where:

- the tax authorities have discretion in granting administrative rulings;
- the rulings are not available to undertakings in a similar legal and factual situation;
- the administration appears to apply a more ‘favourable’ discretionary tax treatment when compared with other taxpayers in a similar factual and legal situation;
- the ruling has been issued in contradiction to the applicable tax provisions and has resulted in a lower amount of tax.”

EC, Draft Notice on the Notion of State Aid

Applying State Aid to Tax Rulings – Is there a selective advantage?

- What is the reference?
 - Domestic transfer pricing rules, domestic interpretation of arm's-length?
 - OECD transfer pricing rules and arm's-length guidelines?
 - Prudent and independent economic operator principle?
- Deviation from the system
 - Inherent in the APA itself?
 - Through the way that the taxpayer has implemented the APA (not meeting critical assumptions)?

Where it began: Using fiscal state aid to address potentially aggressive tax planning

- December 6, 2012: Commission launches its plan on tax base shifting, with state aid playing a critical role
- Parallel objectives with OECD BEPS action plan

“The reason to tackle taxation from the State aid standpoint is simple. Selective taxation is economically inefficient, because it distorts the level playing field for the allocation of capital within the internal market.(...) A limited number of companies actually manage to avoid paying their proper share of taxes by reaching out to certain countries and shifting their profits there. In those cases, where national laws or tax-administration decisions permit or encourage these practices, there might be a State aid component involved and I intend to get to the bottom of it.”

J. Almunia, Speech at European Competition Forum, Feb. 11 2014

What has EC been investigating?

- Commission started requesting information from some Member States on:
 - IP regimes (patent boxes)
 - Tax rulings and APAs
- Requests expanded to all EU member states on December 17, 2014

“We need a full picture of the tax ruling practices in the EU to identify if and where competition in the Single Market is being distorted through selective tax advantages. We will use the information received in today’s inquiry as well as the knowledge gained from our ongoing investigations to combat tax avoidance and fight for fair tax competition.”

*M. Vestager, EC press release,
Dec. 17, 2014*

What triggered the investigations?

- Companies subject to press reports or public hearings: primarily U.S. companies
- On June 11, and October 7, 2014 the Commission published its decisions to open State aid formal investigation procedures against Ireland, Luxembourg, and the Netherlands to assess the appropriateness of the transfer pricing in the tax rulings granted to several highly publicized multinational companies.
- Decision June 11, 2014 SA.38373, SA.38374, SA.38375
“Tax rulings as such are not problematic: they are comfort letters by tax authorities giving a specific company clarity on how its corporate tax will be calculated or on the use of special tax provisions. However, tax rulings may involve state aid within the meaning of EU rules if they are used to provide selective advantages to a specific company or group of companies.”

Significance of State Aid Decisions

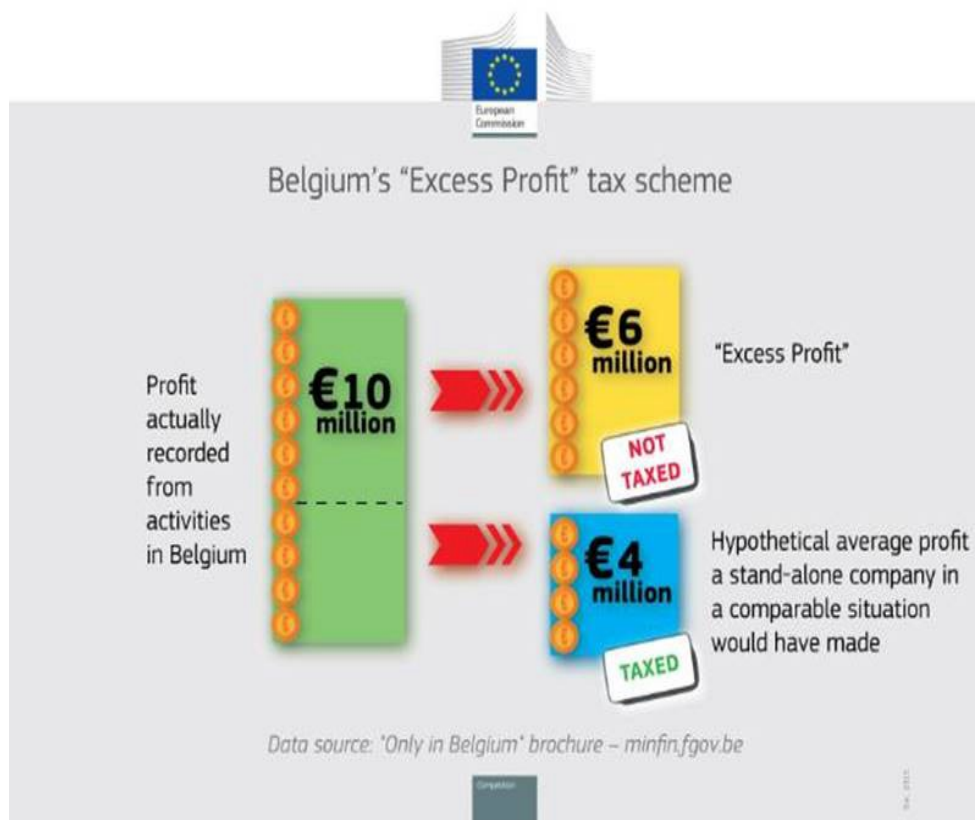
- Why are EC State Aid decisions important?
 - EC using state aid, one of its strongest weapons, to address suspected tax avoidance in the EU
 - Potentially any beneficial tax rulings or agreements could be found to be an illegal subsidy, inconsistent with the internal market
 - Alters certainty of tax consequences otherwise provided in the form of tax rulings or agreements
 - Tax rulings are standard practice, with many taxpayers relying on them, so that State Aid decisions are of interest to many multinational businesses

Recent EC State Aid – Specific Challenges

- The European Commission (“EC”) is reviewing tax rulings and practices to determine if rulings constitute Illegal State Aid. Similar to protecting interstate commerce, the EC is seeking to protect unfair advantages by one EU country over others when methods endorse “*artificial and complex methods to establish taxable profits for the companies that do not reflect economic reality.*”
- The EC has reached the following conclusions:
 - Dutch ruling provided illegal state aid (10/21/15)*;
 - Luxembourg ruling provided illegal state aid (10/21/15)*;
 - Belgium excess profits ruling practice (01/11/16, press release);
- No decision yet:
 - Active investigation into whether the Irish government provided illegal state aid;
 - Active investigation into whether Luxembourg provided illegal state aid.

**decisions are being appealed to European Court of Justice; decisions not yet released due to redaction process*

Belgium – Excess Profit Rulings



- Multinationals could enter into a tax ruling with the Belgian Tax Authorities to determine the hypothetical average profit a stand-alone company in a comparable situation would have made.
- The alleged difference between the actual profit and this hypothetical average is deemed "excess profit" by the Belgian Tax Authorities and exempt from Belgian corporate income tax
- Reasoning is to avoid double taxation. No proof is required. Excess Profit is determined unilaterally by Belgium

Belgium – Excess Profit Rulings

- Downward adjustment = “excess profit” is exempt from tax (= deducted from normal taxable basis which is based on accounting profit)
- Excess profit realised by intangibles such as know-how, reputation, client portfolio, research, economies of scale, synergies, trade organization
- Based on interpretation of the Belgian law, as confirmed in a ruling
- For MNEs, setting up new activities in Belgium. Mostly central entrepreneurs
- Mostly used by EU multinationals (~70% of potential recovery amount)
- Not investigated by European Commission on an individual basis but as a scheme

Belgium – Excess Profit Rulings

Main arguments of the European Commission

1. Selectivity

- only available to MNEs
- only available on the basis of a ruling
- only available to large MNEs that have access to synergies

2. Non compliance with arm's length principle

- central entrepreneur should earn the residual profit (not profit determined on basis of TNMM)

European Commission considers the practice illegal state aid:

- Companies only active in Belgium are not able to claim similar benefits
- Around EUR 700 million must be recovered from 35 multinational companies
- Approximately EUR 500 million comes from European multinationals

State Aid MNE Perspectives

- Recovery against beneficiary is at odds with basic fairness
 - Sovereign provided tax rulings should provide certainty
 - Would not have considered need to seek EC state aid clearance
 - Retroactive taxation
- Cannot be certain whether future rulings would not be challenged
- Should treaties be with EC not member states? EC essentially imposing its own transfer pricing methodologies

State Aid – what is the EC saying?*

- Not unfairly targeting U.S. multinationals
 - Belgium excess profits tax rulings involve non-U.S. MNEs
 - No evidence to support discrimination claims
- Recovery arises because of the failure to obtain pre-clearance of rulings
 - Standstill rule would have applied prior to grant of benefit
 - State aid is not a new issue; it has been applied for decades and is a long-standing rule of law
- Investigations continuing and no plan to target solely U.S. companies

* Source: Karl Soukup, Director, Directorate General Competition, European Commission, Speech at Institute of International Economic Law of Georgetown University Law Center co-sponsored conference (Feb. 22, 2016).

State Aid – what is the U.S. Government saying?*

- Enforcement of rules uneven
 - Appears only companies in the public view are being targeted
 - 1000's of rulings exist so EC must apply rules in a creditable manner; consistent and logical enforcement
- True distortions in marketplace attributable to differences in tax rates, e.g., Ireland at 12.5%
- Acknowledges failure of U.S. tax reform contributing to State Aid and other EU initiatives
 - U.S. MNEs deferred earnings are not “stateless” but belong to U.S., only taxed when repatriated; EU no right to tax
- Fairness concerns with recovery claim; legitimate expectations EC requirement, notwithstanding
 - Fine or tax? U.S. foreign tax credit issues

* Source: Robert B. Stack, Deputy Assistant Secretary, International Tax Affairs (Tax Policy),

State Aid – what else is the U.S. Government saying?

- January 15, 2016, letter from Chair, Ranking Member, and other Finance Committee members, to Treasury Secretary Lew
 - Expressed "strong" concerns regarding State Aid investigations
 - Requests Secretary to consider imposing a double rate of tax under section 891 on taxpayers from foreign countries that engage in discriminatory taxation
 - Treasury should intensify its efforts to caution the EU Commission not to reach retroactive results that are inconsistent with internationally accepted standards

State Aid – what else is the U.S. Government saying?

- February 11, 2016, letter from Treasury Secretary Lew to Jean-Claude Juncker, President of the European Commission
 - Urging EC to reconsider approach of using state aid in civil investigations against U.S. companies, as it could undermine the well-established basis of mutual cooperation and respect among countries
 - 4 main concerns:
 1. New interpretation of state aid & it is being applied retroactively
 2. U.S. companies targeted disproportionately
 3. Income being targeted that member states have no right to tax under well-established international tax standards; it is U.S. income that is being deferred and that could carry foreign tax credits for the recovery
 4. Approach may undermine U.S. tax treaties with EU member states
- EC has dismissed Secretary Lew's concerns:
 - State aid is a long-standing principle and recoveries are not retroactive taxation
 - Recoveries have come from EU companies, not just U.S.

Will US Pay State Aid Costs with FTCs?

Is the Levy a Tax?

- Not fine, penalty, customs duty or interest
- Not in exchange for a specific economic benefit
 - Taxes attributed to a subsidy are not creditable

Is the Levy an Income Tax?

- Realization
- Gross Receipts
- Net Income

Is the Levy an “in lieu of” Tax?

Will the credit be accessible through a direct credit under section 901 or a deemed paid credit under section 902, recognized through a dividend or a subpart F inclusion?

Is the recovery of state aid costs a tax or a fine?

State Aid – Disclosure in the Form 10-K

Disclosure related to State Aid may be included in the following sections:

- Item 1. A — Risk Factors
 - Represent most significant factors that make an offering of the issuers' securities speculative or risky
 - Represent risks specific to the issuer – should not include risks that could apply to any issuer
- Item 8 — Financial Statements and Supplement Data, Income taxes footnote
 - Even if no unrecognized tax benefit (UTB) has been recorded, if it is reasonably possible that the total amount of unrecognized tax benefits will significantly change within 12 months of the reporting date, disclose the nature of the uncertainty, the nature of the event that could occur to cause the change and an estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made
 - If UTB has been recorded, follow disclosure guidance under ASC 740-10-50-15

EC & EU Moving On

- June 17, 2015, EC adopts Action Plan for fair and efficient corporate taxation in the EU.
 - It sets to reform the corporate tax framework in the EU, in order to examine tax compliance, ensure sustainable revenues and support a better business environment in the Single Market.
 - 5 Key Areas for Action have been identified:
 1. Re-launching the Common Consolidated Corporate Tax Base (CCCTB)
 2. Ensuring fair taxation where profits are generated
 3. Creating a better business environment
 4. Increasing transparency
 5. Improving EU coordination
- January 28, 2016, EC issues Anti-Tax Avoidance Package

What does the EC's anti-tax avoidance package say?

“The Anti-Tax Avoidance Package presents a pragmatic approach, bringing together key initiatives needed to enhance effective taxation and transparency in the Single Market. It will add momentum to the current reform process, keep up the pressure on Member States to act, and will help convert high level commitments into legislative action where possible.”

The anti-tax avoidance package includes:

- Proposal for an Anti-Tax Avoidance Directive
- Recommendation on Tax Treaty issues
- Proposal for a Directive implementing the G20/OECD Country by Country Reporting (CbCR)
- Communication on an External Strategy
- Staff Working Document, which provides further analysis and supports these initiatives.

Source: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL, Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU (January 28, 2016)

What does the Anti-tax avoidance directive say?

Anti-Tax Avoidance Directive Proposal

Directive lays down anti- tax avoidance rules in six specific fields:

- Deductibility of interest (Action 4 of BEPS; generally 30% of EBITDA with a group rule);
- Exit taxation (MTM upon leaving taxing jurisdiction in certain cases);
- A switch-over clause (income received is taxed in member state if payor jurisdiction statutory tax rate is less than 40% of statutory tax rate in recipient state; recipient receives deduction for taxes paid on income in payor jurisdiction);
- General anti-abuse rule (GAAR) (disregard arrangements not put into place for valid commercial reasons which reflect economic reality);
- Controlled foreign company (CFC) rules (tax undistributed income of certain >50% owned non-publicly traded companies where ETR in company's jurisdiction is <40% of the ETR in owner's jurisdiction and >50% income of company passive); and
- A framework to tackle hybrid mismatches (Action 2 of BEPS; follow treatment in source member state).

Push for a Common Tax Base

The EC has said this is “No time for business as usual.”

- The Common Consolidated Corporate Tax Base (CCCTB) is central to the Action Plan, as it would fundamentally reform corporate taxation and provide a holistic solution to the problem of profit shifting in Europe, creating fairer and more efficient taxation. It would also create a better tax environment for business, reducing tax burdens.
- The EC has said that once the CCCTB is adopted, it would prevent aggressive tax planning in the EU. Putting CCCTB in place therefore remains the EC's objective. The public consultation on a revised CCCTB proposal has recently closed, and the Commission is on track to adopt the new legislative proposals in autumn 2016. The Commission will encourage Member States to adopt the proposal quickly.

Transparency and the link with State Aid

- **BEPS 5:** priority on improving transparency through “compulsory spontaneous” exchange of information on certain tax rulings with relevant jurisdictions (adopted 5 October 2015).
- **Amended Directive 2011/16/EU:** ECOFIN Counsel presents “mandatory automatic” exchange of tax rulings information between all Member States (adopted 8 December 2015).
 - A wide range of situations, including but not limited to the following types of *advance* cross-border rulings (“rulings”) and *advance* pricing arrangements (“APA’s”) which could be *any communication* or in *any material form*.
 - Must communicate basic information about the type of ruling or advance pricing agreement, its content, criteria used and other member states affected.
 - The Member States will have to adjust their national law in order to comply with the Directive by December 31, 2016.

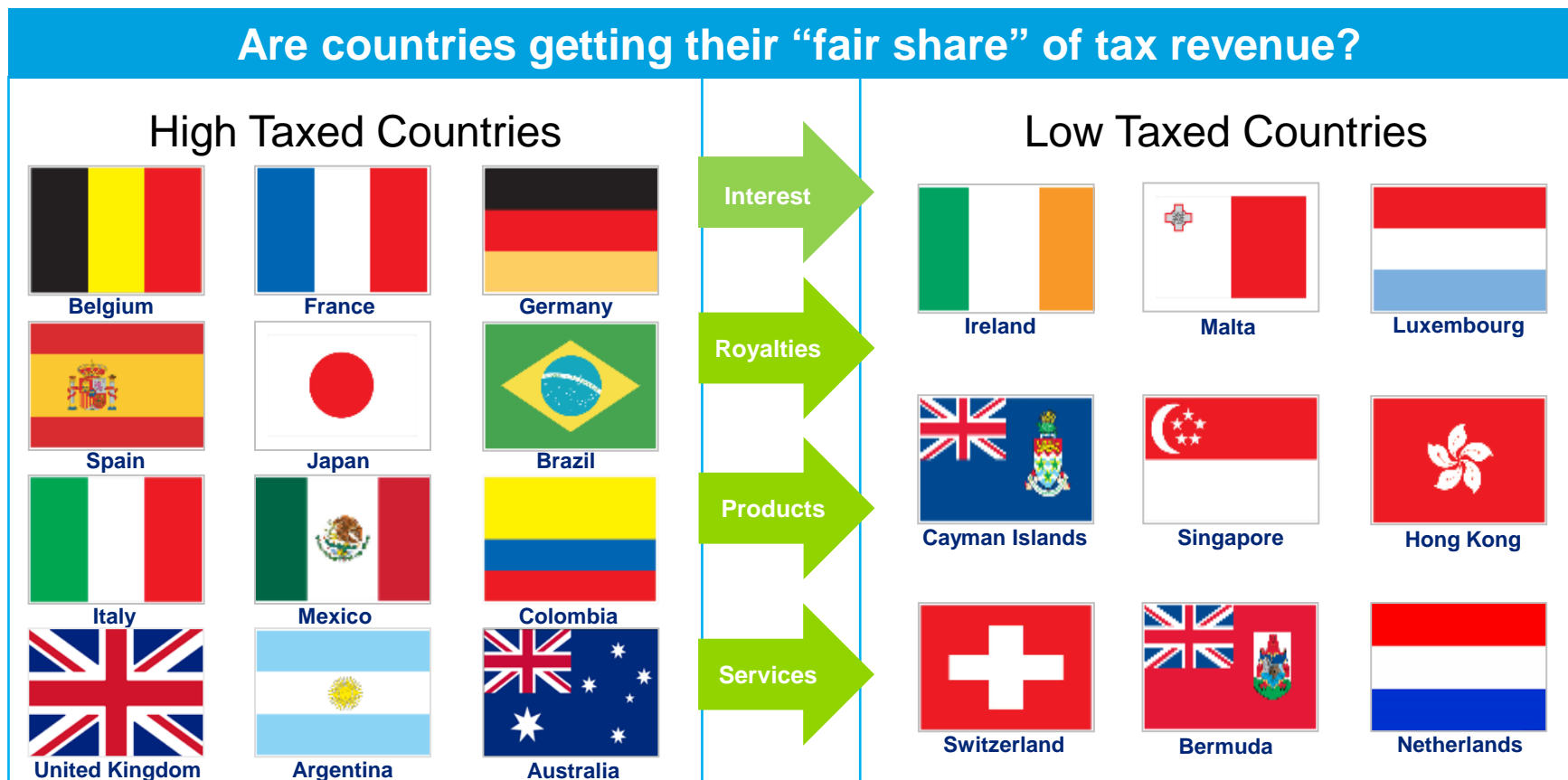
Transparency and the link with BEPS

Directive 2011/16/EU vs BEPS Action 5

Directive 2011/16/EU	BEPS Action 5
Scope/definition of rulings is broadly defined	Scope has six categories (see Chapter 5: BEPS Action 5)
Recipient: competent authorities of Member States through central database	Recipient ('two-part rule') <ul style="list-style-type: none">• Countries of residence of all related parties...; and• The residence country of the ultimate parent company and the immediate parent company via technical system
Two-step exchange process: <ul style="list-style-type: none">• Automatically 'basic information'• Full text of ruling by request	Two-step exchange process: <ul style="list-style-type: none">• Automatically 'basic information'• Full text of ruling by request
No template available (might be based on OECD BEPS template)	Template available
Deadline: exchanged within 3 months following the end of the half calendar year (exclusions apply)	Deadline: exchanged within 3 months (no exclusions)
<u>Past rulings</u> : issued from 1 January 2012 (2012/2013 still valid per 1 January 2014); pre-2017 rulings shared before 1 January 2018	<u>Past rulings</u> : issued on or after 1 January 2010 (still in effect per 1 January 2014); must be shared by the end of 2016

BEPS

What is Base Erosion & Profit Shifting (BEPS)?



BEPS project overview

Final Reports Published

Organisation for Economic Cooperation and Development (OECD) published its Final Reports on BEPS on 10/5/2015:

EU: May implement minimum standards and best practices across 28 member states

US: Congress not directly involved in BEPS project; Final Reports may motivate some sort of action by Congress on international tax issues

Countries have been moving forward on BEPS agenda independent of agreement and finalization of BEPS action items

Highlights of Final Reports

- Neutralize effects of hybrid mismatch arrangements
- Financing – limit base erosion via interest deductions
- Strengthen controlled foreign companies (CFC) rules
- Prevent treaty abuse
- Permanent establishments (PE) – prevent artificial avoidance of PE status
- Intellectual Property – counter harmful tax practices
- Digital Economy and related business models – address mobile income
- Transfer pricing (TP) documentation and transparency
- Dispute resolution – make mechanisms more effective; develop multilateral instruments

Business Response

In this dynamic environment, companies need to respond, as quickly as possible, by:

- Identifying those proposals that *may* impact certain tax benefits to the company in the short, medium, and long term
- Measuring the impact of proposed reforms
- Prioritizing the action items based upon the anticipated or proposed timing taking into account any benefits of taking action prior to the proposal being adopted
- Develop approach to centralized transfer pricing control, documentation and to country by country reporting now
- Considering the potential need for restructuring

Identify

Identify proposals that may impact certain tax benefits to the company in the short, medium, and long term

Measure

Measure the impact of proposed reforms across business, ETR, and risk metrics

Prioritize

Prioritize action items based upon anticipated timing taking into account any benefits of taking action prior to adoption

Communicate

Communicate with key stakeholders, sharing possible restructuring options and other approaches to address impacts

Selected country actions (Europe)

Existing legislation (pre-2015)

Current year legislation (2015)

Expected legislation

Country	Legislation	Date
France	<ul style="list-style-type: none"> Deduction disallowed for low-taxed related party interest expense 	2013
Germany	<ul style="list-style-type: none"> Dividend exemption disallowed on hybrid dividends 	2014
Austria	<ul style="list-style-type: none"> No deduction for payments that are not “sufficiently” taxed or are not taxed at all at the level of the recipient. 10% tax rate at the level of the recipient considered sufficient 	2014
UK	<ul style="list-style-type: none"> Diverted Profits Tax (25 percent of diverted profits) Recent UK Finance Bill released with certain tax impacts (effective 2017) 	4/1/2015
Ireland	<ul style="list-style-type: none"> Default rule all companies incorporated in Ireland are tax resident in Ireland (New companies – 2015; Existing companies – 2020) 	2015 or 2020
Russia	<ul style="list-style-type: none"> Treaty benefits limited to recipients recognized as the actual recipient of income/beneficial owner under Russian law Tax authority challenges to deductions for royalty/interest/service fees when deduction of expenses affects financial performance of local company 	2014 - 2015
Ukraine	<ul style="list-style-type: none"> Transfer pricing rules strengthened to prevent shifting profits offshore PE definition expanded to include location of servers in Ukraine 	2015

Selected country actions (Europe)

Existing legislation (pre-2015)
Current year legislation (2015)
Expected legislation

Country	Legislation	Date
EU member states	<ul style="list-style-type: none"> GAAR introduced in the EU Parent-Subsidiary Directive Anti-hybrid instrument measure: Exemption disallowed on hybrid dividends (Proposed) Directive for exchange of information of rulings within the EU 	2016 - 2017
Luxembourg	<ul style="list-style-type: none"> Suspend consideration of certain types of ruling requests regarding PE status pending US-Lux treaty negotiations 	Possibly 1/1/2016
Switzerland	<ul style="list-style-type: none"> Repealing Auxiliary Company, Mixed Company, Holding Company, and Commissionaire regimes CbC reporting Automatic (spontaneous) data exchange 	Likely next 2-3 years
Germany	<ul style="list-style-type: none"> No deduction on hybrid instruments and in certain double dip structures 	Likely 2016
Italy	<ul style="list-style-type: none"> "Digital tax" – 25 percent WHT would apply on digital sales made by foreign entities to Italian clients. Not applicable if sales made through Italian PE of foreign entity 	Likely 2016

Selected country actions

Existing legislation (pre-2015)

Current year legislation (2015)

Expected legislation

Region	Country	Legislation	Date
Australia	Australia	<ul style="list-style-type: none"> Structures lacking tax presence for purpose of avoiding tax disregarded, with profits from domestic sales being booked domestically Increase maximum penalties for profit-shifting schemes CbC reporting Multinational anti-avoidance law (MAAL) 	2016
North America	Mexico	<ul style="list-style-type: none"> Deduction for royalty and technical assistance fees disallowed unless “subject to tax” in recipient state Treaty benefit only allowed with affidavit evincing double taxation Double deductions by two related parties on single payment disallowed 	2014 2016 – CbC Reporting
South America	Brazil	<ul style="list-style-type: none"> Proposed new reporting requirement for taxpayers to disclose transactions that were carried out to reduce, eliminate or defer taxes 	2016 (if enacted)

Selected country actions

Existing legislation (pre-2015)

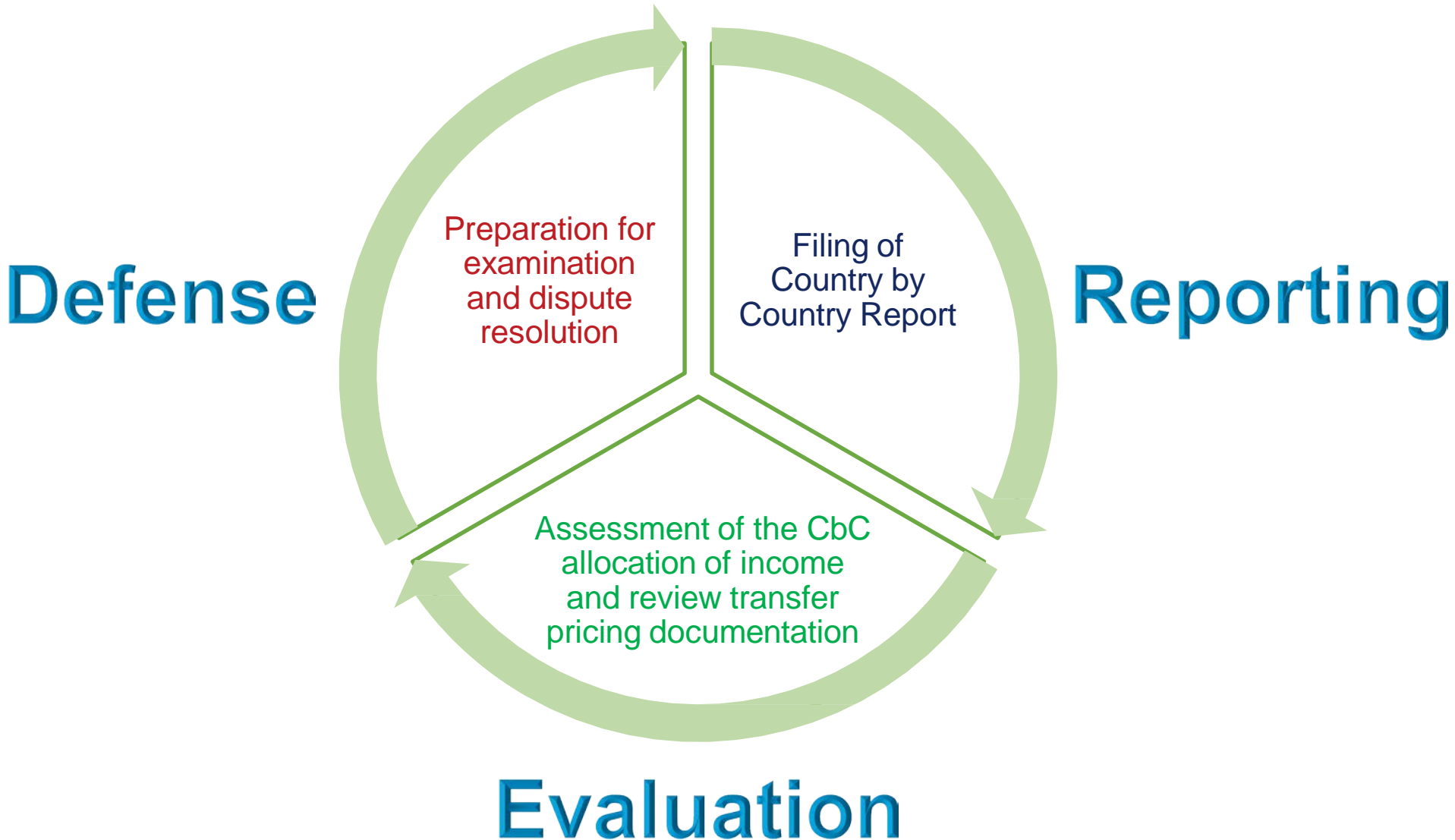
Current year legislation (2015)

Expected legislation

Region	Country	Legislation	Date
Asia	China	<ul style="list-style-type: none"> Deduction of cross-border payments to overseas related parties will be subject to more prudent assessment by the tax authority. Discussion draft of “Implementation Measures of Special Tax Adjustment” released in Sept. 2015 incorporates a number of recommendations of the OECD in the context of the BEPS initiative 	2015 - 2016
	Japan	<ul style="list-style-type: none"> Consumption tax (VAT) amendment: cross-border digital services are deemed to take place at the main office or domicile of the service recipient Exit tax applicable to Japanese resident individuals with certain financial assets 	2015
		<ul style="list-style-type: none"> Disallowance of 95% foreign dividend exemption for dividends that are deductible in the source country (e.g., dividends on redeemable preference shares between Australia and Japan) 	2016

Country by Country Reporting

Three elements to addressing CbC



Process for responding to CbC reporting

Evaluate reporting requirements and data required /
Systems needed / Jurisdiction of tax residence



Prepare initial draft of reporting under proposed
regulations



Assess global reporting, master file and local file



Evaluate examination protocols & Dispute resolution
options



Develop communication program regarding CbC
reporting

Overview of IRS proposed CbC regulations

Consistent with OECD section 13 report with the following changes:

- US ultimate parent entity must file annually if its multinational enterprise (MNE) group had annual revenues of \$850 million or more in the preceding year
- CbC report is due with timely-filed tax return (with extensions) – not 12 months after year-end as suggested by the OECD
- Will apply to taxable years of U.S. parent entity that begin on or after the date final regulations are issued (expected sometime in 2016)
 - Calendar year taxpayers would first apply regulations for 2017 tax year, filed in 2018, exchanged by IRS with treaty and TIEA partners in 2019
 - Fiscal year taxpayers may file earlier
- Requirement to include tax ID number for constituent entities in the tax jurisdiction of residence

CbC constituent entities

- “Constituent entities” includes all business entities (e.g., corporations, partnerships, “disregarded entities” for US income tax purposes, hybrid entities, and trusts, including permanent establishments) including those that are required to consolidate their accounts for financial reporting purposes under U.S. GAAP, or that would be so required if equity interests in the US ultimate parent entity were publicly traded on a US securities exchange
- Does not include a foreign corporation or foreign partnership that is not a CFC or CFP of the US ultimate parent entity, or any permanent establishment of such foreign corporation or foreign partnership

CbC residence information

- **Tax jurisdiction of residence** determines where each “constituent entity” in MNE group reports its revenues, profits, and other required information on an aggregated basis
- Entity is “resident” if it is liable to tax in that jurisdiction based on place of management, place of organization, or other similar criterion.
 - Treaty tie-breaker rules, if any, apply
- Permanent establishment is treated as resident in a jurisdiction to extent of the income attributable to the permanent establishment
- Partnerships and other pass-thru entities that are not **liable** to tax in the jurisdiction in which they are organized generally will have no tax jurisdiction of residence but IRS expects that partners will report their share of partnership items in the **partner’s** jurisdiction (assuming the partner is **liable** to tax in its jurisdiction)

Priority for reporting income by jurisdiction	
First	Taxable at entity level or PE
Second	Taxable at equity holder Level
Third	Not liable to tax in any jurisdiction

Data required for business entities

US Proposed reporting rules require reporting of the global allocation of income and related financial attributes

Entity level data:

- Tax Jurisdiction of Residence
- Tax Jurisdiction of Organization or Incorporation (if different from residence)
- Main Business Activities
- Tax Identification Number (in tax jurisdiction of residence)

Financial data:

Aggregate information reported for each tax jurisdiction of residence and for all constituent entities with no tax jurisdiction includes:

- **Revenues (related, unrelated, total)**
- Profit/Loss before income tax
- Income tax paid (cash)
- Income tax accrued
- Stated capital
- Accumulated earnings
- **Number of employees**
- **Tangible assets (not cash or equivalents)**

CbC constituent entity information

Information Requested

Name of the MNE group: Fiscal year concerned:														
Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organization or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)											
			Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing, or Distribution	Administrative, Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant
	1.													
	2.													
	3.													
	1.													
	2.													
	3.													

*Please specify the nature of the activity of the constituent entity in the "Additional Information" section.

CbC tax jurisdiction of residence

Information Requested

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Name of the MNE group: Fiscal year concerned:	
Additional Information. Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the Country-by-Country Report.	

- Aggregated by tax jurisdiction and for income not reported in any tax jurisdiction

Australia Anti-Tax Avoidance

Australia – Latest Actions*

- On February 22, 2016, the Treasurer of Australia announced that the government will apply new requirements on multinational companies investing in Australia to ensure “companies operating in Australia pay tax on their Australian earnings.”
- The government expects foreign enterprises operating in Australia to meet all tax law obligations and to cooperate with the ATO in a timely and complete manner.
- Generally, multinational companies will be required to comply with Australian tax law, and provide information to the Australian Taxation Office (ATO) as directed, in relation to investments which require an application to the Foreign Investment Review Board.
- Multinational companies also will be required to advise the ATO if investors enter into transactions with non-residents which may be subject to Australia’s transfer pricing or tax anti-avoidance measures.
- If a significant tax risk is identified when assessing a foreign investment application, the investor may be required to enter into advance pricing arrangements with the ATO, seek rulings from the ATO or comply with other ATO directions. A breach of such conditions may result in prosecution, fines and potential divestment of the asset.

** Source: Media Release, Australian Treasury Scott Morrison, Turnbull government makes paying tax in Australia a condition for foreign investment (Feb. 22, 2016), <http://sjm.ministers.treasury.gov.au/media-release/010-2016/>*

Australian BEPS implementation

Australia is at the forefront of responding to the OECD base erosion and profit shifting (BEPS) project, and is entering a new era of demand for tax transparency from multinational businesses

OECD actions	Australian response	Timing
1. Digital economy	Multinational anti-avoidance law (MAAL) Goods and services tax (GST) on digital products	Jan. 1, 2016 July 1, 2017
2. Hybrids	To be reviewed by Board of Taxation prior to implementation	Mid-2016 (est.)
4. Interest deductions	Tightening of thin capitalization rules, but no intention to implement fixed ratio rules	Already in place
5. Harmful tax practices	Information sharing	Immediate
6. Treaty abuse	To be incorporated into negotiation of new/updated tax treaties	Immediate
7. Permanent establishment (PE) status	MAAL [even if fall out of MAAL, still PE changing] OECD standard to be included in new/updated treaties	Jan. 1, 2016
13. Transfer pricing documentation	Country by country reporting Board of Tax: Voluntary tax transparency code ATO tax paid public disclosure	Jan. 1, 2016 Under consultation Dec. 17, 2015

MAAL - Overview

Who is affected?

- Multinational groups with global consolidated turnover of >AUD 1 billion *
 - **Nonresident entity supplies goods and services** to the Australian market
 - Associated Australian entity **undertakes activities in connection with the supply**
 - Sales revenue **recognized by nonresident**
 - There is an anti-avoidance purpose
-

Objective and outcomes

- Conceptually, a greater alignment between the proportionate tax paid on income from the supply and the proportionate economic activity carried out in Australia
 - Behavioral change, and a return to “traditional” transfer pricing arrangements
-

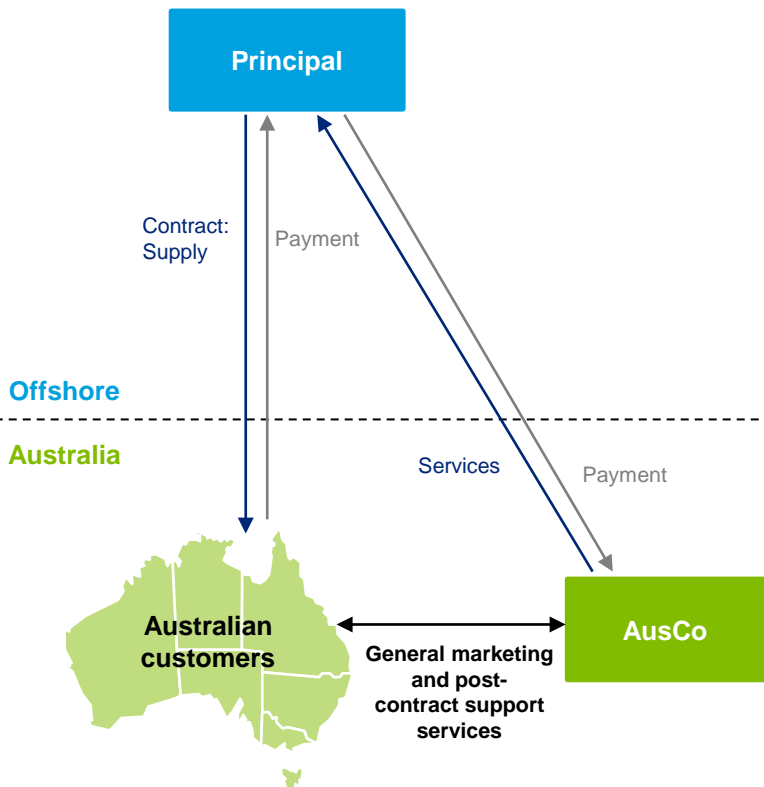
When will it apply?

- As from January 1, 2016, irrespective of when the affected arrangements were entered into
 - As an extension of the general anti-avoidance rules (in priority to treaties)
 - Will operate only to disallow perceived benefits derived after January 1, 2016
-

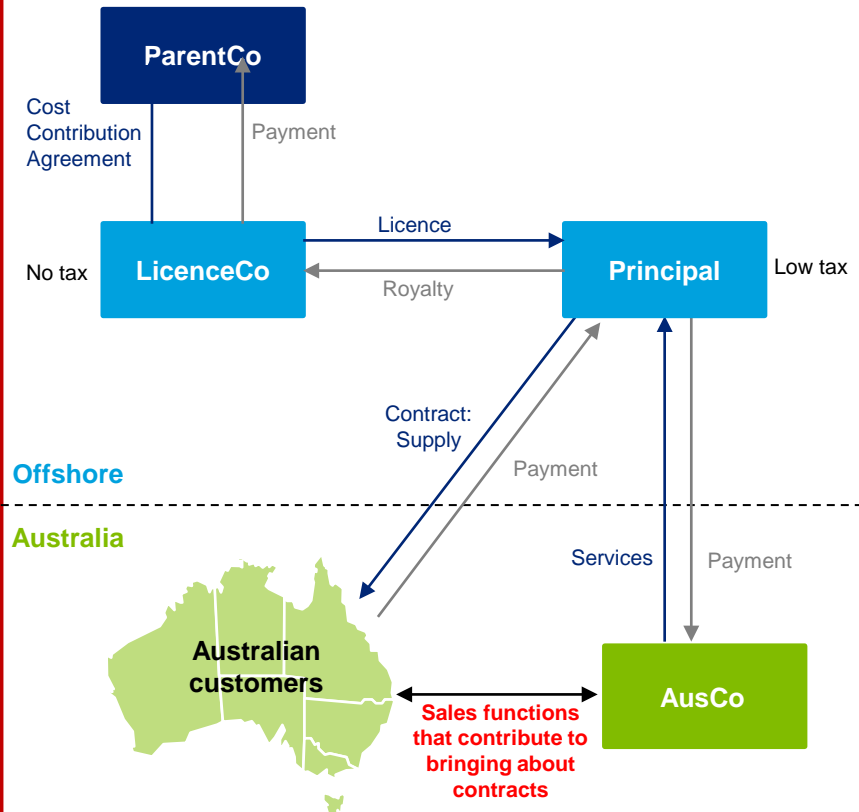
* Current equivalent of approximately USD 700-750 million

MAAL - Examples (per Australian Taxation Office)

Low Risk Scenario



High Risk Scenario



Source: Based on examples in ATO document, Law Companion Guideline 2015/2

MAAL - Issues to consider

Turnover threshold

- Based on AUD converted, consolidated global accounting income
 - Extent of activity or supplies into Australia not relevant to the threshold (as for country-by-country reporting)
-

Supply to an Australian customer

- Wide scope: Goods, services and includes e-commerce transactions
 - Excludes certain financial arrangements (e.g. debt and equity)
-

Activities undertaken in Australia

- Fact dependent; activities must be directly in connection with the supply
 - Includes activities bringing about the contract for supply (including building client relationships)
-

Associate or commercially dependent

- “Associate” is a defined term, but complex in practice
 - “Commercially dependent” is undefined
-

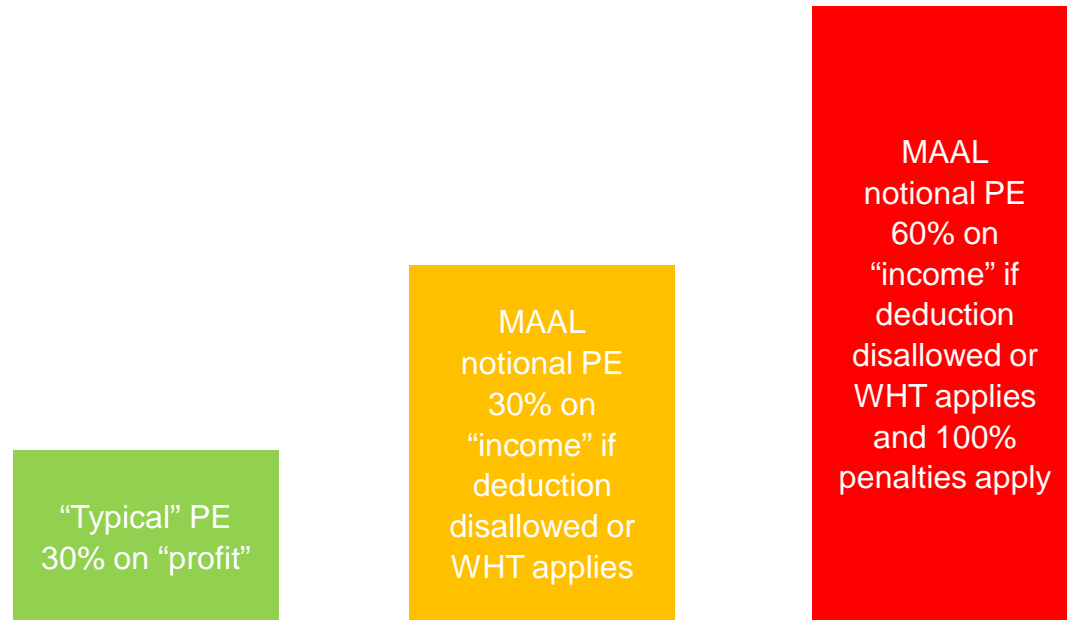
Principal purpose

- Must be a tax benefit
- Can include reduction in foreign tax liabilities
- Presumption to rebut if other tests met?

MAAL - Implications if rules apply

Consequences

- Nonresident essentially is taxed in equivalent manner to having an Australian PE
- Implications for deductibility of costs effectively brought into the Australian “net”
- Potential for Australian withholding taxes to apply
- Potential penalties of 100%



MAAL - How to respond?

ATO approach

- ATO roadmap released in January, 2016
 - Divides taxpayers into 5 categories for future ATO interaction
-

Steps to reviewing position

- Need to consider implications for accounting for uncertain tax positions
- The ATO has already approached certain taxpayers in Q1 2016
- Review and consider application of law to current supply arrangements
- Review options to change supply arrangements, if commercially viable
 - Low-risk scenario? Buy-sell model or outsource Australian activity?
 - Voluntary transfer pricing adjustments
 - Other

Country-by-country (CbC) reporting

Core conditions

- Significant global entity (consolidated global turnover > AUD 1 billion)
-

Implications

- Will be required to adopt three tiers of reporting:
 - Master file
 - Local file
 - CbC report
 - Will be required by all affected Australian entities, unless an exemption is granted
 - May be an exemption for inbound CbC if foreign parent makes report available
-

When will it apply?

- From January 1, 2016, irrespective of when the arrangement was entered into

Tax transparency - ATO report

Core conditions

- AUD 100 million turnover (based on the tax return of the Australian entity or group)
 - Limited exclusion for certain Australian owned private companies (< AUD 200 million turnover)
-

Implications

- Will result in inclusion of data in publicly available ATO tax transparency report
 - Disclosure will include raw data, with no context:
 - Operating revenue (not profit, at this stage)
 - Taxable income
 - Tax payable
-

When will it apply?

- First report released on December 12, 2015 based on 2013-14 income year data

Tax transparency - Financial reporting requirements

Core conditions

- Significant global entities
- Australian resident company or foreign resident with a PE in Australia

Implications

- Requirement to provide general-purpose financial reports to the ATO
Currently many such companies may be preparing limited scope financial reports
Therefore may be exposed to more disclosure and costs
- ATO, in turn, will provide reports to ASIC (Australian equivalent of SEC)

When will it apply?

- The first income year starting on or after July 1, 2016 (note, unlike Australian entities who may have aligned their year end with a foreign parent, most foreign resident entities with a PE may operate on a default June 30 year end)

Other developments

- Board of Taxation has made recommendations in relation to the implementation of additional financial reporting disclosures reconciling income tax expense, as well as a “taxes paid” report
- To be monitored when consultation is completed in Q1 2016

Anti-hybrid rules

Core conditions

- To be confirmed (subject to findings of the Board of Taxation)
 - Expected to be in line with OECD recommendations
-

Implications

- Expected to be in line with OECD recommendations, e.g. likely disallowance of interest deduction on inbound hybrid instruments
 - Further implications for hybrid entities and imported mismatches
-

When will it apply?

- Board of Taxation has been requested to report in March 2016
- May allow announcement of legislative change in FY 16 federal budget
- Measures may apply from the time of the announcement (in line with past practice)

Stronger penalties

Australia has implemented stronger penalties to address potential tax avoidance and profit shifting



- Apply to significant global entities
- Apply if position not “reasonably arguable”
- Apply from July 1, 2015 (irrespective of when scheme entered into)

Behavior	Base penalty amount	Aggravating factors	Disclosure during examination	Disclosure before examination
Tax avoidance scheme	100	120	80	20
If reasonably arguable	25	30	20	5
Profit-shifting scheme	50	60	40	10
If reasonably arguable	10	12	8	2

United Kingdom Anti-Hybrid Actions

UK Hybrid and other Mismatches

- Draft legislation published for consultation on December 9, 2015. Closing date for comments was February 3, 2016. HMRC examples were published on December 22, 2015.
- New rules will replace the existing arbitrage rules from January 1, 2017.
- Rules provide for counteraction of certain arrangements that would otherwise give rise to:
 - i) deduction/non-inclusion mismatches
 - ii) double deduction mismatches.

UK Hybrid and other Mismatches (con't)

- Specifically Chapters 3 – 9 provide for the counteraction of:
 - Chapter 3: certain deduction/non inclusion mismatches arising from payments or quasi payments under or in connection with financial instruments;
 - Chapter 4: certain deduction/non inclusion mismatches arising from payments or quasi payments and involving certain repos, stock lending arrangements or other arrangements for, or relating to, transfers of financial instruments.
 - Chapter 5: certain deduction/non inclusion mismatches arising from payments or quasi payments in relation to which the payer is a hybrid payer.
 - Chapter 6: certain deduction/non inclusion mismatches arising from payments or quasi payments in relation to which the payee is a hybrid payee.
 - Chapter 7: certain double deduction mismatches arising from a company being a hybrid entity.
 - Chapter 8: certain double deduction mismatches arising involving dual resident companies.
 - Chapter 9: imported mismatches
- The rules only apply for corporation tax purposes

Timing of Hybrid/Mismatch Proposed Rules

- Counteraction of deduction/non inclusion mismatches and imported mismatches applies to payments made on or after January 1, 2017 and for quasi payments where the payment period begins on or after January 1, 2017.
- The rules for the counteraction of double deduction mismatches have effect for accounting periods beginning on or after January 1, 2017.
- Where a payment period or accounting period straddles January 1, 2017, the period before January 1, 2017 and the period after January 1, 2017 are treated as two separate payment periods/accounting periods.
- Amounts are to be apportioned between the two periods on a time basis unless that would give an unjust and unreasonable result in which case a just and reasonable basis can be used.

Permitted reasons for deduction/non inclusion mismatches

- A person not being liable, under the law of any territory, to tax on any income or profits received by the person or received for the person's benefit
- A person being subject to tax that is not charged on income or profits arising from a source outside the territory under the law of which the tax is imposed,
- A person not being liable for any tax on the ground of sovereign immunity, or
- A person being an offshore fund or authorised investment fund (subject to certain conditions)

Corporate Expatriations

Potential Considerations for Relocating

- High U.S. corporate tax rate, relative to foreign countries
- Worldwide tax – Residence Based
 - Foreign countries have territorial regimes
- Deferred foreign earnings trapped overseas
 - Reported to be collectively over a trillion dollars
- Corporate tax reform not forthcoming
 - Various proposals but no consensus

2004 Law

Section 7874 limits benefit of inversions:

1. When a foreign corporation acquires substantially all of the assets of a domestic corporation or substantially all of a trade or business of a domestic partnership;
2. After the acquisition, at least 60% of the foreign acquirer's stock is owned by the former shareholders or former partners of the domestic target by reason of their ownership in the target; and
3. After the acquisition, the expanded affiliated group does not have substantially business activities in the foreign acquirer's country of incorporation relative to the group's total business activities

At 80% ownership continuity, the foreign acquirer is treated as a domestic corporation

At 60% ownership continuity, tax attributes and restructuring opportunities limited

Treasury Guidance

Notice 2014-52

- Among other things, provides rules that (i) disregard certain stock of a foreign acquirer having significant passive assets, (ii) disregard non-ordinary course distributions of the domestic target, and (iii) limit the ability to distribute a domestic target tax-free

Notice 2015-79

- Among other things, further tightens rules to (i) require foreign acquirer to be subject to tax as a resident in a foreign country in order to have substantial business activities there; (ii) disregard certain stock of a foreign acquirer established in third country transactions; (iii) clarify the definition of nonqualified property for purposes of disregarding foreign acquirer stock
- Corrects and clarifies rules announced in Notice 2014-52

Treasury & IRS have issued multiple rounds of guidance to address continued re-domiciling activities, including Notice 2014-52 and, most recently, Notice 2015-79, that, among other things, disregard the issuance of foreign acquirer stock attributable to passive assets. Both Notices provide rules that limit post re-domiciling planning, e.g., structures that seek to avoid section 956 or that would de-CFC a foreign corporation

Questions





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