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Base Erosion and Profit Shifting (BEPS)

The Organisation for Economic Cooperation and Development (OECD) issued the final package of reports concerning the Action Plan on Base Erosion and Profit Shifting (BEPS) on 5 October 2015. A joint OECD and G20 initiative triggered the preparation of the package in 2013. Over a two year period the OECD succeeded in identifying 15 key areas and providing guidance on how to detect aggressive tax planning and to restrict it using international tax system tools.

1. OECD

Unification of national regulations

Generally, the OECD recommends the unification of national regulations. The aim is to eliminate differences in dealing with the same case in various countries.

a) Hybrid structures

Countries should strive to implement or amend national legislation to avoid situations in which different classifications of income under different national legal systems provide the tax benefit of the non-taxation of such income in both countries. It is foreseen that countries shall fully implement the proposed regulations. Such regulations will probably be introduced according to which certain types of income shall be exempt from taxation in the country where the taxpayer is domiciled if these payments are non-taxable in the country where the income is generated.

b) CFC ("Controlled Foreign Company")

CFC regulations aim at the restriction of tax optimisation through subsidiaries established in tax havens.

c) Financing – tax deductibility of interests

Currently, the tax deductibility of interests is governed by thin capitalisation regulations. For the future, the OECD recommends that the EBITDA to net interest ratio is applied. 10 – 30 % should serve as the limit for tax deductibility; interest exceeding this limit should be non-tax deductible. All interest paid should be now included in the test of tax deductibility regardless of who has provided the loan or credit.

d) Abuse of tax havens

Generally, countries should strive to identify harmful tax practices that are abused by multinational corporations. The establishment of so-called IP Boxes in tax havens can be cited as an example. IP Boxes are used by companies to allocate intangible assets, in particular trademarks, and income related thereto.

Taxation of profits in the country of origin

The OECD has introduced a simple regulation – companies should pay taxes where they generate profits. The aim is to avoid the unjustified taxation of profits in a country other than that in which the profits were achieved, with the justification based on any Article of Double Taxation Treaties in force.

a) Abuse of Double Taxation Treaties

The OECD suggests restricting practices involving transferring profits through an intermediary domiciled in a country where the intermediary has a tax benefit from the relevant type of income. In order to achieve this goal, the OECD suggests 2 methods for determining the place of taxation:

- Principal Purpose Test – assessment of the very nature of the transaction;
- Limitation of Benefits – identification of the actual recipient of payments.

b) Avoidance of permanent establishment status

The limitation of the possibilities used to artificially avoid the obligation to register a permanent establishment and tax profits attributable to such a PE shall be a future concern. One typical example is fragmenting contracts in order not to exceed the holding period. Dividing contracts among several entities should no longer be possible. Also the definition of a dependent agent should be specified. Henceforth, a person will be considered a dependent agent even if they significantly contribute to the conclusion of the contract although they do not enter into the contract themselves on behalf of the represented company.

Václavské nám. 40, 110 00 Praha 1

Fax: +420 221 111 788

Tel.: +420 221 111 777

E-mail: info@alferypartner.com

www.alferypartner.com



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c) Transfer Pricing

The trend of previous years shall continue in the area of transfer pricing. Henceforth, greater emphasis should be placed on the taxation of profits in the country where the profits were generated. This BEPS part provides guidelines on how profits from intangible assets should be attributed to the beneficial owner instead of entities domiciled in tax havens.

At the same time, it is laid down that risks should be attributed to the entity by which such risks are managed. This principle is in line with the approach of the Czech tax administration which focuses on verifying the transfer pricing methodology in order that it respects the actual extent of functions and risks borne by the respective taxable entity.

In this context, the OECD Transfer Pricing Guidelines have been revised. Among other things, a simplified procedure for services with a low value added has been incorporated into the Guidelines. In the case of these services, a uniform mark-up amounting to 5 % may be applied.

Transparency

a) Digital economy

In BEPS, the OECD reflects the phenomenon of the digital economy. In fact, the digital economy presents a risk for the identification of the place of taxation by enabling the taxation of profits outside the actual place of business. The same applies to indirect taxes (VAT). It is therefore necessary to take account of changes in the definition of a permanent establishment which shall respond to the existence and expansion of the digital economy. Specific recommendations and adaptation of the terminology in connection with digital economy can be expected in 2020.

b) Aggressive Tax Planning

Within BEPS, the OECD warns of aggressive tax planning and encourages its detection and prevention. At the same time, it introduces the obligation to notify any suspected aggressive planning. However, the specific regulation of this obligation should remain at the discretion of the individual country.

c) Transfer Pricing Documentation

So far, the OECD has taken a "two-stage" stance as regards transfer pricing documentation: it should contain the master file and the local file. The OECD now suggests adding a third stage, namely Country by Country Reporting (CBCR). According to this principle, the parent companies of international corporations with a turnover exceeding 750 million EUR each year should provide their tax administrations with a CBCR containing information on the profit achieved and tax paid in the particular countries. The competent tax administration automatically forwards this information to the other jurisdictions.

For the first time, CBCR should be submitted for the year 2016, by the end of 2017 at the latest. The competent tax administration should then provide this information to the other jurisdictions by mid-2018. The obligation to submit CBCR and forward the relevant information would also apply to the Czech Republic.

d) Dispute settlement

The OECD calls on countries to settle disputes more efficiently by mutual agreement.

2. The European Union and BEPS

In 2015 the European Commission started to incorporate into European legislation the recommendations and principles defined by the BEPS Action Plan. The European Union will gradually prepare legislative measures for the coordinated implementation of particular BEPS regulations into national legal systems.

In late January 2016 the European Commission published a package of measures called Anti-BEPS. This package includes recommendations for the coordination of EU member states in the following areas:

- Legally binding measures for detecting and preventing aggressive methods of tax planning,
- Recommendations regarding regulation of Double Taxation Treaties in order to avoid using them for aggressive tax planning,
- Introducing reports on selected information (so-called Country-by-Country Reporting).



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In January 2016 the European Commission also announced that it would return to the project of the Common Consolidated Corporate Tax Base (CCCTB). The European Commission intends to continue to encourage member states' cooperation in introducing the financial transaction tax.

Taking into account the experience in neighbouring countries, we can expect that Czech regulations relating to BEPS will be tightened in the immediate future. The update of transfer pricing legislation will certainly be one of the first areas to be involved. Whilst under Czech legislation entities are obliged to draw up a study and to document transfer pricing upon the request of the tax administration, some countries have already introduced the obligation to maintain the documentation on an ongoing basis and to submit, upon request, such documentation to the tax administration within a relatively short period of time.

Furthermore, it should be noted that specific tools and methods for the implementation of further BEPS objectives should be established in 2016. You should therefore consider BEPS regulations in planning future international cash flows and to adapt your group strategy accordingly.

Václavské nám. 40, 110 00 Praha 1

Fax: +420 221 111 788

Tel.: +420 221 111 777

E-mail: info@alferypartner.com

www.alferypartner.com

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