



BEPS

How BEPS is changing tax landscape in India

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Agenda

Introduction - BEPS

Equalisation levy & significant economic presence

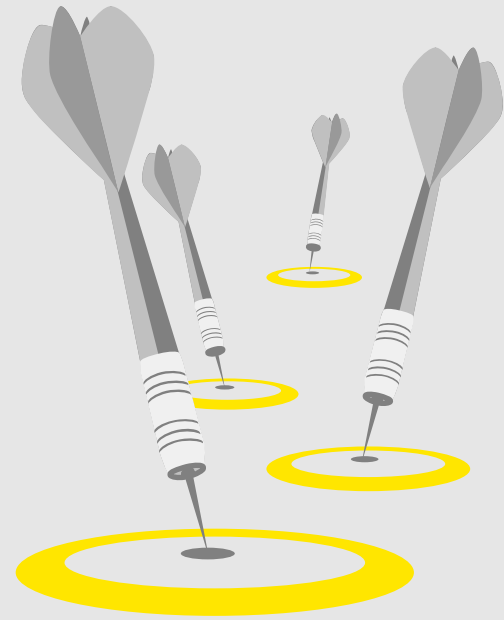
Interest limitations

Prevent artificial avoidance of PE

Master file & Country-by-Country Reporting

Intangibles & Risk & Capital

Other action points

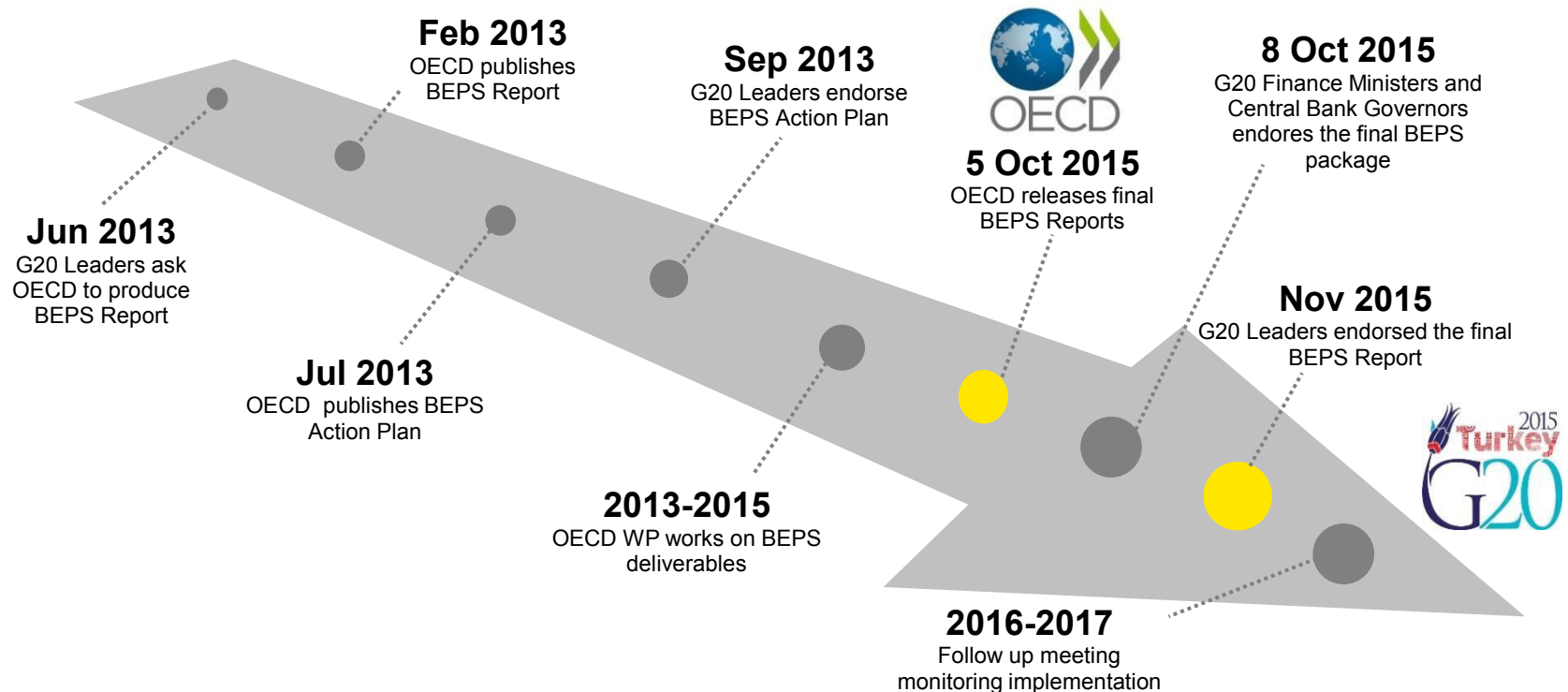




Introduction - Base Erosion and Profit Shifting ('BEPS')

History of BEPS project

- ▶ On 5 October 2015, the OECD issued its 'final' reports on the 15 Action points identified in its Action Plan on BEPS. The reports have been the subject of consultation and the content of the reports is largely in line with expectations.
- ▶ This effort is supported by the G7 and G20 countries, the European Union (EU) has been working in parallel, and developing countries are involved as well.



Three pillars of OECD BEPS framework

Coherence

Harmful or inappropriate use of international tax legislation to obtain unintended tax benefits

Hybrid mismatch arrangements (2)

Controlled foreign company (CFC) rules (3)

Interest deductions (4)

Harmful tax practices (5)

Substance

Mismatches where profits are being taxed vs. where people responsible for generating these profits are located

Preventing tax treaty abuse (6)

Avoidance of permanent establishment status (7)

Transfer pricing (TP): intangibles (8)

TP: risk and capital (9)

TP: high risk transactions (10)

Transparency

Provide tax authorities information to carry out audits better and determine if "fair share" of taxes are being paid

Methodologies and data analysis (11)

Disclosure rules (12)

TP documentation (13)

Dispute resolution (14)

Digital economy (1)

Multilateral instrument (15)

Changes to domestic legislation needed

Clarifies/reinforces existing TP Guidelines

Peer review mechanisms

Changes to bilateral tax treaties needed



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BEPS Action Plan

No.	Action name	Action objective
1	Digital economy	Rework existing tax rules to deal with digital economy. May involve introduction of VAT on digital goods, virtual PE rules, WHT, etc.
2	Hybrid mismatch arrangements	To curb abuse of hybrid instruments/ entities May involve ordering rules to specify primary and defensive rules with respect to the deduction and the exemption
3	CFC rules	Curb tax deferral through parking of profits to low/new tax jurisdictions. May involve identification of best practices and likely a proposal for some form of minimum standard for CFC rules
4	Limit base erosion via interest deductions	Address thin capitalization issues. Group wide approach and fixed ratio approach being evaluated
5	Counter harmful tax practices	Curb tax competition among countries to attract investments e.g., UK Patent Box, Dutch Innovation Box, low/ reduced CTX rates
6	Prevent treaty abuse	Objective of treaty is not to create double non-taxation. May involve introduction of US style LOB or UK style GAAR (principle purpose test) rules
7	Prevent artificial avoidance of PE	Amending PE article in tax treaties to remove exemptions to PE clause and address artificial avoidance arrangements

BEPS Action Plan

No.	Action name	Action objective
8	TP aspects of intangibles	Ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in line with value creation
9	Risks and capital	Substance over form w.r.t. capital contribution or allocation of risks
10	Other high risk transactions	Develop rules to prevent BEPS involving transactions which would not (or would only very rarely) occur between third parties. e.g., intra group services, management fees, etc.
11	Analyze data on BEPS	Analyzing economic impact of actions taken to address BEPS on ongoing basis (taxpayer confidentiality, compliance costs and burdens on taxpayers and tax administrations)
12	Disclosure of aggressive tax planning	Develop mandatory disclosure rules for aggressive or abusive transactions, arrangements or structures
13	Re-examine TP documentation	Introducing three tiered documentation consisting of Master file, Local file and CbC reporting template
14	Dispute resolution	Improving effectiveness of MAP and arbitration provisions
15	Multilateral instrument	Develop multilateral instruments which would be signed by all countries to agree upon common treaty arrangements

BEPS Implementation in India

1

Introduction of Equalization Levy at the rate of 6% on certain digital advertising transactions in 2016 Union Budget. Concept of significant economic presence introduced in 2017 Union budget

4

Introduction of the interest deduction limitation rule in the 2017 Union Budget

5

Introduction of patent box regime in Finance Budget 2016

6

By way of MLI, re-negotiation of tax treaties to ensure greater source based taxation/ prevent treaty abuse

7

Budget 2017 amended business connection definition in line with new Agency PE definition. Amending tax treaties by way of MLI or re-negotiation

8

Tax administration and taxpayers expected to give consideration while applying arm's length principles

13

Introduction of CbCR and MF TP documentation in the 2016 Union Budget

14

Acceptance of MAP/BAPA regardless of Article 9(2), amendment of treaties through MLI

15

On 07 June 2017, India along with 67 other countries signed the MLI to modify existing tax treaties.

**Equalisation levy and
significant economic
presence**



Equalisation Levy (EQL) - Background

Indian Budget 2016:

- ▶ introduce an EQL of 6% on B2B transactions
- ▶ where the payment exceeds INR 100,000
 - ▶ by an Indian resident (& carrying on business or profession)
 - ▶ for specified services
 - ▶ Online¹ advertisements
 - ▶ Provision for digital advertising space
 - ▶ Any other facility or service for the purpose of online advertisement
 - ▶ Any other service as notified
 - ▶ to a **non-resident** (NR)
 - ▶ No EQL if NR service provider has a PE in India; and specified services is effectively connected to such PE

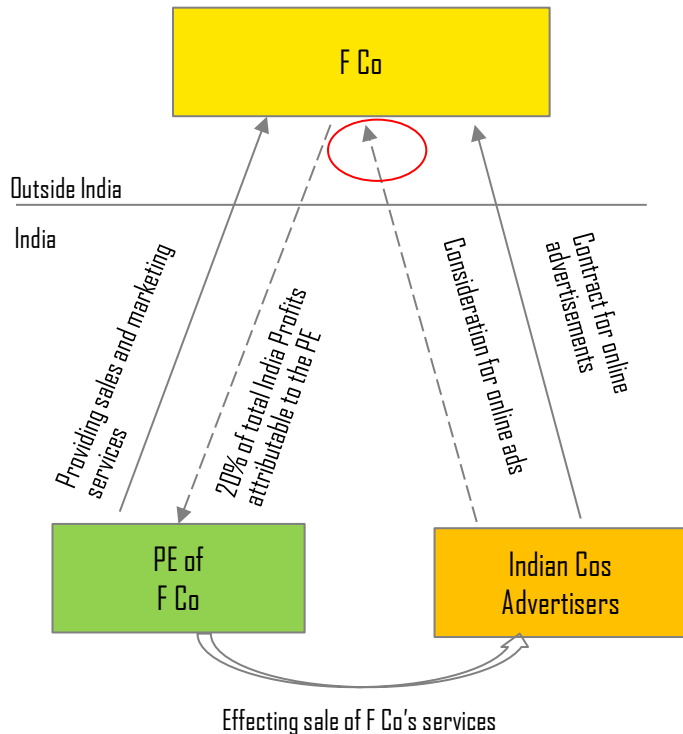
Income arising from specified services and subject to EQL would be exempt in the hands of the non-resident service provider [Section 10(50)]

Expenditure to be allowed as deduction to payer only on payment of levy

- ▶ Penalty and interest prescribed for non payment of levy
- ▶ Reporting requirements applicable to payer to be prescribed

¹"Online" means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network

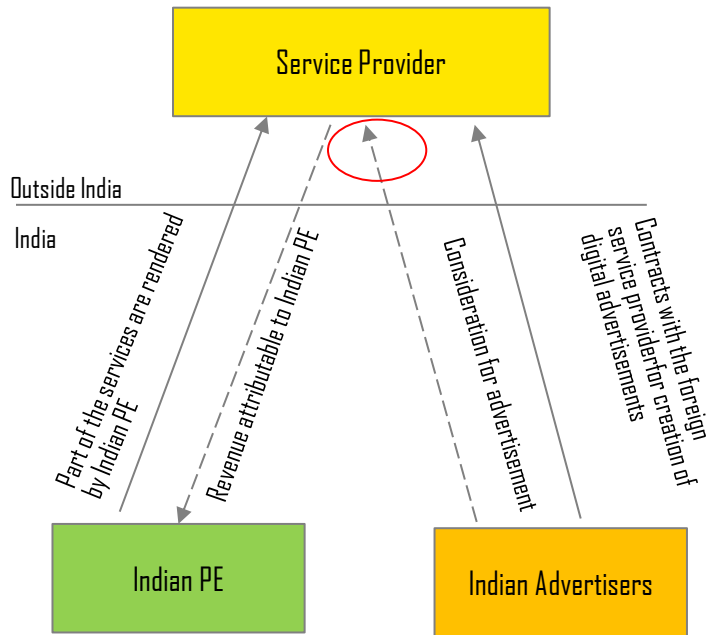
Case Study 1 : Profit attribution to PE



- ▶ F Co is contracted by the Indian advertisers for online advertisements – total revenue from Indian Advertisers is 100
- ▶ F Co Net Profit (Margin) is 15%
- ▶ The Indian PE of the F Co. undertakes sales and marketing functions for F Co
- ▶ F Co has been filing returns & is being assessed to tax in India
- ▶ Profit attributable to the PE is 20% of the overall India profits of F Co

The entire amount of 100 is not subject to EQL?

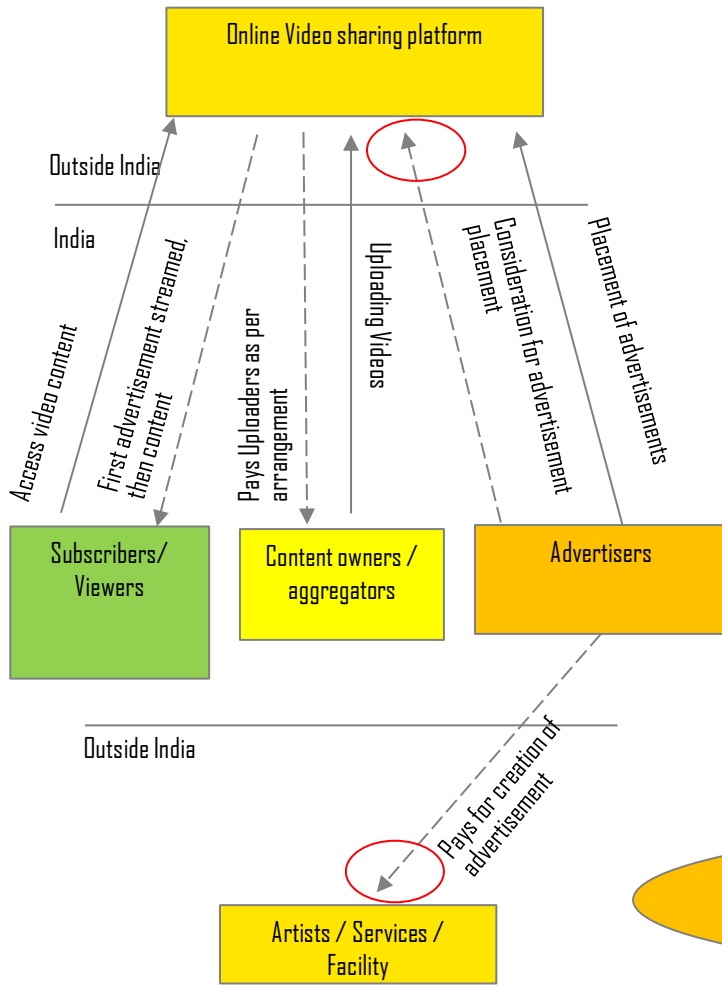
Case Study 2 : Services rendered by F Co + Indian PE



- ▶ Indian advertiser contracts with foreign service provider for creation of digital advertisements
- ▶ Part of the services are rendered by foreign service provider through its Indian PE
- ▶ Consideration paid by the Indian advertiser to the foreign service provider
- ▶ Portion of the revenues of the foreign service provider is attributed to the Indian PE

What portion of the receipts is subject to EQL?

Case Study 3 : Online video sharing platform



- ▶ Content owners / aggregators upload videos on the platform
- ▶ Advertisers place advertisements on the platform (and make payment to the platform owner for the same)
- ▶ The video sharing platform is accessed by subscribers / viewers
 - ▶ First the advertisement is streamed
 - ▶ The video is subsequently streamed
- ▶ As regard the advertisement uploaded by the advertiser the following may be noted:
 - ▶ For creation of advertisement, consideration was paid to artists, facility and services providers (some of the payments are to service providers outside India)
 - ▶ The advertisement was created for broadcast on multiple platforms - online, theatres/screens, TV, radio

Is the payment by the advertiser to artists / service provider subject to EQL?

Open Issues

- ▶ Is imposition of EQL fair? Compliance burden on Indian payer, can it be shifted?
- ▶ Rationale of choosing the rate of 6%
- ▶ Availability of foreign tax credit
- ▶ Will EQL increase the cost to Indian Cos – Tax protected contracts
- ▶ Lack of advance ruling measures to determine applicability of EQL (eg. Sec. 195/197 of ITA / AAR)
- ▶ Lack of assessment mechanism
- ▶ Lack of grievance redressal mechanism
- ▶ Provisions related to 'refund' of EQL already paid, if subsequently the recipient is litigated to have to have PE
- ▶ Which payments would be covered within the 'specified services'?
 - ▶ Any other facility or service for the purpose of online advertisement
- ▶ Levy likely to be extended to other online services – based on recommendations of the committee?
- ▶ EQL provisions designed in a manner to enable the Revenue Authorities:
 - ▶ To inventorise key players operating in the digital economy space in India and test the PE status in respect of such players

Significant economic presence [Finance Act 2018]

- ▶ Finance Act 2018 amended the definition of business connection. As per amended definition '*significant economic presence*' (SEP) would constitute business connection
- ▶ SEP has been defined as under :
 - ▶ transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if aggregate of the payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed
 - ▶ Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through a digital means
- ▶ The transactions or activities to constitute SEP in India, whether or not,
 - ▶ The agreement for such transactions or activities is entered in India; or
 - ▶ The non-resident has a residence or place of business in India; or
 - ▶ The non-resident renders services in India

No corresponding amendment in tax treaties entered into by India through MLI or otherwise to include concept of SEP

Interest deduction limitations



Section 94B : Interest limitation

What?

- ▶ Sec 94B starts with *non-obstante clause*; and will override any other provision of the Act that allows or regulates interest deduction

- ▶ Regulates disallowance of *interest or similar consideration* in respect of any 'debt' issued by Non-Resident AE

Whereby debt is widely defined to mean

- ▶ Any loan, financial instrument, finance lease, financial derivative, or
- ▶ Any arrangement that gives rise to interest, discounts or other finance charges

Deeming fiction

- ▶ Debt issued by lender who is non-AE is deemed to have been issued by AE if:
 - ▶ AE provides an *implicit or explicit* guarantee to the lender; or
 - ▶ AE deposits a corresponding and matching amount of funds with the lender

- ▶ Disallowance of interest u/s 94B irrespective of interest payment being at ALP

Not applicable to taxpayer engaged in the business of banking or insurance

Interest limitation

When?

- ▶ Applicable if all the following conditions are cumulatively fulfilled:
 - ▶ Taxpayer is an **Indian company** or a **PE of a foreign company in India**, who;
 - ▶ Pays interest or similar consideration in respect of any 'debt' issued by a NR being an AE of the Taxpayer, and;
 - ▶ Such payment is deductible in computing income chargeable under the head PGBP, and;
 - ▶ Such payment (AE interest) exceeds 1 Cr

How?

Disallowance of interest expense

Restricted to lower of the following:

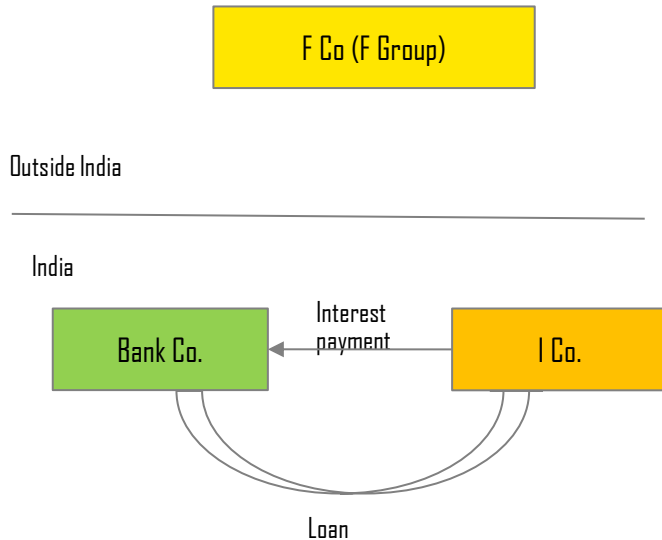
- ▶ Total interest paid or payable on debt which is in excess of 30% of EBIDTA; or
- ▶ Interest paid or payable to AE

Carry forward of disallowed interest

Interest disallowed can be carried forward to be set off against taxable profits of any business or profession carried on in a subsequent year

- ▶ Maximum carry forward for 8 succeeding assessment years
- ▶ Set off in a subsequent year is also subject to restriction as per aforesaid formula

Case Study 1 : Case of implicit guarantee



Facts :

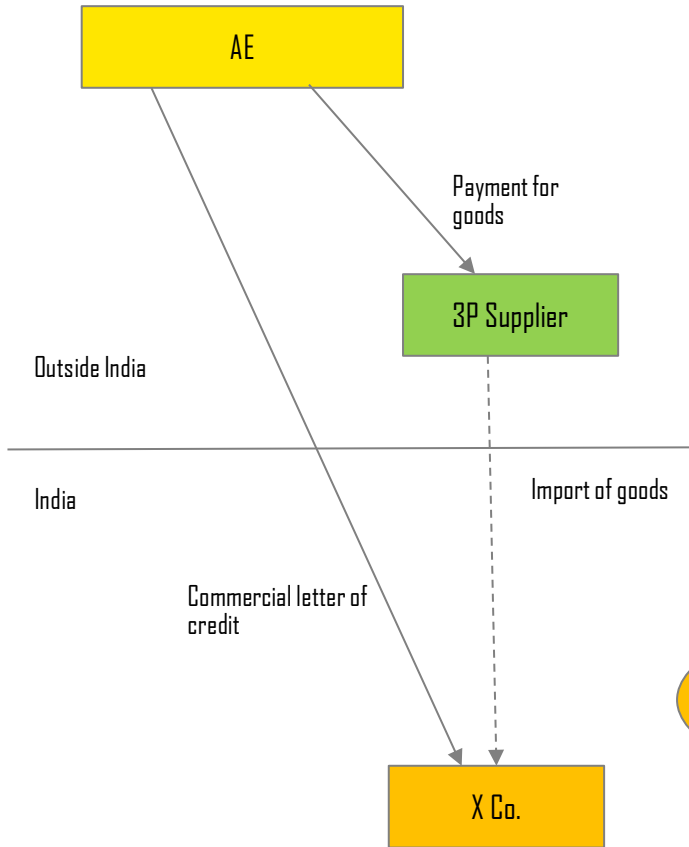
- ▶ I Co is a part of F Group and has credit rating of Baa
- ▶ Bank Co is the multinational bank which provides banking services to F Group globally
- ▶ I Co. obtains a loan from Bank Co. at 9% interest rate which is rate charged to entities with credit rating of A
- ▶ Interest rate prevailing for entities credit rating Baa is about 12%

Contention of tax authorities :

- ▶ F Co. has provided implicit guarantee to I Co. leading to reduction in interest rate
 - ▶ Bank Co would be treated as AE for the purpose of interest limitation deduction provisions
- ▶ As per OECD TP Guidelines 2017, no guarantee fee is to be charged on account of benefit obtained through passive association

- ▶ Whether interest limitation provisions will be applicable ?
- ▶ In case the arm's length interest range post search for comparable loan data is from 8%-12%, whether implicit guarantee exists?
- ▶ Whether transfer pricing provisions are applicable in cases where third party is treated as deemed AE?

Case Study 2 : Trade finance

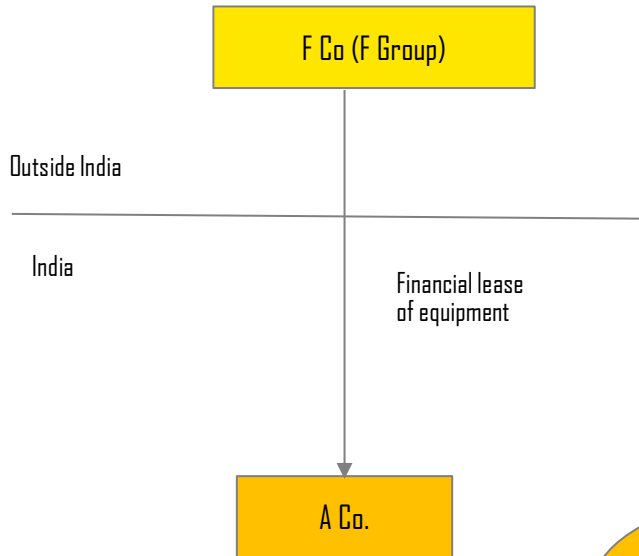


Facts :

- ▶ X Co is a newly incorporated company and imports goods from third party supplier outside India
- ▶ As credit period from third party supplier is not available, X Co's AE issues it a commercial letter of credit (CLC)
- ▶ As per terms of CLC, AE makes immediate payment to third party supplier for purchase of goods by X Co and allows 3 months credit period to X Co
- ▶ AE makes payment of 100 to X Co. and recovers 110 from X Co. post 3 months.

Whether provisions of section 94B are applicable to the arrangement?

Case Study 3 : Financial lease of equipment



Facts :

- ▶ A Co is a part of F Group and has credit rating of Baa
- ▶ A Co. obtains equipment on financial lease from F Co
- ▶ In its financial statements, periodically A Co deducts the finance charges in respect of the leased asset

Whether finance charges in respect of financial lease of equipment will be considered for application of section 94B?

Artificial avoidance of PE



Permanent Establishment Amendment

Business connection

Taxability under the Act is determined on the basis of provisions of the Act or tax treaty,
whichever is more beneficial to the tax payer

Under the Act, income accruing or arising (directly or indirectly) from **any Business Connection in India** would be deemed to accrue or arise in India

Definition of BC prior to Budget 2018

- ▶ Business connection shall include any business activity carried out through a person who, acts on behalf of non-resident and –
 - (a) habitually exercises in India, **an authority to conclude contracts** on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
 - (b) has no such authority, but **habitually maintains in India a stock of goods** or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
 - (c) **habitually secures orders** in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident

Definition of BC post Budget 2018

- ▶ Budget 2018 has expanded the definition of business connection to include 'a person who acts on behalf of the non-resident and **habitually plays the principal role leading to conclusion of contracts by that non-resident...**
Amendment proposed to replace clause (a) of the existing definition
- ▶ Thus an agent would include not only a person who habitually concludes contracts on behalf of the non-resident, **but also a person who habitually plays a principal role leading to the conclusion of contracts**
- ▶ This is in line with the proposed expanded definition under BEPS Action Plan 7 and MLI provisions with a slight variation that under the proposed definition under the Act, the term '**without material modification by the principal**' has not been introduced

PE implications

Agency PE – under the BEPS regime

- ▶ Under the BEPS provisions and as per the revised definition of Agency PE clause, taxpayer would be said to have a PE in India if:

*a person (other than an independent agent) who acts on behalf of the principal and **habitually concludes contracts OR habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the principal, and these contracts are***

*a) **in the name of the principal, or***

*b) **for the transfer of the ownership of, or for the granting of the right to use, property owned by the principal or that the principal has the right to use, or***

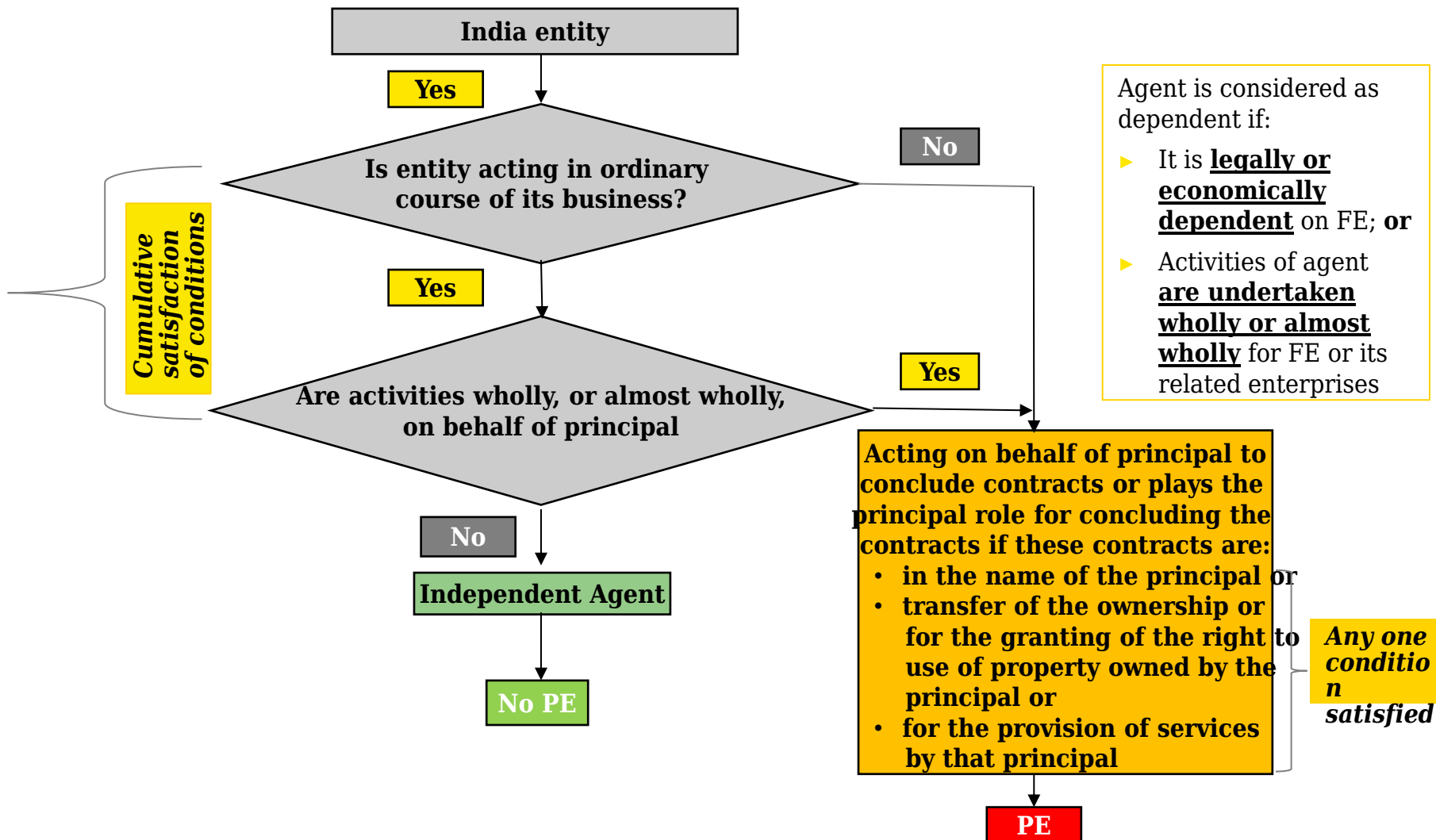
*c) **for the provision of services by that principal***

- ▶ As can be seen, under the BEPS regime, focus is placed on “**principal role**” in the process, rather than actual/ formal conclusion
- ▶ Vide Budget 2018, definition of **business connection** has been expanded to incorporate “principal role” even under the Act with slight variation that the words “**routinely concluded without material modification**” are not present in the amended definition under the Act

The Multilateral Convention to implement tax treaty related measures to prevent BEPS (the MLI) signed by India also includes above clause in respect of Agency PE definition. The MLI is a multilateral tax treaty which would amend 93 tax treaties entered into by India with other countries. Thus, the Agency PE definition of all these tax treaties would also stand amended.

PE implications

Agency PE – Overview (under the Tax Treaty)



MLI : Specific activity exclusion

- ▶ Under MLI, India has opted for option which provides for specified activity exclusion. The MLI clause reads as under :

Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, the term “permanent establishment” shall be deemed not to include:

a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character;

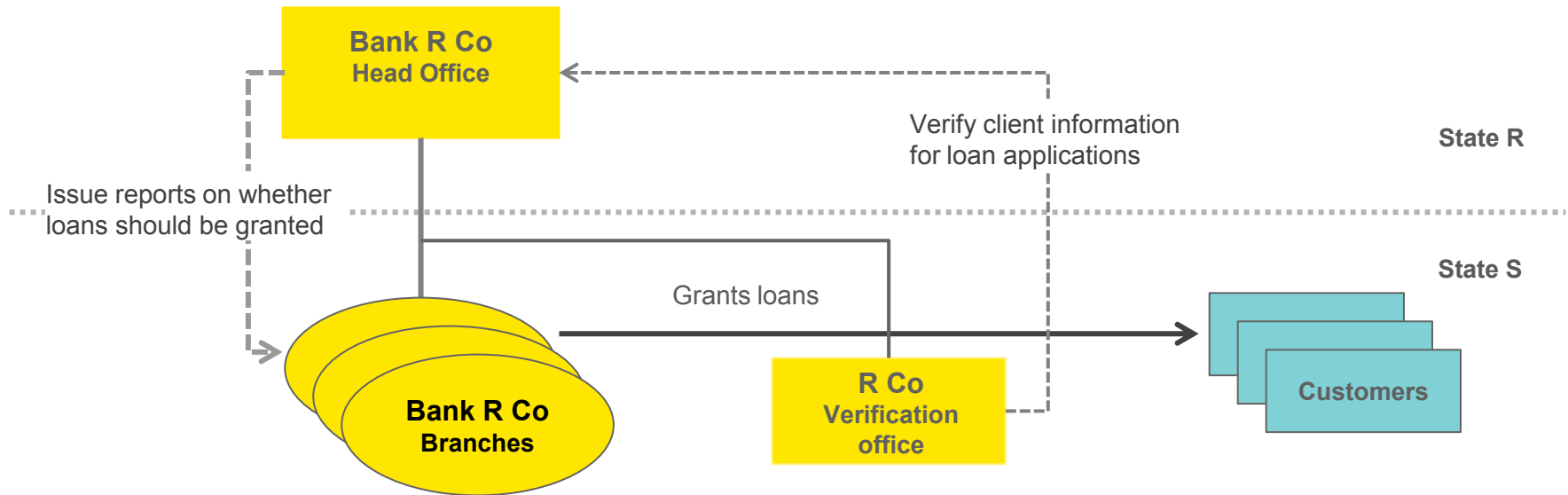
b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a);

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b),

provided that such activity or, in the case of subparagraph c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

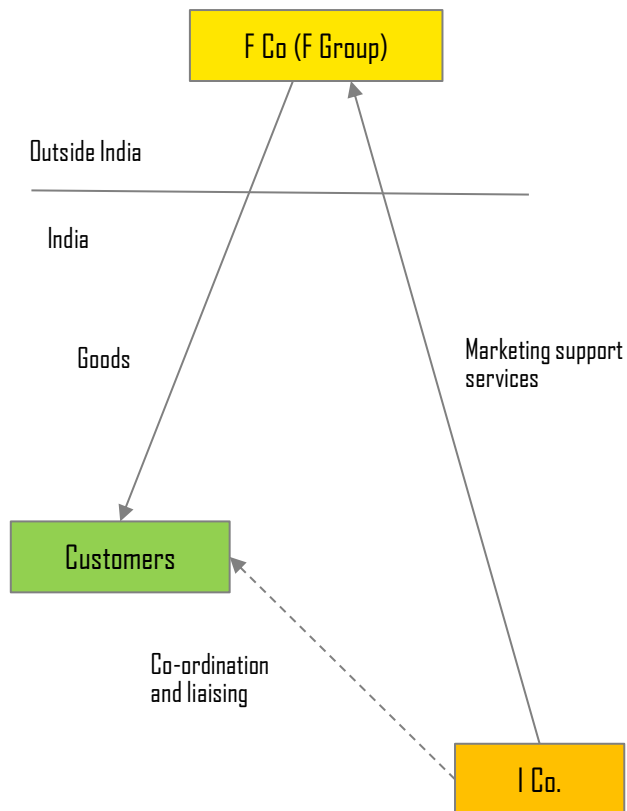
- ▶ Apart from specific activities listed in the tax treaties only those activities which are of preparatory and auxiliary character would be exempt from PE definition under tax treaty
- ▶ India has also adopted anti-fragmentation rules so as that enterprise or closely related enterprise performing activities at a same place or at another place in same jurisdiction do not avail the PE exemption if the overall activity resulting from combination of activities is not preparatory & auxiliary in nature and constitute complimentary functions that are part of cohesive business operations

Illustration of anti-fragmentation rule in action



- ▶ The business activities carried on by Bank R Co at its branches and verification office constitute complementary functions that are part of a cohesive business operation (i.e., the granting of loans to customers)
- ▶ Hence, the verification office cannot make use of the specific activity exemption on the grounds that the verification activities are of a preparatory or auxiliary character

Case Study : Marketing support services



Facts :

- ▶ I Co is a member of F Group
- ▶ I Co provides marketing support services to F Co for sale of goods in India
- ▶ I Co 's activities consists of identifying customers, canvassing and marketing F Co's goods, co-ordinating and liaising with F Co's customers in India
- ▶ I Co also negotiates the price and other terms and conditions of the sales contracts with customers in line with the guidelines given by F Co
- ▶ Before the price and other terms are finalised, I Co seeks approval of F Co
- ▶ F Co reviews the contract and makes modifications (if required) to price and terms for further negotiation with customers
- ▶ Contracts are executed by F Co. outside India

Whether I Co constitutes Agency PE of F Co. in India?

- ▶ Scenario 2 : Will answer be different if F Co. was Singapore Co or Swiss Co?
- ▶ Scenario 3 : Will the answer be different if F Co. executed the contracts without reviewing the pricing and other terms & conditions agreed by I Co?

Master file & Country by Country reporting



Action 13: India MF and CbCR regulations

	Master File	CbCR
Who has to report?	Part B of Form 3CEAA to be filed if : <ul style="list-style-type: none"> Consolidated revenue of the group exceeds INR 500 crores Aggregate value of the international transaction exceeds INR 50 crores (tangibles) or INR 10 crores (sale, purchase, transfer or lease of intangible property) 	<ul style="list-style-type: none"> Consolidated revenue above INR 5,500 crores converted on basis of exchange rate as on the last day of each year);
When to report?	<ul style="list-style-type: none"> 30 November 2018 for FY 2017-18 onwards 	<ul style="list-style-type: none"> Report to be furnished with income tax department on or before 12 months from end of reporting accounting year
What to report?	<ul style="list-style-type: none"> Information about the MNE's business, transfer pricing policies and agreements in a single document available to all tax authorities where the MNE has operations 	<ul style="list-style-type: none"> For Indian Parent entity/ Alternate reporting entity (ARE) - details as prescribed (covered in the ensuing slides) Indian subsidiaries of MNE groups to file CbC notification at least two months prior to due date of CbC filing (for Indian parent entity/ARE)
Filing mechanism	Direct filing to DGIT (Risk Assessment) through electronic mode	
Local File	Local file is the regular TP documentation	

India : Guidance on appropriate use of CbC reports (CBDT Instruction No. 2/2018)

- ▶ Access to CbC reports
 - ▶ TPO to have access to CbC report when the relevant entity is picked up for TP assessment
 - ▶ TPO to follow standard operating procedures which will be formulated

- ▶ CbC reports to be used for high level TP risk assessment
 - ▶ Centralised Risks Assessment Unit (CRAU) of CBDT shall first evaluate the CbC reports (both filed and received) which could provide some perspectives on the potential risks arising from the TP arrangements between the Indian constituent entity and its affiliates
 - ▶ Constituent entity may be selected for audit for further examination for particular financial year
 - ▶ TPO during the course of TP assessment may make enquiries based on information made available in CbC report in addition to other available information
 - ▶ No restriction on the TPO's scope that the enquiries should only be limited to the potential risks identified by the CRAU

- ▶ CBC reports to be also used for assessment of other BEPS related risks and economic and statistical purposes

- ▶ CbC reports filed in India and received from other jurisdictions will be subject to strict confidentiality norms under provisions of Indian tax laws and tax treaties

- ▶ Use of CbC reports by TPO to be monitored by jurisdictional commissioner. Breach of appropriate to be reported to Indian competent authority and appropriate disclosure of such breaches to be made to Coordinating Body Secretariat in the OECD

Action 13: India Masterfile regulations

Organization structure	Business description	Intangibles	Intercompany financial activities	Financial and tax positions
<p>Structure chart:</p> <ul style="list-style-type: none"> ▶ List of all the entities along with their addresses ▶ Legal status and ownership 	<ul style="list-style-type: none"> ▶ Nature of business ▶ Important drivers of business profit ▶ Supply chain of: <ul style="list-style-type: none"> ▶ Five largest products/services by turnover ▶ Products/services generating more than 5% of consolidated group revenue ▶ Main geographic markets for the products/services ▶ Description of important service arrangements along with their capabilities ▶ Functional analysis of the entities that contribute at least 10% of the revenue or assets or profits of the MNE group ▶ TP policy for service cost allocation and pricing intra-group services ▶ Business restructuring/acquisitions/divestments during the financial year 	<ul style="list-style-type: none"> ▶ Overall strategy description ▶ List of entities (with address) engaged in development and management of intangibles ▶ List of important intangibles and legal owners ▶ List of important intangible/cost contribution/research/license agreements ▶ TP policy for R&D and intangible ▶ Details of important transfers 	<ul style="list-style-type: none"> ▶ Financing arrangements of the group, including names and address of top 10 unrelated lenders ▶ List of entities providing central financing functions with address of operation and effective management ▶ Details of financial TP policies 	<ul style="list-style-type: none"> ▶ Annual consolidated financial statements ▶ List and description of existing unilateral advance pricing agreements ('APA's) and other tax rulings

Highlights indicate specific requirements as compared to OECD's BEPS Action 13.

Case Studies : Master File reporting

Case 1 -

- ▶ I Co is a part of A Group
- ▶ The consolidated turnover of A Group is INR 700 crores
- ▶ During the financial year, I Co makes the sale of goods amounting to INR 30 crore to its AE
- ▶ At the end of the year, I Co had receivables amounting to INR 22 crore

Whether master file reporting requirements are applicable to I Co. ?

Case 2 -

- ▶ I Co is a part of F Group
- ▶ The consolidated turnover of F Group is INR 1500 crores
- ▶ During the financial year, I Co issues shares amounting to INR 55 crores to its AE

Whether master file reporting requirements are applicable to I Co. ?

Case 3 -

- ▶ I Co is a part of G Group
- ▶ The consolidated turnover of G Group is INR 900 crores
- ▶ During the financial year, I Co has international transactions amounting to INR 50 lac with its AEs

Whether I Co is liable to file Part A of master file with Indian tax authorities ?

Case 4 -

- ▶ I Co is a part of K Group
- ▶ The consolidated turnover of K Group is INR 550 crores
- ▶ During the financial year, I Co enters into transaction of purchase of goods amounting to INR 100 crore with C Co a third party. The pricing and other terms of this transaction are pursuant to prior agreement which exists between C Co. and I Co's AE

Whether master file reporting requirements are applicable to I Co. ?

Action 13: CbCR contents as per India Rules

► Part A: Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the Multinational Enterprise group:

Reportable accounting year:

Currency Used:

Tax jurisdiction	Revenues			Profit (loss) before income tax	Income tax paid (on cash basis)	Income Tax Accrued-Reportable Accounting Year	Stated capital	Accumulated earnings	Number of employees	Tangible assets other than cash and cash equivalents
	Unrelated party	Related party	Total							

1.

2.

► Part B: List of all constituent entities of the MNE group included in each aggregation by tax jurisdiction, including designation of main business Activity

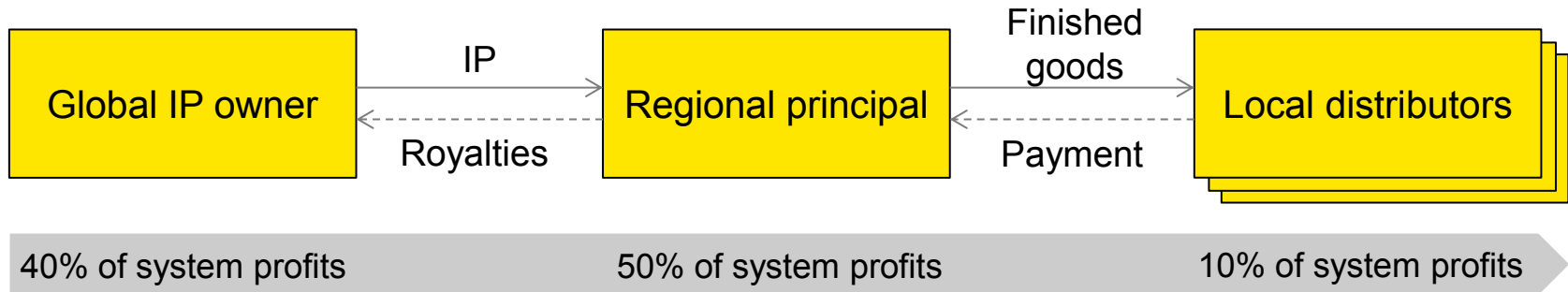
Tax jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organization or incorporation if different from tax jurisdiction of residence	Main business activity(ies)									
			R&D	Holding or managing IP	Purchasing or procurement	Mfg or production	Sales, mktg or distribution	Admin., mgmt or support services	Provision of services to unrelated parties	Internal group finance	Regulated financial services	Insurance

1.

2.

► Part C: Additional Information (to facilitate understanding of Part A and Part B)

Traditional TP/ supply chain planning



- ▶ Today - local jurisdictions only see local transactions – e.g. is distributor appropriately remunerated?

- ▶ Post-Action 13, all jurisdictions get full supply chain visibility, giving rise to wider exposure
 - ▶ Is distributor profitability artificially low because of IP transaction elsewhere?
 - ▶ What value addition does the regional principal do?
 - ▶ Does the IP owner have adequate substance?

Case Studies : CbC reporting

- ▶ **Case 1** – Group A acquires Group B in Year1. For Year0 (Y0), the consolidated turnover of both Group A and Group B is below Euro 750 million. However, combined turnover exceeded the CbC reporting threshold. Will CbC reporting be applicable to merged Group A in Year1 (Y1)?
- ▶ **Case 2** – Group B is demerged from Group A in Y0. In Y0 the consolidated turnover of sub-group entities of Group B exceeded Euro 750 million. Whether CbC reporting is applicable to Group B in Year 1
- ▶ **Case 3** - Group Y acquires Group Z on 1 October 2017 (in Y1). The consolidated turnover of both sub-group entities of Group Y and Group Z exceed Euro 750 million in Y0.
 - Whether Group Z has to file CbC report for period 1 April 2017 to 30 September 2017?
 - Whether Group Y has to report all or pro-rata share of Group Z's financial data?
- ▶ **Case 4** – Group S acquires Group T in Y1. In Y0, the consolidated turnover of Group S is below Euro 750 million, but the consolidated turnover of Group T exceeds Euro 750 million. Whether CbC reporting is applicable to Group S in Y1
- ▶ **Case 5** – Group C reports Group D as discontinued operations in its consolidated financial statements as per IFRS 5 pending the completion of merger of Group D with third party group. The results from discontinued operations are disclosed as line item in profit and loss account. Post exclusion of revenues of Group D in Y0, the consolidated revenue of the Group C falls below Euro 750 million. Whether CbC reporting is applicable to Group C in Y1?
- ▶ **Case 6** – AEs have seconded 40 employees to I Co. The employees have retained lien over their employment with AEs. The salary of the employees is reimbursed by AEs to I Co. The employees are under legal and directional control of I Co. Whether I Co should report seconded employees as its own workforce in CbC report?

Intangibles, risks & capital



Action 8 – 10: Overview

BEPS Action 8, 9 and 10

Assure that transfer pricing outcomes are in line with value creation

Action 8: Intangibles

- Wider and clearer definition of “intangibles”
- Introduction of a six step framework
- Legal ownership alone does not generate a right to the return generated by the exploitation of an intangible
- Focus on **Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) functions**

Action 9: Risk and Capital

- Focus on conduct of parties and their capability and functionality to manage risks.
- Assumption of risk without **‘control’ over that risk** is likely to be problematic
- Separate consideration regarding an appropriate return to any cash investment
- Introduction of a six step framework

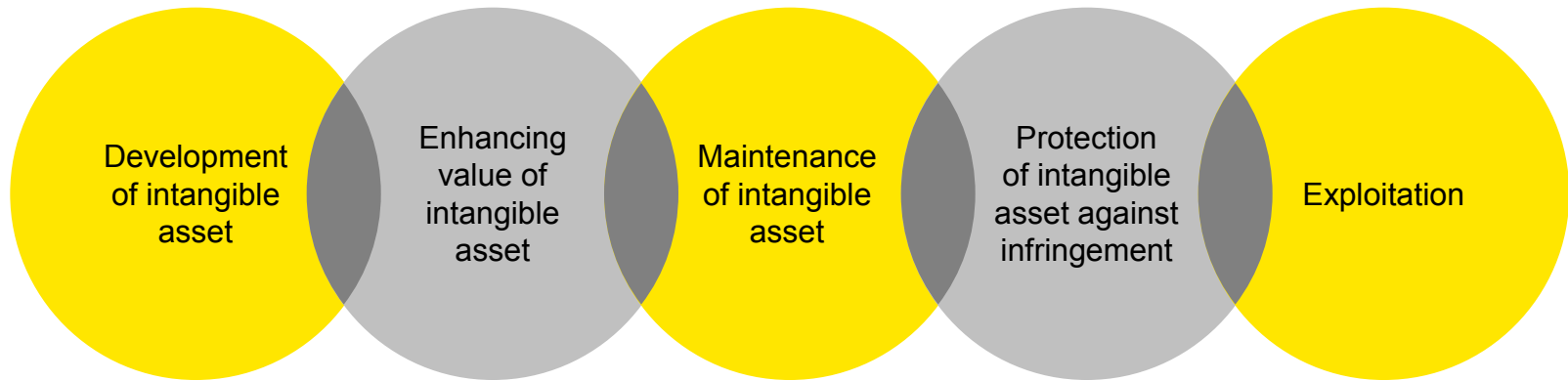
Action 10: Other high-risk transactions

- Intra-group services / low value-add services
- Profit Splits
- Recognition of transactions
- Commodity transactions

▶ BEPS triggers a shift from “**arm’s length pricing**” to “**arm’s length profit allocation**”

▶ Risks should be allocated to enterprise that **exercises control** and has **financial capacity to assume the risk**

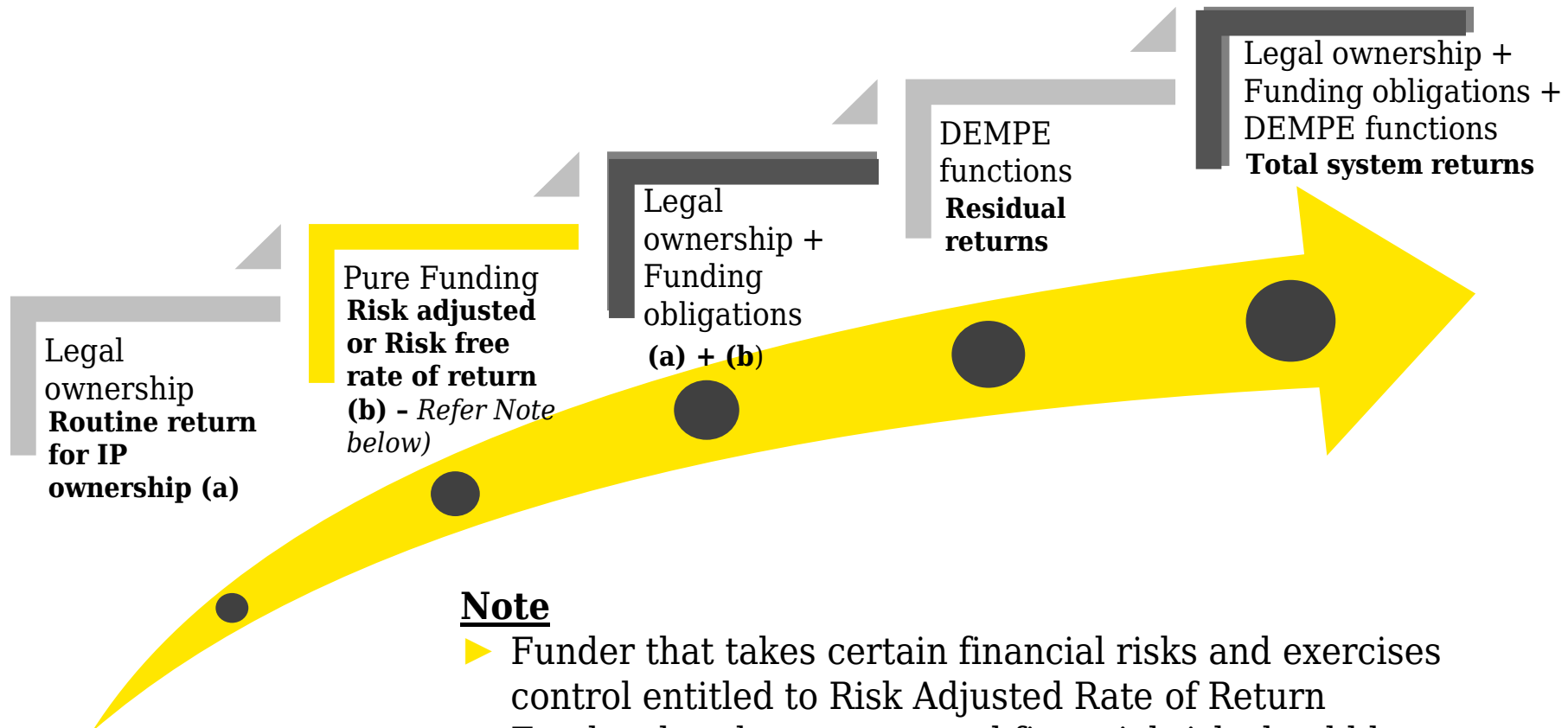
Strong focus on DEMPE functions



- ▶ Requirement to directly perform or to control the performance of DEMPE functions and related risks
- ▶ Return to be retained by an entity depends on the contributions it makes through DEMPE functions to the anticipated value of intangible relative to contributions made by other group members

The new OECD guidance focuses on ‘substance’ for conducting transfer pricing analysis of intangibles

BEPS Action 8 – Return entitlement



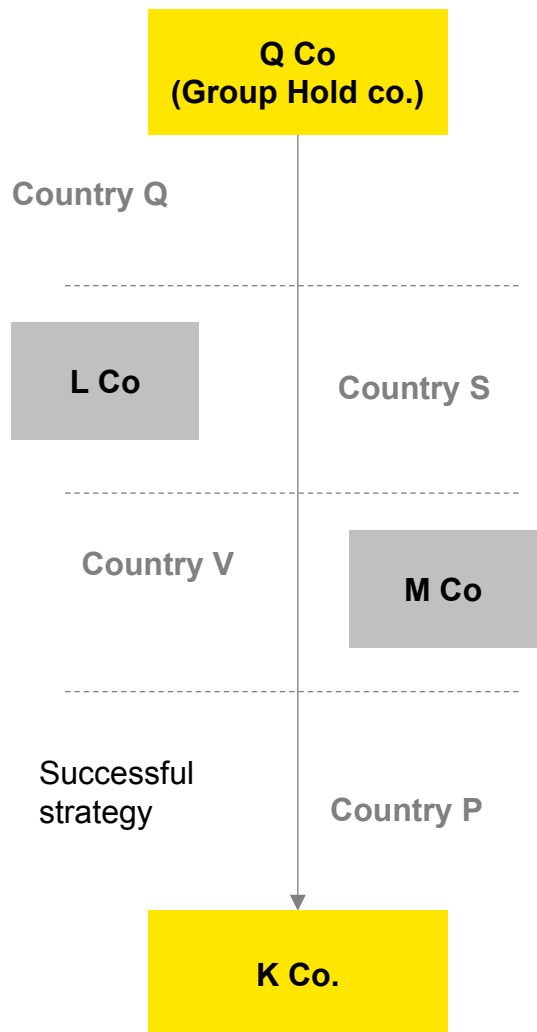
Note

- ▶ Funder that takes certain financial risks and exercises control entitled to Risk Adjusted Rate of Return
- ▶ Funder that does not control financial risk should be entitled to no more than a risk-free financial return

Six step analytical framework for analysing risks

- 1** Identify economically significant risks with specificity
- 2** Determine contractual risk allocation
- 3** Determine how the associated enterprises operate in relation to assumption and management of risks, in particular control functions and financial capacity to assume the risk
- 4** Interpret the outcome of step 1-3 and determine whether the contractual assumption of risk is consistent with actual conduct
- 5** Where the party assuming risk does not control the risk or does not have the financial capacity to assume the risk, apply specific guidance on allocating risk
- 6** The transaction as accurately delineated should be priced, appropriately compensating risk management functions

Case Study 1 – Strategy transfer



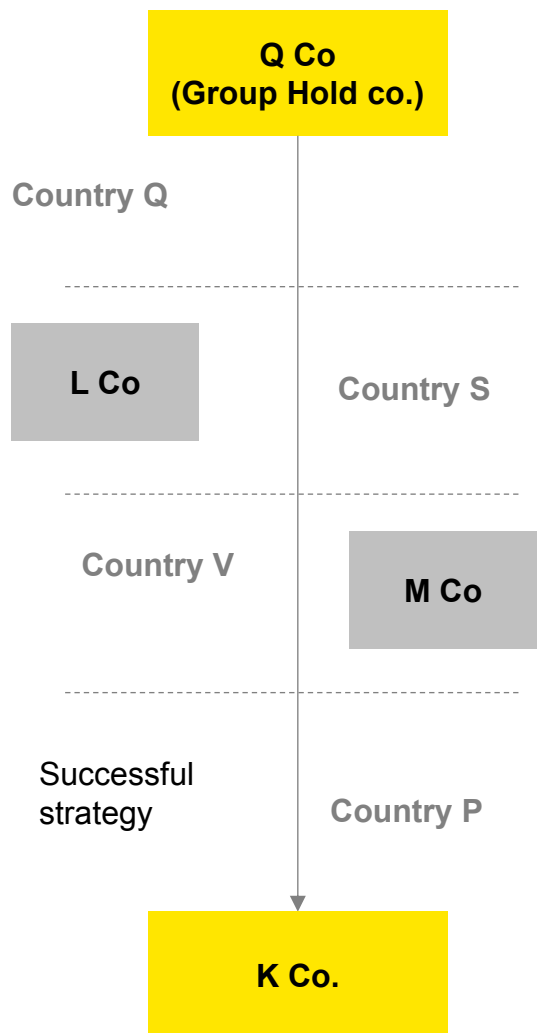
Facts:

- ▶ Q Co. is the holding company of the MNE group with L Co., M Co. and P Co. as its members
- ▶ K Co. Located in Country P has suffered persistent low margins
- ▶ L Co. and M Co. are high profit making companies and have been successful on account of a particular marketing strategy
- ▶ Q Co. has documented the key factors of successful marketing strategy of L Co. and M Co.
- ▶ K Co. avails such strategy documentation from Q Co. , for which it does not make any payment
- ▶ K Co. implements such marketing strategy and makes additional profits to the tune of 5% points

Actions by tax authorities in Q Co. jurisdiction:

- ▶ The tax authorities treated 'strategy documentation' as a intangible for transfer pricing purposes
- ▶ A TP adjustment is made for transfer of strategy documentation by Q Co. to K Co.
- ▶ Tax authorities in jurisdiction of Q Co. allocate 5% additional profit made by K Co. to Q Co.

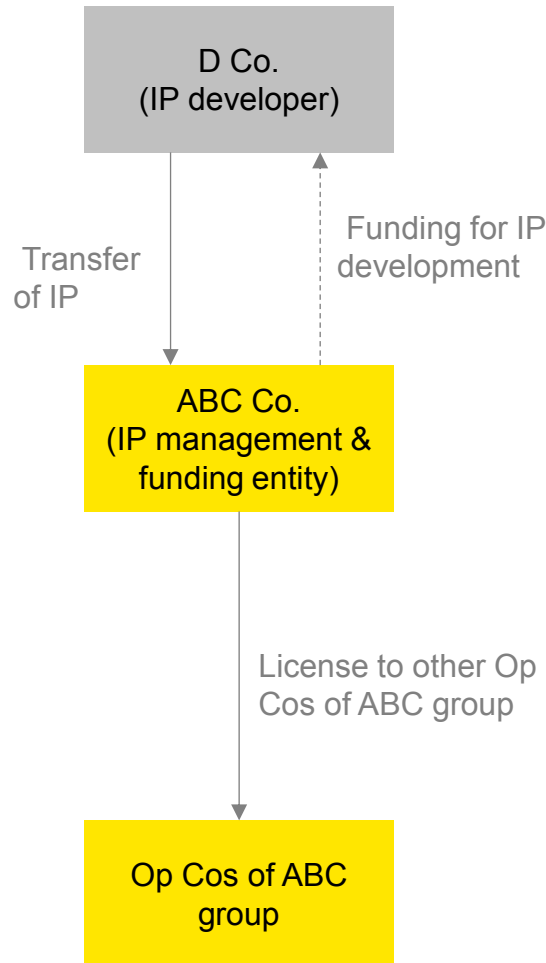
Case Study 1 – Strategy transfer (contd)



Key issues & considerations:

- ▶ Whether 'strategy' falls under the purview of definition of intangible asset as given by OECD Action 8 deliverable report?
 - ▶ Whether strategy can be owned or controlled by a particular enterprise?
- ▶ Whether TP adjustment made by tax authorities is correct?
 - ▶ Whether allocation of 5% incremental profit made by K Co should be attributable entirely to Q Co.?
 - ▶ Return for implementation function to K Co?
 - ▶ Whether remuneration on strategy transfer should be paid to L Co. or M Co. who devised the strategy, rather than Q Co. which documented success factors?
 - ▶ Whether incremental profit be split between Q Co., L Co. and M Co. as per their relative contributions?
- ▶ Whether transfer of strategy documentation was provision of service by Q Co. to K Co.?
 - ▶ No payment of service fee to Q Co. as benefit to K Co. was incidental benefit on account of existing strategy existing within group?

Case 2 - DEMPE Functions



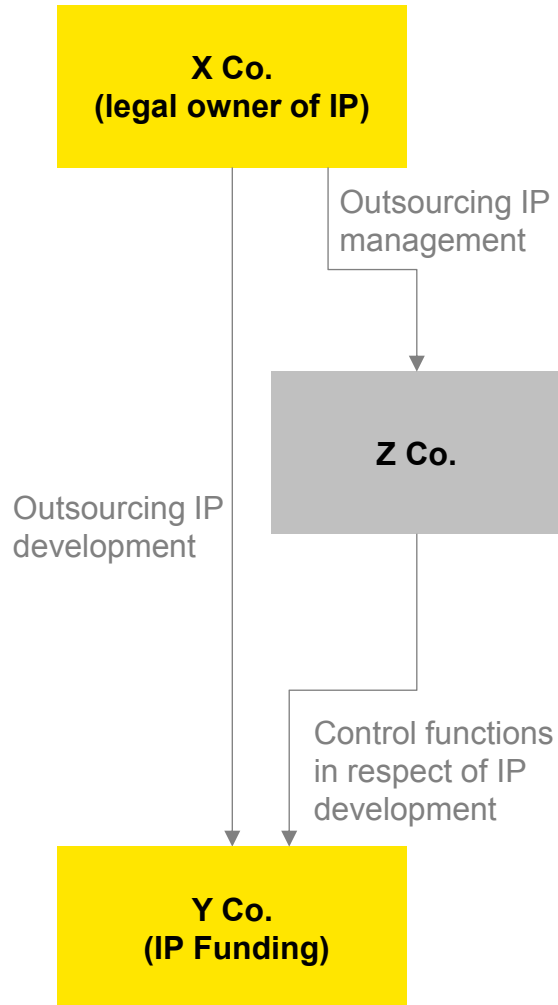
Facts:

- ▶ ABC Co. was holding company of ABC group.
- ▶ ABC Co. funded D Co., it's AE, for development of IP
- ▶ On IP development, the ABC Co. was registered as legal owner of IP
- ▶ D Co. was remunerated for IP development on cost plus basis
- ▶ ABC Co. takes major decision on control and management of IP
- ▶ ABC Co. manages IP and licenses to operating cos of ABC Group and received royalty fees

Key issues & considerations:

- ▶ Whether ABC is entitled to royalty return on exploitation of IP by operating cos. of ABC group?
- ▶ Appropriate arm's length return to be paid to ABC Co. and D Co. on IP exploitation?
- ▶ Whether royalty payments should be split between IP co and ABC co. for IP development and other functions?

Case study 3 - DEMPE Functions



Facts:

- ▶ X Co., Y Co. and Z Co. are members of A group
- ▶ X Co. is a legal owner of intangible asset to be developed
- ▶ X Co. outsources the IP development to Y Co.
- ▶ Y Co. funds the IP development and performs development functions
- ▶ Y Co. performs intangible development under control and direction of Z Co
- ▶ Z Co. takes all the important decisions in respect of research, strategic decisions in relation to IP development programmes and preparation of budgets
- ▶ X Co. has outsourced IP protection and maintenance functions to Z Co.

Key issues & considerations:

- ▶ Relevant risks associated with outsourced functions?
- ▶ Risk bearing entities? Control over risks?
- ▶ Appropriate return to be remunerated to entities in transaction?
- ▶ Is X Co., which is legal owner of intangible entitled to any return?
- ▶ Benchmarking outsourcing transactions from TP perspective?

Other action points



Dispute Resolution

- ▶ India has recently clarified its position on acceptance of Mutual Agreement Procedure (MAP) in cases of countries where Article 9(2) is absent
 - ▶ MAP applications will be accepted, regardless of the presence or otherwise of Article 9(2) (or its relevant equivalent Article) in the DTAAAs
- ▶ India does not accept the mandatory arbitration as it considers that such mandatory arbitration impinges on its sovereignty and limits the ability to apply domestic laws to determine tax base of non-residents/foreign companies

Mutual Agreement Procedure (MAP) : Impact of India's MLI position on Indian treaties

Insertion of OECD modelled Article 9(2)	Belgium, France, Russia, Italy, Sweden, Switzerland,
No impact – Article 9(2) already present in existing bilateral treaties	Australia, Canada, Cyprus, Denmark, Finland, Ireland, Israel, Japan, Korea, Netherlands, Singapore, UK
Time period of MAP access increased from 2 to 3 years	Belgium, Canada, Italy, UK
Insertion of provision facilitating bilateral resolution of MAP cases	Mexico only
Inclusion of a provision that MAP will be implemented irrespective of domestic law time limits	UK
Inclusion of a provision that CAs will suo-moto resolve treaty interpretation issues	Greece only
Inclusion of a provision that CAs will suo-moto resolve double taxation issues	Australia, Belgium, UK

Indian Patent regime [s. 115BBF]

► Comparison of BEPS Action 5 IP regime and Patent Box regime introduced vide FA 2016

BEPS Action 5 IP regime	Patent Box regime introduced in India
Extends to different kinds of IPs and not only patents	Restricted to patents only
Substantial activity requirement for eligibility of preferential rate	The patent needs to be developed in India.
Regime to provide for a preferential rate on IP-related income to the extent it was generated by qualifying expenditures (Nexus Approach).	Regime to provide for a preferential rate on royalty from patents if such patent is developed and registered in India
Proportionality principle is applied to determine what income may justifiably receive tax benefits without regime being considered harmful Qualifying expenditures $\frac{\text{incurred to develop IP Asset}}{\text{Overall expenditures incurred to develop IP Asset}} \times \text{Overall Income from IP}$ = Income receiving tax benefits	Royalty income from patent developed and registered in India is eligible for 10% tax rate
Overall income to be limited to IP income such as royalties, capital gains and other income from sale of an IP asset, and embedded IP income from sale of products and use of processes directly related to the IP asset	Eligible income is only royalty income and specifically excludes capital gains and consideration for sale of product manufactured with use of “patented process” or the “patented article” for commercial use.