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# **EOI & Tax Transparency**

## **A BEPS PERSPECTIVE**

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# We wish to discuss

- **Exchange of Information: Evolution & Existing Framework**
- **BEPS & Exchange of Information**
  - Fiscally Transparent Entities
  - EOI & Collective Investment Vehicles (CIV)
  - Beneficial Ownership
  - PPT
  - Capital Gains from Shares driving Value from Immov Property
  - Anti Abuse Rule for PE in Ill Jurisdiction
  - Closely Related Entity
  - Domestic Anti Abuse Laws (GAAR, POEM, CFC)
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- **BEPS & New Challenges**
- **How BEPS may impact Information Exchange Regimes**
- **Discussion & Comments**

# EOI: Evolution

- Article 26 (EOI) has existed in the MTCs since their inception
- PURPOSE & SCOPE
  - OECD MTC 1963 : “...shall exchange such information as is **necessary** for the carryig out of this Convention and of the domestic laws...concerning taxes covered by this Convention...”
  - 2000 Update : “...concerning **taxes of every kind and description**...”
  - 2005 Update : “....shall exchange such information as is **foreseeably relevant** for carryig out of this Convention or to the administration or enforcement of the the domestic laws ... concerning taxes of every kind and description... imposed on behalf of the Contracting States or of their **political subdivisions or local authorities**...”
- 2005 Update: Para 4 added → Obligation to **Collect** and supply information  
Para 5 added → Overruled Banking Secrecy & Fiduciary Relationship privileges

*Long Standing Concept; Enlarging Scope ?*

# EOI: Existing Framework

- Exchange under bilateral DTAA's (all taxes)
- Exchange under bilateral TIEAs (limited usually to direct taxes)
- Multilateral Convention on Mutual Administrative Assistance in Tax Matters (124 signatories)
- CRS Multilateral Competent Authority Agreement (for Spontaneous/Automatic) (100+ signatories)
- Country by Country (CbC) Reporting

## Multilateral Convention

*Article 2(1)(a) : Taxes on income or profits / capital gains / net wealth*

*Article 2(1)(b) – reservations possible (uncommon)*

*Taxes imposed by political sub-divisions or local authorities / Social security contributions / other taxes (except customs) including estate, inheritance or gift taxes, taxes on immovable property, general consumption taxes (VAT/Sales Tax/GST/Excise tax), Motor Vehicle Tax, Taxes on Movable Property*

*Long Standing Concept; Enlarging Scope ?*

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# EOI: Fiscally Transparent Entities

- OECD Report on Partnerships (1992) noted :
  - Not clear whether partnership is a “person” under the MTC
  - Fiscally Transparent Partnership “Not Liable” → Not RESIDENT
  - Treaty benefit may be given to partners, but can be withheld if information is not readily available
- Article 1 of MTCs amended in 2017 to incorporate treaty benefits for fiscally transparent partnerships
- Article 3 of MLI applies this to CTAs

## Para 5 of OECD Commentary on Art 1

*...States should not be expected to grant the benefits of a bilateral tax convention in cases where they cannot verify whether a person is truly entitled to these benefits. Thus, if an entity is established in a jurisdiction from which a Contracting State cannot obtain tax information, that State would need to be provided with all the necessary information in order to be able to grant the benefits of the Convention. In such a case, the Contracting State might well decide to use the refund mechanism for the purposes of applying the benefits of the Convention even though it normally applies these benefits at the time of the payment of the relevant income.*

*Eol essential for granting treaty benefits to fiscally transparent entities?*

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# EOI: Collective Investment Vehicles

- **The issues related to treaty benefits to the CIVs:**
  - Extent of benefit – limited to income in hands of resident beneficiaries
  - Information regarding beneficiaries and its verification a crucial concern for according treaty benefits to CIVs
  - Should CIVs be considered a “Qualified Resident” for the purpose of Limitation of Benefit rule?
  - Is it practical to expect CIV to have complete, detailed and updated information regarding its beneficiaries
  - Application of “Equivalent beneficiary” concept to CIV → Not unless effective Eol available and practicable

*(Para 23-48 of OECD Commentary on Art 1 & Para 55-67 of Commentary on Article 29)*

*...Because ownership of interests in CIVs changes regularly, and such interests frequently are held through intermediaries, the CIV and its managers often do not themselves know the names and treaty status of the beneficial owners of interests. It would be impractical for the CIV to collect such information from the relevant intermediaries on a daily basis. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily tracing of the Convention even though it normally applies these benefits at the time of the payment of the relevant income.*

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# EOI: Closely Related Person

Para 8 of Article 5(PE) in OECD MTC (2017)

*For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises.*

*In any case, a person or enterprise shall be considered to be closely related to an enterprise if*

*one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares **or of the beneficial equity interest in the company**)*

*or if another person or enterprise **possesses directly or indirectly more than 50 per cent of the beneficial interest** (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares **or of the beneficial equity interest in the company**) in the person and the enterprise or in the two enterprises.*

*Potential for satisfying the condition of “foreseeably relevant” for seeking information ?*

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# EOI: Domestic Anti Abuse Laws

*Request can be made if foreseeably relevant for*

- *Carrying out provisions of DTAA*
- *Administration/Enforcement of domestic laws*

*Administration/Enforcement of domestic laws*

- *In all new (after 2009) or modified treaties and also in Multilateral Convention and SAARC Agreement*
- *Can be used to receive information purely for the purposes of tackling domestic tax evasion*
- *Most useful for normal assessment charges also*
- *GAAR*
- *POEM*

*Potential for satisfying the condition of “foreseeably relevant” for seeking information ?*

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# BEPS Action 5: Tax Transparency

## Action 5: Mandate

***Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.***

*It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework*

# BEPS Action 5: Tax Transparency

## Substantial Activity Requirement

- ❑ **Substantial activity** requirement to assess preferential regimes - to realign taxation of profits with the substantial activities that generate them.
- ❑ Based on “**NEXUS APPROACH**” developed for IP regimes
  - Taxpayer allowed to benefit only to the extent that it incurred qualifying research and development (R&D) expenditures for developing IP
  - Uses **expenditure as a proxy for activity**
- ❑ Same principle can also be applied to other preferential regimes requiring substantial activities for grant of benefits to taxpayer
- ❑ **Benefits limited to the extent** that the taxpayer undertook the core income-generating activities required to produce the type of income covered by the preferential regime.

# BEPS Action 5: Tax Transparency

- ❑ Compulsory spontaneous exchange of six categories of rulings:
  - (i) Rulings related to preferential regimes;
  - (ii) Cross border unilateral advance pricing arrangements (APAs) or other unilateral TP Rulings;
  - (iii) Rulings giving a downward adjustment to profits;
  - (iv) Permanent establishment (PE) Rulings;
  - (v) Conduit Rulings;
  - (vi) Ruling where FHTP concludes that absence of exchange would give rise to BEPS
- ❑ From 1 April 2016 → All Future rulings
- ❑ Exchange of certain past rulings carried on till 31 December 2016.
- ❑ Final Report on Action 5 sets out best practices for cross-border rulings.

# BEPS Action 5: Tax Transparency

## Review of preferential regimes

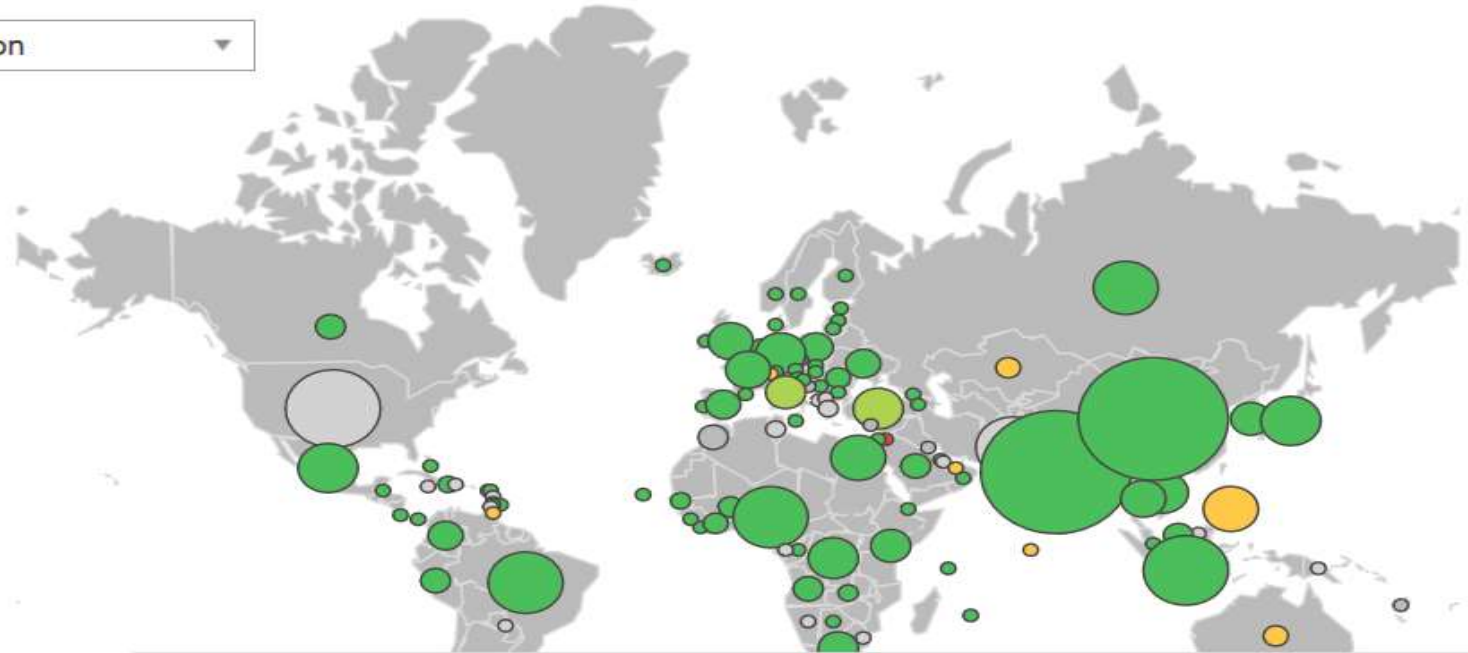
- ❑ During Action 5 Work, 43 preferential regimes reviewed, 16 were IP regimes.
  - *In respect of substantial activity all IP regimes reviewed were inconsistent, either in whole or in part, with the “Nexus Approach”*
  - *Subsequently, countries with such regimes proceeded with a review of possible amendments of the relevant features of their regimes.*
- ❑ The FHTP’s work on reviewing preferential regimes continues on foll lines:
  - *Assessment to identify features that can facilitate BEPS, & have potential to unfairly impact tax base of other jurisdictions.*
  - Peer review and Monitoring of the Action 5 Transparency Framework through Compulsory Spontaneous Exchange of relevant information on Taxpayer-specific Rulings which, in the absence of such information exchange, could give rise to BEPS concerns
  - Review of Substantial Activities requirements in No or only Nominal tax jurisdictions to ensure a level playing field.

*Deterrence ?*

# BEPS Action 5: Tax Transparency

Review of preferential regimes

on ▼



## Existence of any harmful tax practices (Action 5) ⓘ

● = not harmful

● = not harmful (except for transitional issue which is harmful)

● = in the process of being amended/eliminated

● = actually harmful

● = under review/review scheduled

Click on a jurisdiction to access a detailed summary.







*Deterrence ?*

# BEPS Action 5: Tax Transparency

- ❑ Nov' 2018: A **New Substantial Activity Standard for No or Nominal Tax Regimes**:
  - *Applicable to jurisdictions with No or only Nominal Taxes*
  - *Requires that for certain highly mobile sectors of business activity, the core **income generating activities** must be conducted with **qualified employees** and **operating expenditure** in the jurisdiction.*
  - *Introduced through Consensus at FHTP & with Approval of Inclusive Framework*
  - *One of the purposes to ensure a level playing field between the other jurisdictions, which have or are in the process of amending their preferential tax regimes and the No or Only Nominal Tax Regimes (where tax benefit may be equivalent to the preferential tax regimes)*
  - *Of the 12 No or Only Nominal Tax Regimes assessed, 11 found in compliance with the accepted standards. Only one (UAE) in the process of making changes*



# Application of substance requirements for IP Income

Lower risk scenarios				Higher risk scenarios (i.e. involvement of foreign related parties)			
<b>1. IP assets (e.g. patents)</b> <i>Substantial activity = R&amp;D</i>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A.</b> Business type, gross income, expenses and assets, premises, employees, proof of core income generating activities, etc.		<b>1. IP assets (e.g. patents)</b> <i>Substantial activity = R&amp;D</i>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A.</b> Business type, gross income, expenses and assets, premises, employees, proof of core income generating activities, etc.	
<b>2. Marketing assets (e.g. trademarks)</b> <i>Substantial activity = branding and marketing</i>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A.</b> Business type, gross income, expenses and assets, premises, employees, proof of core income generating activities, etc.		<b>2. Marketing assets (e.g. trademarks)</b> <i>Substantial activity = branding and marketing</i>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A.</b> Business type, gross income, expenses and assets, premises, employees, proof of core income generating activities, etc.	
<b>3. Other Core Income Generating Activities (CIGA)</b> <i>Substantial activity = Strategic decision-making, managing and bearing principal risks, underlying trading activities, etc.</i>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A.</b> Business type, gross income, expenses and assets, premises, employees, proof of core income generating activities, etc.		<b>3. Other Core Income Generating Activities (CIGA)</b> <i>Substantial activity =</i> <ul style="list-style-type: none"> <li>• High degree of DEMPE; &amp;</li> <li>• Historical DEMPE; &amp;</li> <li>• Full time highly skilled employees that permanently reside and perform CIGA in the jurisdiction</li> </ul>	Necessary staff, premises, equipment, expenditure, decision-making etc.	<b>Filing information</b> <b>Type A</b> information PLUS <b>Type B</b> information Detailed business plans • Employee information • Proof of decision-making in jurisdiction	

## Scenarios which are not sufficient to meet substance requirements for IP income

4. Merely passively holding the IP asset in the jurisdiction



5. Periodic decisions of non-resident board members



## Jurisdictions with Fully Equipped Monitoring Mechanisms

Scenario requiring exchange	Content of exchange	Recipient jurisdictions
Non-compliance by the entity	<ul style="list-style-type: none"> <li>• Entity name and address</li> <li>• Summary of what elements of the core income generating activities test the entity has failed to meet</li> <li>• Name of the immediate parent, ultimate parent, and ultimate beneficial owner</li> <li>• Type of mobile income</li> <li>• Amount and type of gross income</li> <li>• Amount and type of expenses incurred, and assets and premises held, in the course of carrying out the business</li> <li>• Number of full-time, qualified employees</li> <li>• Any other relevant information.</li> </ul>	Residence jurisdictions of: <ul style="list-style-type: none"> <li>• Immediate parent</li> <li>• Ultimate parent</li> <li>• Ultimate beneficial owner</li> </ul>
In high risk cases (see paragraph 34) that are not also cases of non-compliance by the entity	<p><u>Step 1:</u> annual exchange of:</p> <ul style="list-style-type: none"> <li>• Entity name and address</li> <li>• Type of mobile income</li> <li>• Name of the immediate parent, ultimate parent, and ultimate beneficial owner</li> <li>• Amount and type of gross income (e.g. rents, royalties, dividends, sales, services)</li> </ul> <p><u>Step 2:</u> recipient jurisdiction makes follow up request for further information</p>	Residence jurisdictions of: <ul style="list-style-type: none"> <li>• Immediate parent</li> <li>• Ultimate parent</li> <li>• Ultimate beneficial owner</li> </ul>

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# Changing Eol Regimes

## FATCA & CRS

- *Limitation on Eol on Request : Necessary to Foreseeably Relevant*
- *Broadening Scope of Taxes*
- *Global consensus towards Automatic Exchange of Information (AEOI)*
- *Concerns in USA on Offshore tax evasion (\$100 billion tax revenue loss) led to enactment of FATCA*
- *30% withholding tax on US Source Payments unless FIs enter into agreement with US IRS to provide information about accounts held by them by USA persons of entities controlled by US persons*
- *Reporting of foreign accounts and assets in new Form 8938*
- *Transmission of client confidential information not permitted under domestic laws of concerned countries*
- *Inter Governmental Agreements signed by most jurisdictions*
- *Automatic Exchange of Information – not always fully reciprocal*

*Is Automatic Eol the future regime?*

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## BEPS Concerns

- *Rules that can lead to rise in Eol Requests:*
  - *BEPS Modifications*
  - *Beneficial Ownership*
  - *PPT*
  - *Endorsement of Anti Abuse Rules*
- *Will they lead to more Eol Request workload?*
- *More focussed requests?*
- *Domestic Law Provisions may also precipitate Eol a lot more*
- *Litigation in Courts & its costs?*
- *Can these problems be addressed by expanding Automatic Eol?*
- *Preferential Tax Regimes → Are they undergoing changes?*
- *Would it further push countries to multilateral regimes?*

*Is Automatic Eol the future regime?*

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