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Non-U.S. International Tax News and Issues

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Agenda

- OECD Developments
  - OECD Program of Work: Overview
  - Pilar 1: Profit allocation and nexus rules
  - Pillar 2: Global anti-base erosion proposal
- EU Developments
  - Digital tax proposals
  - Economic substance legislation
  - Disclosure rules
- Local Country Developments
  - Unilateral measures
  - Use of data by tax authorities

OECD Developments

Digital Taxation: Scoping the Issue

- Under current law, jurisdictions' right to tax business profits is generally based on physical presence within a country.
  - "Permanent Establishment" ("PE"): office or other fixed place of business
- The Internet permits companies to build their brand, develop an engaged customer base, and create value…
  - without physical locations, in many circumstances.
- Operations within a country, if required, can be limited to routine activities that some argue does not reflect the level of economic engagement within the country.

OECD/G20 Inclusive Framework: Two Pillars

Pillar 1

Revision of the existing profit allocation and nexus rules: Realigning *who gets to tax*

Will require global consensus for implementation

Pillar 2

A global anti-base erosion proposal: Ensuring enough tax is paid somewhere

Could be implemented on a unilateral basis

OECD Progress to Date

Policy Note

"Addressing the Tax Challenges of the Digital Economy"

- Issued in January 2019
- Sets out two-pillar approach

Public Consultation Document

- Issued in **February 2019**
- Comments sought on policy issues and technical aspects
- Followed by public consultation meeting in Paris in **March 2019**

Program of Work

- Roadmap to work towards consensus solution to tax challenges posed by digitalization by end-2020
- Released on **May 31, 2019**, and endorsed by G20 Finance Ministers June 8-9, 2019

NEW

Pillar 1 Proposal

"Secretariat Proposal for a 'Unified Approach'"

- Released **Oct. 9, 2019**
- Public consultation set for Nov. 20-21, 2019

Pillar 1: Profit Allocation and Nexus Rules

Key features of Secretariat's proposed "Unified Approach"

1. Scope
   a. Large "consumer-facing" businesses (*not* the same as B2C)
   b. Size threshold to be determined; €750M revenue suggested as an option
   c. Extractives assumed out of scope; other sector carveouts?

2. New nexus
   a. Not dependent on physical presence
   b. New self-standing treaty provision
   c. Potential thresholds, e.g., country-specific sales thresholds

3. New profit allocation rule
   a. Goes beyond arm's length principle
   b. Calculated using a three-tier mechanism

Pillar 1: Profit Allocation and Nexus Rules

Proposed three-tiered profit allocation mechanism

Amount A: a share of an MNE’s non-routine return attributable to market intangibles allocated to market jurisdictions using a formulaic approach

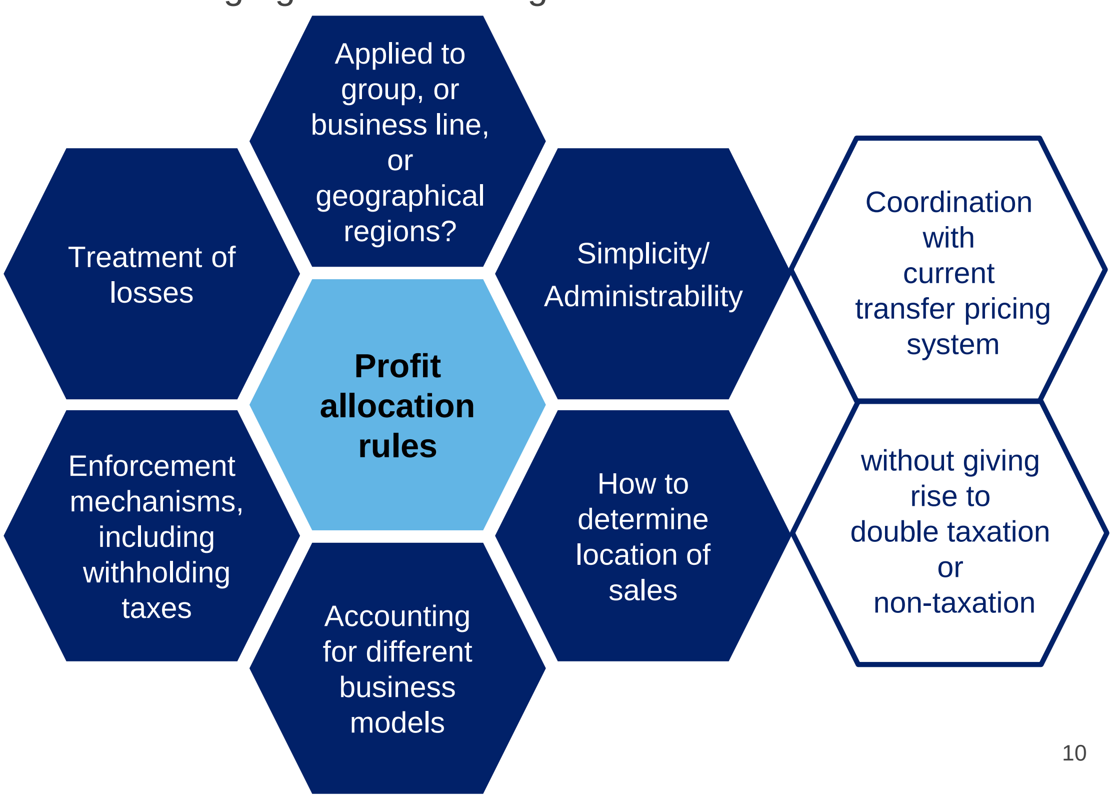
1. Identify the group’s profits, potentially from consolidated financial statements
2. Identify “routine” profits to be excluded from allocation
3. Determine the split of remaining non-routine profits between the portion attributable to market intangibles vs. to other factors (trade intangibles, capital and risk), using a simplified convention such as a fixed percentage
4. Allocate the relevant amount, based on an allocation key such as sales

Amount B: a fixed return for baseline marketing and distribution functions that take place in a market jurisdiction

Amount C: an additional return in accordance with existing transfer pricing rules when a market jurisdiction can successfully establish – subject to robust and binding dispute resolution mechanisms – that there are more functions in the market jurisdiction than have been included in Amount B

Pillar 1: Profit Allocation and Nexus Rules

Reallocation of taxing rights: other design considerations



Pillar 2: Global Anti-Base Erosion Proposal (“GloBE”)

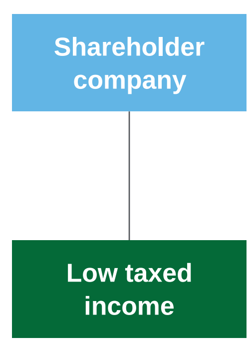
- Global minimum tax
- Rules to permit countries to tax profits where income is subject to **no or very low taxation**
- This proposal has **two inter-related elements:**

Income inclusion rule

Tax on base-eroding payments

Pillar 2: Income Inclusion Rule

- Requires a **shareholder** to bring income into account if income of controlled company not subject to tax at **a minimum rate**
- This rule would **supplement** rather than replace **CFC rules**
- **Switch-over rule** for exempt branches, or income derived from foreign immovable property



- Rule would operate as a **top up to the minimum rate of tax**
- Minimum rate will be a **fixed percentage tax rate**
  - ➢ Specific fixed percentage rate not yet agreed

Pillar 2: Tax on Base-Eroding Payments

Undertaxed payments rule:

- **Denies a deduction** for payments to a related party, that are not subject to a minimum tax rate
- Broad scope proposed, including conduit and imported arrangements

Subject to tax rule:

- Denies **treaty reliefs** to undertaxed payments (e.g., interest and royalty articles)
- Could be limited to related party payments, or broader scope for payments of interest, royalties and for capital gains

New International Tax Architecture

Changes to the **OECD Transfer Pricing Guidelines**

Changes to **double tax treaties**

Changes to OECD guidance on the **attribution of profits** to a **permanent establishment**

Changes to **domestic law**

EU Developments

EU Proposals on Digital Taxation

- Political pressure in Europe to change the tax rules around the digital economy has continued unabated.
- On March 21, 2018, the Commission released its package of proposals.

Draft directive: Interim proposal

Digital Services Tax

Draft directive: Comprehensive solution

Significant digital presence

Commission recommendation

Amending third party treaties

- Directives affecting tax need unanimous approval from Member States before they can be adopted.
- Both draft directives set out a January 1, 2020 commencement date.

Economic Substance Legislation

- Under pressure from EU Code of Conduct Group, certain jurisdictions from EU “gray list” were required to enact economic substance legislation or face “blacklisting” by EU.
- In most cases, legislation effective as of January 1, 2019 with transitional relief for “grandfathered” companies expiring July 1, 2019.
- Further regulations and guidance are expected in many locations and it is possible that existing rules may change.

Anguilla	Bahamas	Bahrain	Barbados	Bermuda
BVI	Cayman Islands	Guernsey	Isle of Man	Jersey
Marshall Islands	Mauritius	Seychelles	Turks and Caicos	UAE

Economic Substance Legislation

- Although each jurisdiction is different, the legislation followed similar patterns in many jurisdictions and was based on guidance and requirements issue by the EU and OECD
- Three requirements to demonstrate economic substance:
  - Directed and managed test
  - Core income generating activities test
  - Adequate test
- Penalties
  - Financial
  - Removal from companies register
  - Criminal penalties in some jurisdictions

DAC6: Summary

1. **What is required to be disclosed?**
Any "**cross border arrangement**" that contains one or more of the "**hallmarks**" listed in the Directive. These hallmarks are features in a tax planning arrangement that could potentially enable tax avoidance or abuse.

2. **Who is required to make the disclosure?**
The Directive is broad in scope. **Intermediaries** include any **EU** based person that **designs, markets, organises or makes available** for or **manages implementation** of a reportable cross- border arrangement. This includes lawyers, accountants, tax and financial advisers, banks.

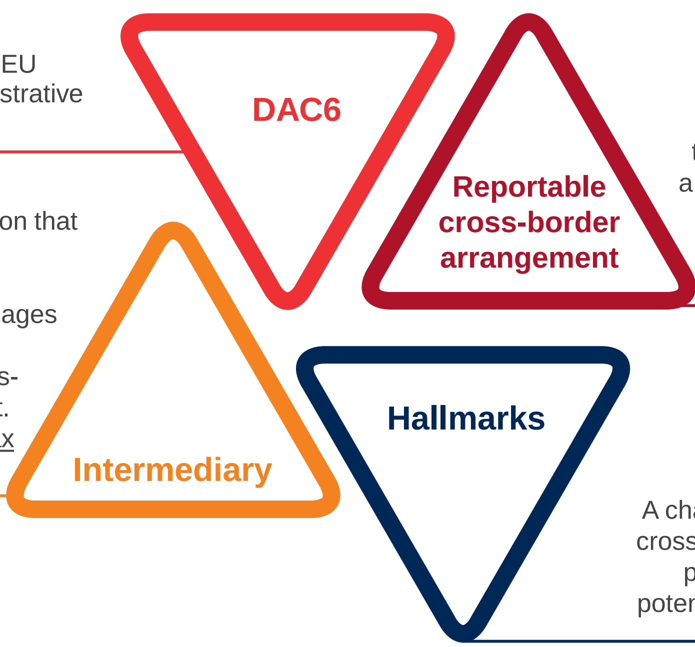
3. **When is the disclosure obligation triggered?**
When the arrangement / structure is first made available for implementation, and whenever services in respect of the arrangement / structure are provided.

4. **When must the disclosure be made?**
Within **30 days** after the arrangement / structure is made available for implementation or services in respect thereof are supplied. Arrangements entered into on or after June 25, 2018, are potentially reportable and will need to be disclosed by August 31, 2020.

DAC6: Key Terms

Sixth update of the EU Directive on Administrative Co-operation

Any EU-based person that designs, markets, organises or makes available for or manages implementation of a reportable cross-border arrangement. Not necessarily a tax adviser!



An arrangement concerning either more than one Member State or a Member State and a third country that bears one or more of the "hallmarks" listed in the Directive.

A characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance.

DAC6: It's Already in Force!

- **May 25** (2018) — DAC6 Directive adopted by ECOFIN
- **June 5** (2018) — Publication in EU official journal
- **June 25** (2018) — Directive enters into force
- **Dec 31** (2019) — Deadline for implemen-tation of Directive in member states
- **July 1** (2020) — Enforcement begins
- **Aug 31** (2020) — Deadline for retrospective filing obligation for "first reporting period" (June 25, 2018 to July 1, 2020)
- **Oct 31** (2020) — First exchange of reports by tax authorities

2018 | 2019 | 2020

➢ ***Countries may decide to broaden the scope of reportable transactions, widen the definition of taxes covered, and/or bring forward their reporting dates***

Local Country Developments

Unilateral Measures: French Digital Services Tax (“DST”)

– Signed into law July 25 by French President Emmanuel Macron, the French DST is a 3% tax on gross revenue derived by providers of certain “digital services” (online advertising, the sale of data for advertising purposes, and fees derived from linking users to online sales platforms).

– This 3% tax will apply retroactively from January 1, 2019, to multinational companies that generate more than €750M in global digital sales and more than €25M in digital sales in France.

– On July 10, US Trade Representative (USTR) Robert Lighthizer launched an investigation under the Trade Act of 1974 to determine whether the tax is discriminatory and restricts US commerce. If it is determined to do so, USTR could decide what actions to take – including whether to impose tariffs on French products sold into the US.

– President Trump and President Macron directly discussed the issue in late August, and Macron announced that the two had struck a deal resolving the dispute and implied that France would refund DSTs paid if and when a multilateral agreement is reached. However, Trump and other US officials have not confirmed a deal or provided additional details of the discussion.

Unilateral Measures: UK Tax on Offshore Receipts in respect of Intangible Property (“ORIP”)

– Introduced from April 6, 2019

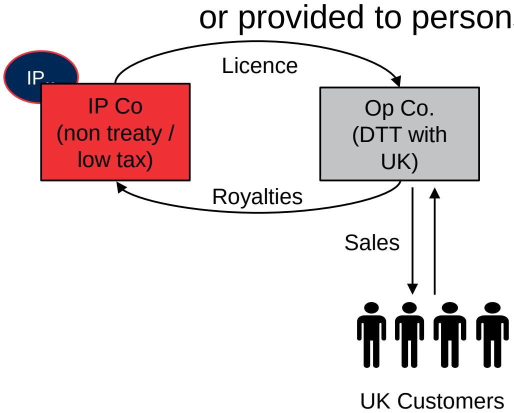
– Imposes an income tax charge of 20%

– On gross income

– Of a foreign entity not resident in a “full treaty territory”

– In respect of “UK-derived amounts”

  - “Enables, facilitates, or promotes UK sales”
  - “UK sales” means services, goods or other property provided in the UK or provided to persons in the UK



– Arrangements on or after October 29, 2018 (e.g., on-shoring transactions) may be subject to an anti-avoidance rule

Use of Data by Tax Authorities

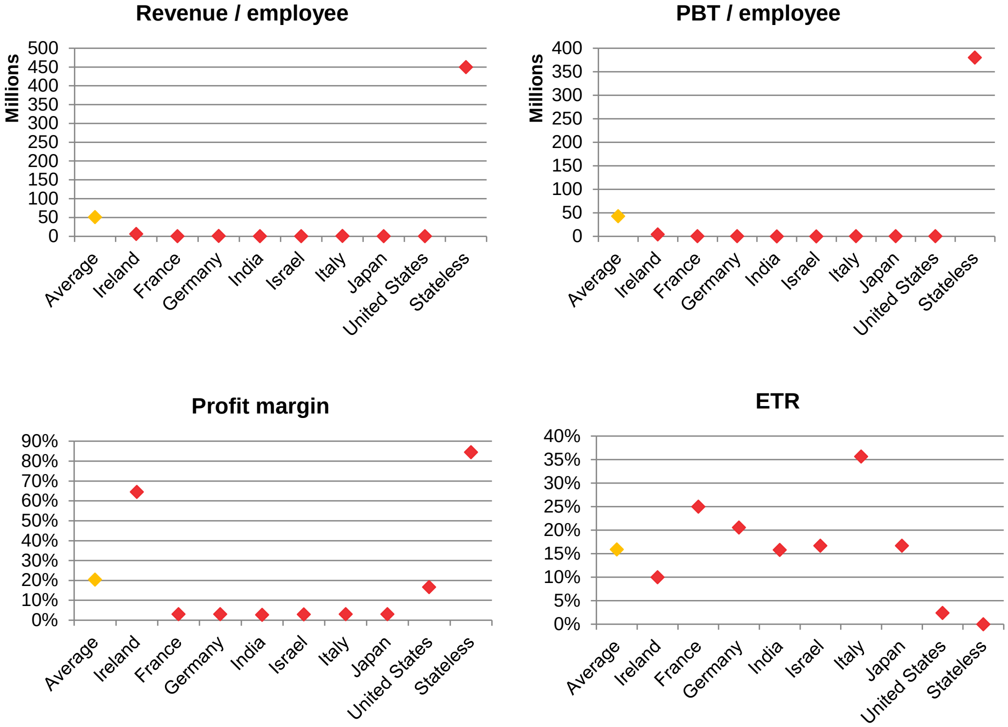
- Transparency initiatives such as Country by Country Reporting and DAC6 are giving tax authorities access to more information than ever before
- A number of jurisdictions are introducing programs to use this data to identify taxpayers of interest

What Tax Risk Indicators Might a CbC Report Show?

- OECD has provided a number of examples of potential tax risk indicators, including, among others:
  - A high proportion of related party revenues in a particular jurisdiction
  - Results in a jurisdiction that deviate from potential comparables
  - Jurisdictions with significant profits but little activity, or low levels of tax accrued
  - Jurisdictions with significant activities but low levels of profit
  - IP separated from related activities
  - Group includes entities with dual residence, or with no tax residence

➢ These are only potential risk indicators and may be fully explained by non-BEPS factors.

Data Analytics



Key ratios:

- Revenue per employee by jurisdiction
- PBT per employee by jurisdiction
- Profit margin by jurisdiction
- ETR by jurisdiction
- Regional comparisons
- Y-o-Y fluctuations

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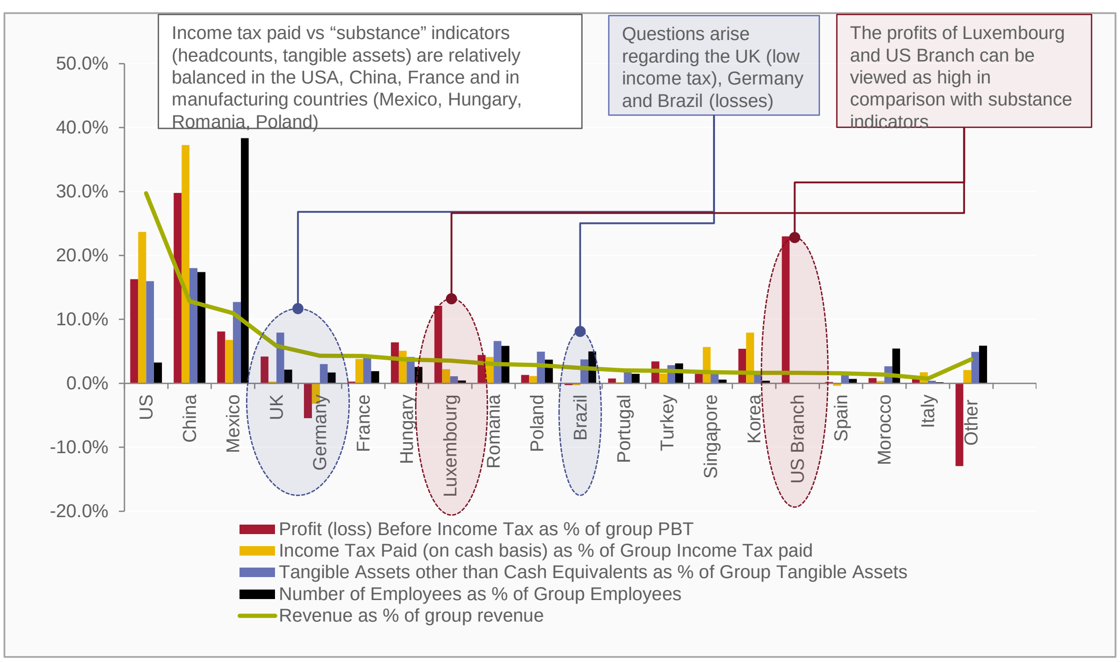
How Will Data Be Used?

The current state data can be used to gain a snapshot on, for example, proportionate profitability v. headcount amongst the group entities.



Use of Data by Tax Authorities: Netherlands

- Dutch CbC team:
  - Includes a number of new FTEs as part of the Coordination Group on Transfer Pricing (“CGTP”)
  - Centralized risk assessment: assessment through data analytics, assessment by CbC team, CbC team (together with CGTP) contacts account team, CbC team/CGTP and account team approach taxpayer to further discuss
  - CbC report is “one of the tools”
- Expectation:
  - 150 Dutch ultimate parent entities
  - 3,000 Dutch constituent entities of non-Dutch ultimate parent companies

Use of Data by Tax Authorities: China

- Multinationals are increasingly viewed on a holistic basis from a transfer pricing perspective
- Tax authorities have been piloting a “Profit Margin Monitoring System” for multinationals, which will pool information from:
  - Tax returns
  - Related party transaction disclosure reports
  - Audit reports
  - TP documentation
  - Master file and country by country reports
  - 10-K
- After comparing key parameters reported in China, the tax authorities assign a risk level – high risk taxpayers subject to audit

Questions?