



BEPS

Beyond Fortune 1000

October 2016

BEPS Overview

Timeline

- Pre-2013 - Organization for Economic Cooperation and Development (OECD) concern that existing tax rules allow artificial shifting of profits to low or no-tax jurisdictions, creating opportunities for base erosion and profit shifting (BEPS)
- 2013 - OECD and G20 countries begin a project to address BEPS
- October, 2015 - OECD and G20 adopt a 15-point action plan to address BEPS and ensure profits are taxed to location where economic activities and value is created
- Recommendations in BEPS action plan are implemented through changes in domestic law and treaty provisions of cooperating countries
- This action plan applies to all companies operating in OECD and G-20 countries
- As of October 14, 2016, 86 countries have joined the BEPS framework

BEPS Action Plan – 15 Points

- **ACTION 1** - Address the tax challenges of the digital economy
- **ACTION 2** - Neutralize the effects of hybrid mismatch arrangements
- **ACTION 3** - Strengthen CFC rules
- **ACTION 4** - Limit base erosion via interest deductions and other financial payments
- **ACTION 5** - Counter harmful tax practices more effectively, taking into account transparency and substance
- **ACTION 6** - Prevent treaty abuse
- **ACTION 7** - Prevent the artificial avoidance of PE status
- **ACTIONS 8, 9, 10** - Assure that transfer pricing outcomes are in line with value creation:
 - **ACTION 8** – Intangibles
 - **ACTION 9** – Risks and capital
 - **ACTION 10** – Other high-risk transactions
- **ACTION 11** - Establish methodologies to collect and analyze data on BEPS and the actions to address it
- **ACTION 12** - Require taxpayers to disclose their aggressive tax planning arrangements
- **ACTION 13** - Re-examine transfer pricing documentation
- **ACTION 14** - Make dispute resolution mechanisms more effective
- **ACTION 15** - Develop a multilateral instrument

BEPS Applicability to Various Countries

United States

- Proposed Revisions to the U.S. Model Income Tax Convention
- Treasury proposes to deny treaty benefits for interest, royalties, or other income that benefit from a "special" tax regime in the recipient's country of residence
- Defined as any legislation, regulation, or administrative practice (such as a tax ruling that provides a preferential effective rate of tax to the tested income, including reductions in tax rate or tax base, unless an exception applies)
- Restriction is aimed at related-party income that is deductible in one country and taxed at preferential effective tax rates in the other country

Exceptions would include:

- Tax regimes that do not disproportionately benefit interest, royalties, or other income
- Regimes regarding royalties that satisfy a substantial activity requirement
- Regimes that implement the principles of the treaty's business profits or associated enterprises article (e.g., Advance Pricing Agreements)
- Certain nonprofit exemptions; certain pension and retirement benefit exemptions
- Regimes aimed at certain collective investment vehicles, and any regime designated by an agreement of the Contracting States

BEPS Applicability to Various Countries

Luxembourg

- Action 5 - Introduced on 29 October 2015 e-filing procedures for corporate income tax returns optional for 2016, becoming mandatory from 2017
- Action 8-10 - from 1 January 2015, all companies must maintain all documentation supporting arm's length remuneration for transactions between related parties. If not done, the arm's length determination will be performed by Luxembourg tax authorities
- Action 5 - Draft bills repeal current IP regime from 1 July 2016 for corporate income tax purposes. For net wealth tax purposes the IP regime is abolished on 1 January 2017.
- Action 2 - 10 July 2015, Government's Council approved implementation of anti-hybrid rules in Luxembourg Income Tax law. A distribution from a subsidiary ('participation') will no longer be exempt in Luxembourg, if tax deductible in another EU member state
- Action 2 - U.S. branch of a head office in Luxembourg (LuxCo's), and the U.S. branch of LLCs in which LuxCo's hold a share interest may need to be replaced in case double non-taxation occurs, i.e. the branch is recognized as a permanent establishment ("PE") in the U.S. for Luxembourg tax purposes, but it does not qualify as a "U.S. trade or business" from a U.S. tax perspective. If US modifies its tax treaty with Luxembourg on this issue, these changes may apply from 1 January 2016 or 1 January 2017

BEPS Applicability to Various Countries

Netherlands

- Action 2 – Intends to reach agreement soon on guidance and explanatory notes on hybrid PE mismatches, in situations involving third countries
- Action 12 - Developing EU guidance for implementing disclosure of aggressive tax planning, with a view to facilitate exchange of such information between tax authorities
- Actions 8 to 10 - will start developing transfer pricing guidance on the interpretation of harmful measures (granting of tax advantages even in the absence of any real economic activity), to align transfer pricing outcomes with value creation

Germany

- Action 12 – 2014 bill introduced to disclose aggressive tax planning – not yet law
- Action 13 – Transfer pricing legislation passed – expected to become law during 2016
- Action 13 – Legislation passed to make mandatory automatic exchange of information in the field of taxation - expected to become law by end of 2016

- *Digital nexus or PE – Location of servers*
- *VAT – digital sales*
- *withholding tax, or excise taxes*
- *Operating structure and digital companies*

Data Centers (Servers) – Location and Potential PE Issues

- **Issue**
- Servers should be located outside US, to avoid global income becoming subject to US taxation
- US should NOT own the off-shore servers, or it will have PE in the local countries
- Ownership of data servers in various countries can create Permanent Establishment (PE) – as a “fixed place” branch of US in those countries
- Results in US having local taxable income attributed to it, from these branch countries
- PE usually depends on if the country uses “Agency” principle, or interprets “OECD guidelines”
- OECD - “A place where computer equipment, such as a server, is located may in certain circumstances constitute a PE, if the functions performed at that place go beyond what is preparatory or auxiliary”
- **Suggestions to Avoid PE – If servers are needed by US**
- Have servers owned by foreign affiliate, to avoid in-country servers creating PE, and then have a cost-plus charge-out by foreign affiliate, as provision of services for these servers to the US

PE – Servers – Example of Rules in Various Countries

Germany

- **Creates PE** - Based on latest German tax rules and OECD guidelines
- However, there are no high court decisions yet as to if servers would be treated as PE
- If Germany, suggest implementing a cost-plus agreement with German service provider

Ireland

- **Possible PE** – if Ireland strictly interprets OECD rules, rather than domestic Agency rules
- Irish domestic rules - Mere activity through server does not constitute branch or agency
- Irish Revenue - Not yet given guidance if mere presence of servers in Ireland creates PE
- OECD – “A place where computer equipment, such as a server, is located may in certain circumstances constitute a PE, if the functions performed at that place go beyond what is preparatory or auxiliary”

PE – Servers – Example of Rules in Various Countries

UK

- **NOT a PE** - Existence of servers alone in UK does not create PE
- Per HMRC interpretation of the OECD model treaty (definition of a fixed place of business PE), a server “does NOT fit well with the examples of what constitutes a PE”
- HMRC is clear in its view that just a server, or a server in combination with websites, cannot constitute a PE, if a server was only part of the presence that an overseas company had in the UK
- Does not dismiss the possibility that servers, in combination with other assets and activities in UK could create PE

Netherlands

- **Creates PE** – unless server operations are restricted to “preparatory or auxiliary activities”
- PE exists - if the functions performed by the servers are an essential and significant part of the business activity of the enterprise as a whole; or
- If the core functions of the company are carried on through the servers
- Examples – sales or customer order fulfilment carried on by the servers

- Evolving international VAT/GST guidelines to clarify VAT/GST application to digital transactions (BEPS Action 1) to provide guidelines on the place of taxation for B2C supplies of services and intangibles:
- General rule - most B2C services should be taxed using the 'destination principle'. This approach uses the customer's usual residence as the best proxy for identifying the place of consumption, and is consistent with the OECD's Guidelines on B2B supplies of services and intangibles (services)
- 'On the spot' services - because the general rule may not be useful here, they should generally be taxed where the services are actually performed. This would apply where such services:
 - are physically performed at a readily identifiable location
 - are ordinarily consumed at the same time as, and at the same place where, they are physically performed
 - ordinarily require the physical presence of both the provider and the consumer at the same time and place
- Specific rules - certain transactions will not fit either the proposed general rule or the rule for on-the-spot services. The OECD proposes a two-step procedure for developing specific rules for such transactions.
- Procedure would involve testing whether the relevant general rule would not lead to an appropriate result and the proposed specific rule would lead to a significantly better result
- Immovable and movable property services - the draft suggests some rules for real estate-related services and movable property services

Withholding Taxes on Digital Goods

- Transaction subject to withholding tax?
- Depends on characterization of transaction and receiving country
- Character - sale of digital goods and services, or IP license?
- Japan and Korea – SAAS treated as IP license – taxed as royalty
- Creates withholding tax of 20% or more, unless reduced by treaty
- Other countries – depends if transaction treated as services or royalty
- If services, almost uniformly not subject to withholding tax on sale

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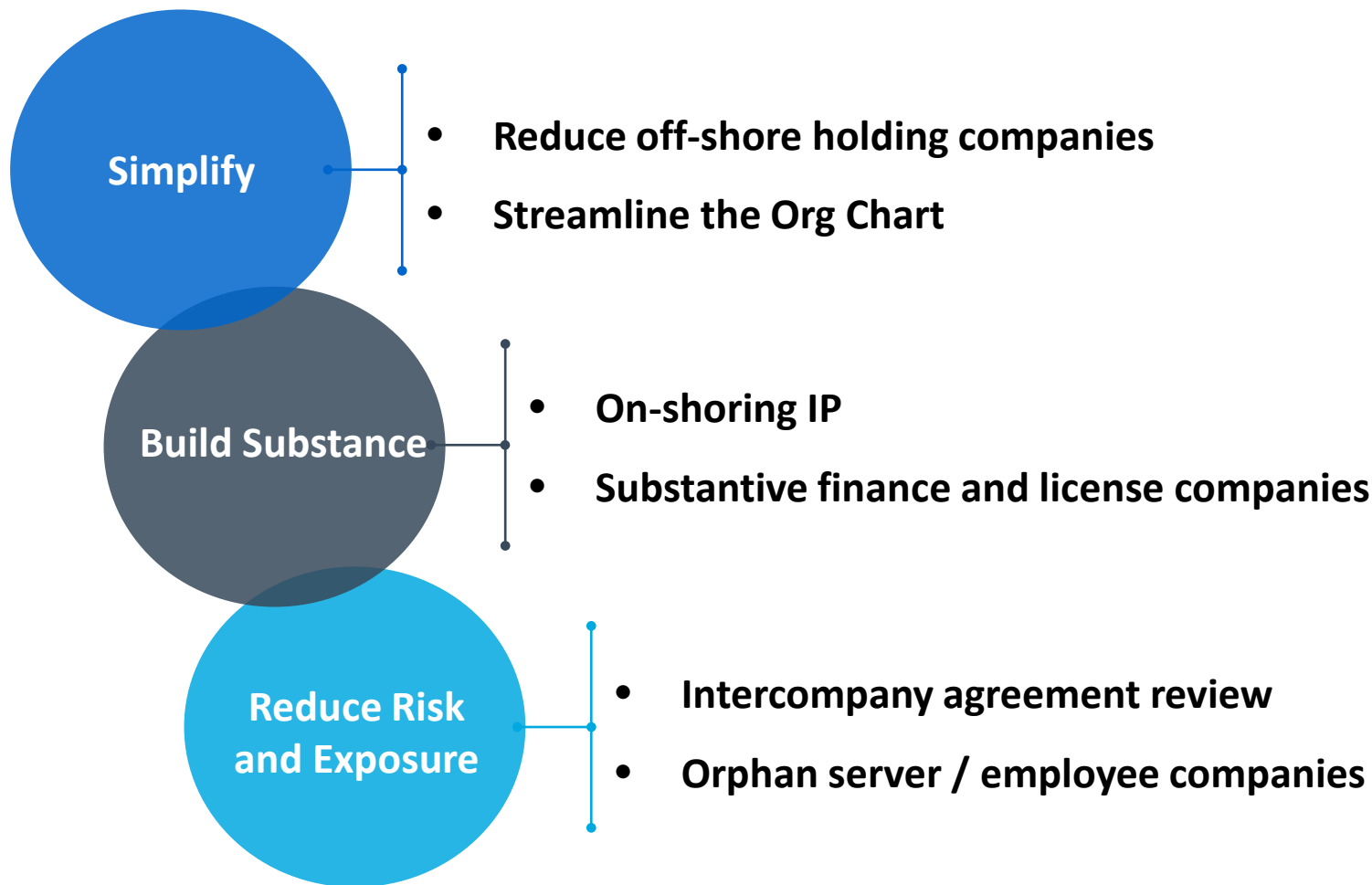
Memberships

American Institute of
Certified Public
Accountants (AICPA)

California Society of
Certified Public
Accountants (CalCPA)

- Partner-In-Charge, Armanino's International Tax Practice
- 23 years of tax and accounting experience
- 14 years at Deloitte & Touche LLP – International Tax Partner
- He specialized in international tax structuring, cross-boarder transactions, transfer pricing, M&A integration.
- Expertise in servicing internet, software, computer hardware and IT services industries
- Jon has a vast international network built on years of experience working with professionals around the world
- Helping technology companies successfully expand their operations worldwide
- Bachelor of Science and Master's in Taxation from Brigham Young University

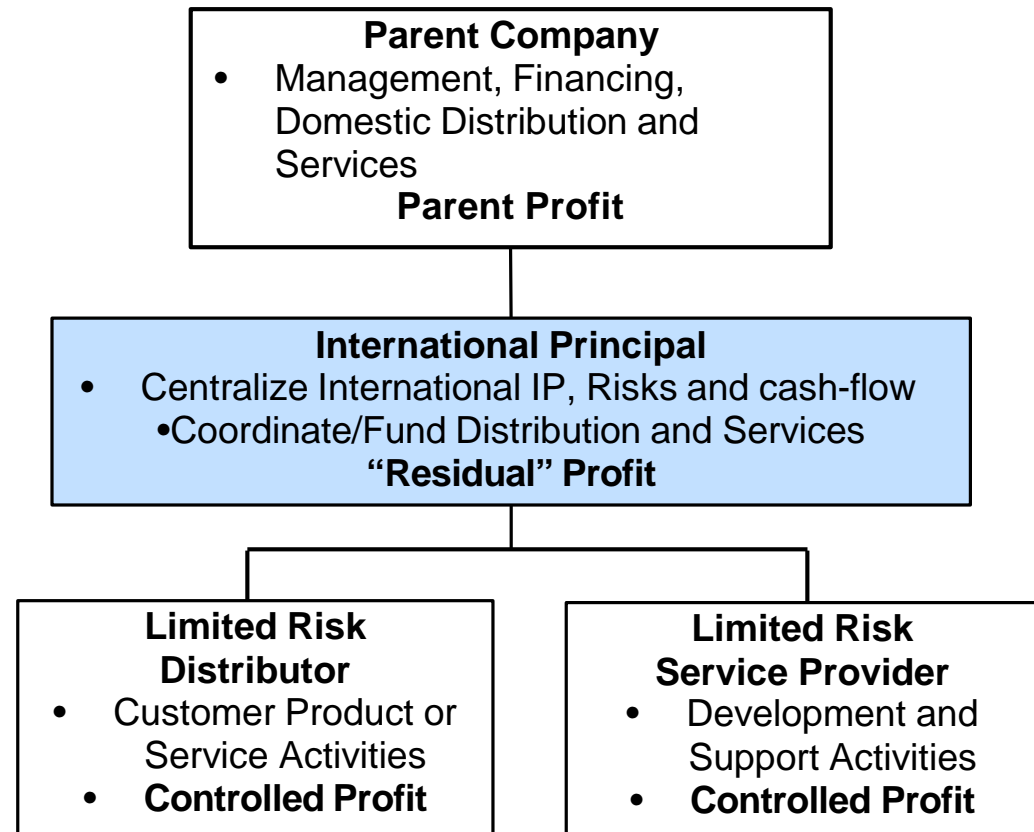
BEPS Inspired Actions on Global Business - Selected Examples



IMPACTS ON GLOBAL BUSINESS

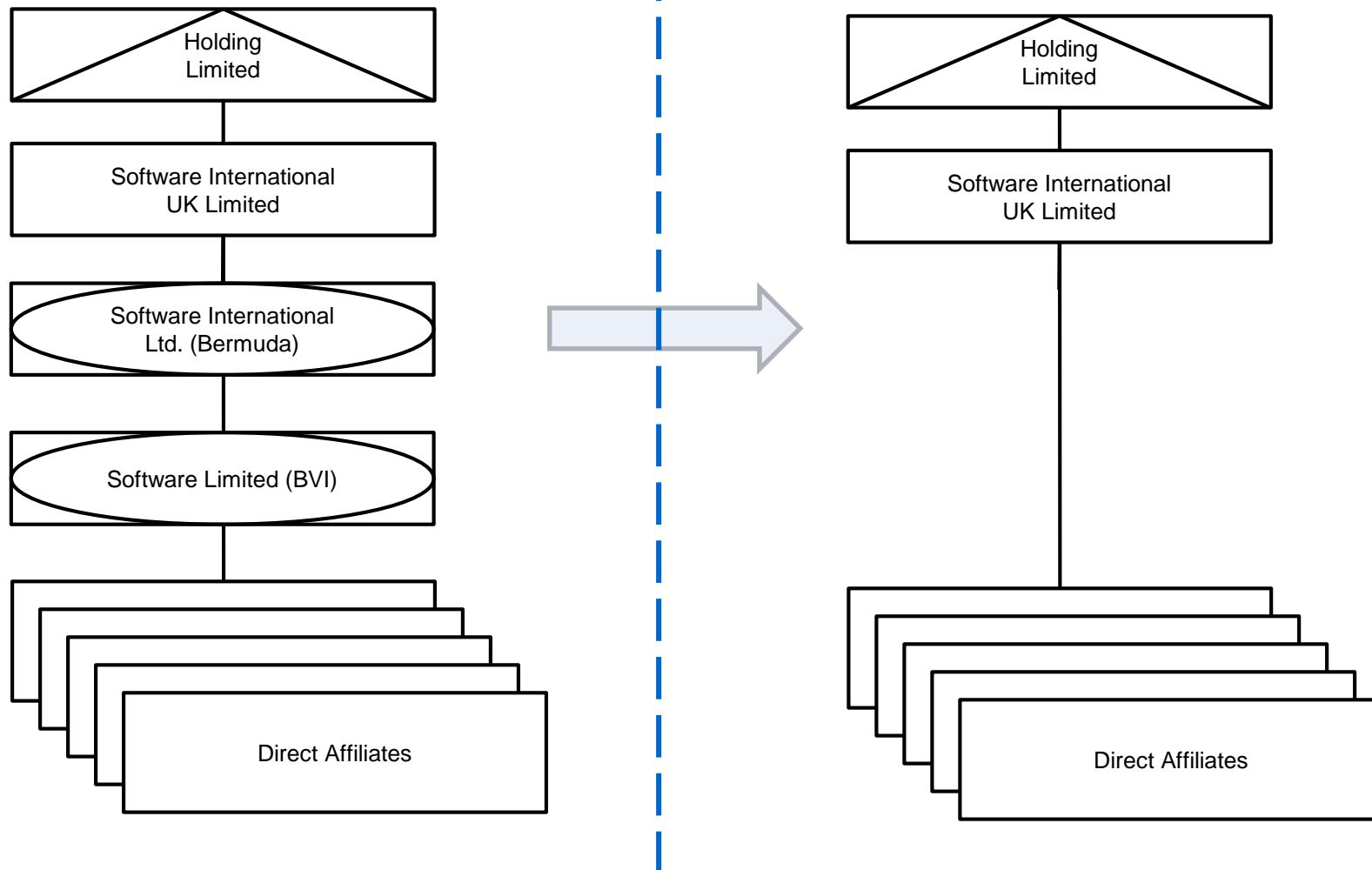
Basics of International Structure

- Structure
- Intangible Property
- Principal company
- Local Sales and Service

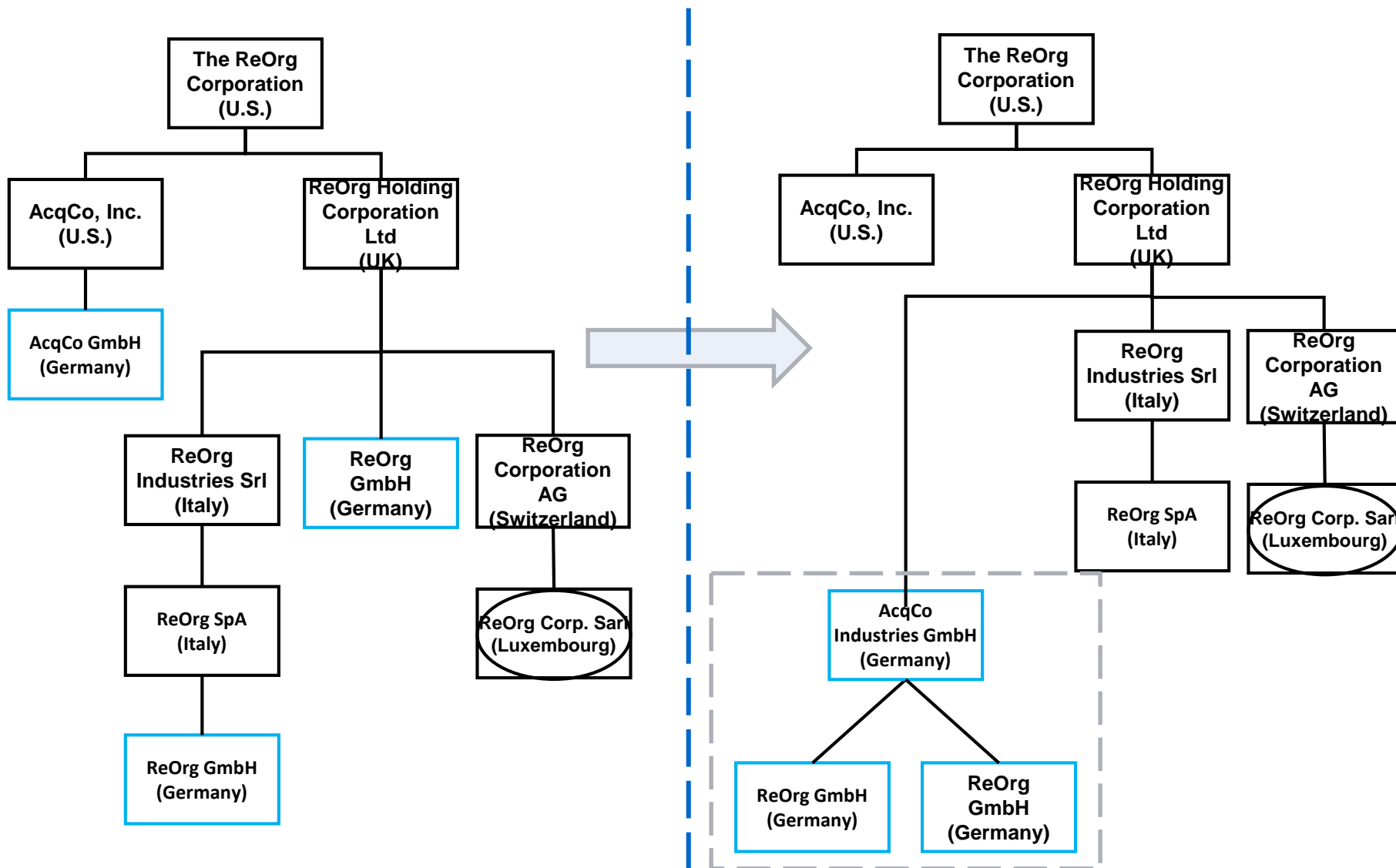


“Global Tax Rate Makers,” JP Morgan (May 2012)

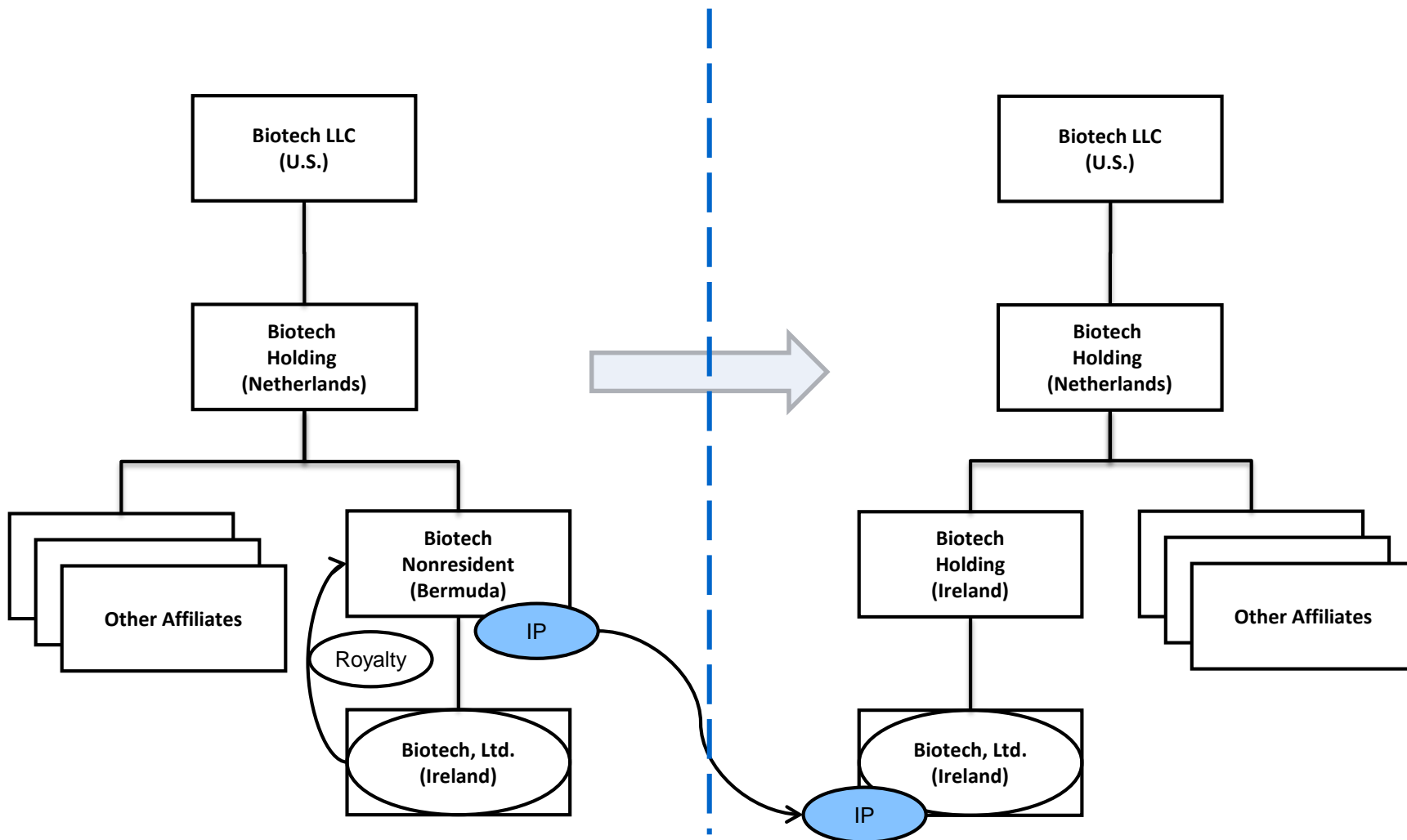
SIMPLIFY: Reduce Offshore Holding Companies



SIMPLIFY: Streamline Org Chart

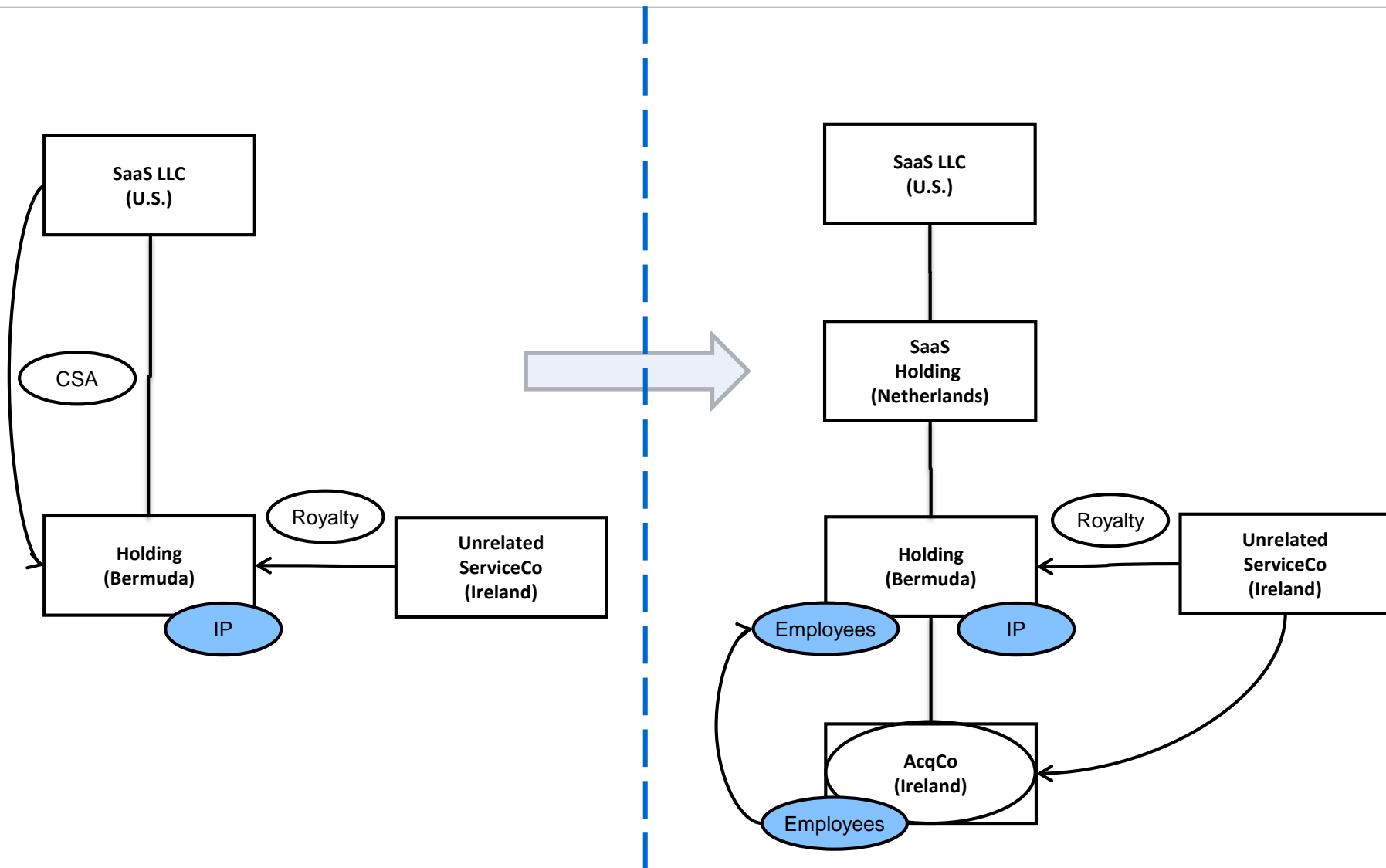


BUILDING SUBSTANCE: On-Shoring IP



BUILDING SUBSTANCE :

License company



REDUCE RISK and EXPOSURE

Intercompany Agreement Review



Objectives

Assess consistency / completeness of:

- Intercompany agreements and
- Transfer pricing policies and reports, with
- Accounting for internal transactions, and
- Cross border operations

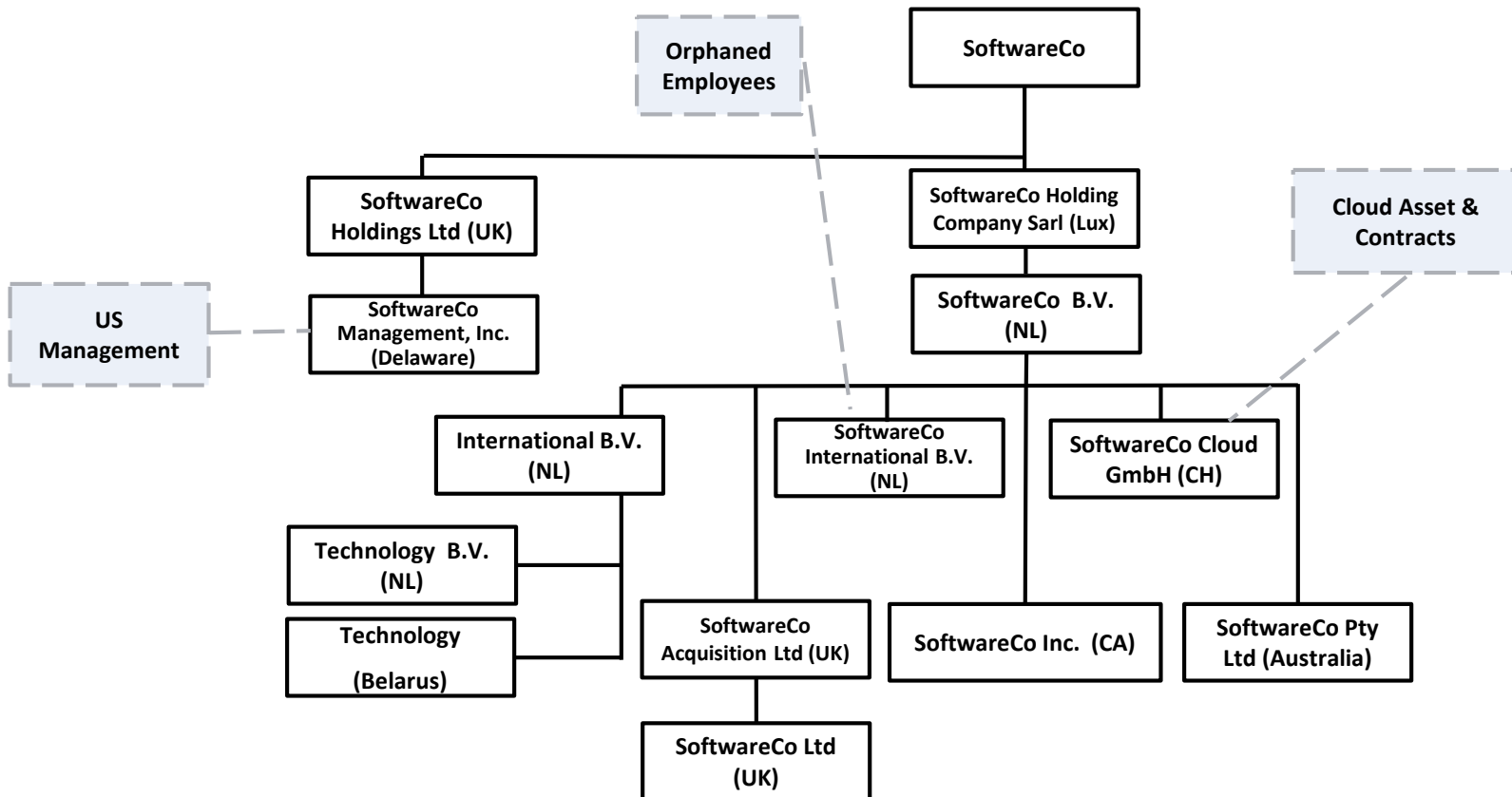
Benefits

- Improved corporate governance / compliance
- Tax authority readiness and reduction of audit adjustments
- Confirm conformity with transfer pricing reports
- Avoid undetected financial statement implications
- Reduce exposure to IP related conflicts
- Support tax planning objectives and integrate of future acquisitions

From	To	Method	Base	Factor
Intangible Property License:				
International	Principal	Royalty	Revenues	%
US	Principal	Royalty	Revenues	%
Engineering Development Services:				
Russia	Principal	Cost +	Costs	%
US	Principal	Cost Share	Costs	%
Sales & Marketing Support Services:				
LRD 1	Principal	Cost +	Costs (1)	8%
LRD 2	Principal	Cost +	Costs (2)	5%

REDUCE RISK and EXPOSURE

Orphan server / employee companies



- Michael Hardgrove has provided international tax consulting, legal entity structuring, cross-border reorganization and intangible property transaction services to numerous public and private companies with operations throughout the world.
- His practice focuses on optimizing the potential benefits of international structures and business operations, including assessing international tax exposures, recommending efficient strategies, and executing the legal steps required to meet the primary objectives of minimizing costs, lowering tax rates and improving cash flows.
- Michael's proactive approach and unique international tax and legal practice has often been recognized for its consistent abilities in identifying cash saving opportunities, providing strategic planning, advocating defensible positions and advising on alternative approaches to manage international tax, legal and business matters.
- Beyond his own expertise on international tax and structuring matters, he manages, supervises and oversees a team of DLA Piper's top lawyers, economists and tax professionals, in order to consistently deliver on international tax and structuring objectives. This team has the proven capability to address the full range of inter-related tax and legal issues relevant to complex international transactions, by utilizing lawyers with significant experience in specific areas of tax law as well as providing global solutions with coordinated advice across all relevant jurisdictions, including these specific areas:
 - Foreign Group Entity structuring services
 - Legal Agreement Drafting and Reviewing of Intercompany Transactions and Execution
 - International Transaction Execution, Global Resources and Legal Services
 - Global Alignment and Integration
 - Regional principal trading company implementation and supply chain conversion legal services
 - Tax Advocacy
 - Structuring for Tax Efficient international Expansion and company Value



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Education

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