taxsutra

BMR Advisors

October / November 2014 Issue - 1

SCALING BEPS

OECD
BEPS
G20 DWG

SCALING BEPS

CONTENTS

1	**DISSECTING BEPS ACTION PLANS – 8 & 13**	**05**
	1.1 ACTION PLAN 13 : TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING	05
	1.1.1 TAXSUTRA BRIEF	05
	1.1.2 BMR POINT OF VIEW	09
	1.2 ACTION PLAN 8 : GUIDANCE ON TRANSFER PRICING ASPECTS OF INTANGIBLES	12
	1.2.1 TAXSUTRA BRIEF	12
	1.2.2 BMR POINT OF VIEW	15
2	**FACE TO FACE : INTERVIEW WITH OECD's PASCAL SAINT-AMANS**	**18**
3	**SHOOTING STRAIGHT - PHILIP BAKER**	**23**
4	**EXPERT GAZE : CONCEPT OF LOCATION SAVING AND LOCATION SPECIFIC ADVANTAGE : BY SANJIV MALHOTRA**	**25**
5	**NEWS WRAP UP**	**33**
6	**NEUTRALISING THE EFFECT OF HYBRID MISMATCH ARRANGEMENT – A STEP TOWARDS RIGHT PATH : BY AMOD KHARE AND PAVAN KAKADE**	**39**
7	**BEPS TIMELINE**	**43**

INTRODUCTION

Note from the Editor:

'BEPS'.. a word that will in all probability, go down in history as the word that re-defined the boundaries of tax planning as well as tax avoidance. With the G-20 determined to put an end to 'double non-taxation', the OECD finds itself armed with a political 'mandate' to alter the rules of the game in a way that will cause seismic changes in the tax world.

The doubting Thomasses, skeptical if the BEPS project would see light of the day, were proven wrong when last month, the OECD released reports on 7 out of the 15 Action Plans, including those with significant ramifications like Transfer Pricing documentation & Country-by-Country reporting. The next 12-15 months will witness some contentious action plans being brought to the fore, including one of the most eagerly awaited ones - 'Digital Economy'. The BEPS project is almost certain to have a significant impact on the way Multinational Enterprises carry out their day to day business, and shall once again bring tax to the forefront of the boardroom discussions.

Taxsutra and BMR Advisors are glad to release our bi-monthly newsletter - 'Scaling BEPS', that will be your one stop shop for everything you need to know about the latest in the BEPS world. Over the next 6 editions, this newsletter shall simplify and dissect each of the 15 Action Plans, get you exclusive interviews with the policy makers and ofcourse expert views and counter views on every aspect of BEPS.

In our inaugural newsletter, OECD Tax Policy Director Pascal Saint-Amans takes some tough questions from us and doesn't duck any! We analyse Action Plans 8 & 13 (TP Documentation & Intangibles) in detail and serve you a platter of expert views including our special series featuring Philip Baker – 'Shooting Straight'.

Join us in what promises to be an exciting roller coaster ride over the next 12 months – The BEPS Show!

1 DISSECTING BEPS ACTION PLANS

1.1 ACTION PLAN 13: TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING

The country-by-country report requires multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued. It also requires MNEs to report their total employment, capital, retained earnings and tangible assets in each tax jurisdiction. Finally, it requires MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity engages in

1.1.1 Taxsutra Brief

OECD had released a discussion draft on transfer pricing (TP) documentation and country-by-country reporting on January 30, 2014, proposing that the text of Chapter V of the Transfer Pricing Guidelines be replaced. The previous Chapter V did not provide for a list of documents to be included in the TP documentation nor did it provide clear guidance with respect to the link between the process for documenting transfer pricing, the administration of penalties and the burden of proof. In March 2014, OECD received voluminous comments from more than 100 stakeholders, running into over 1100 pages. Last month, OECD published the Report on Action 13, outlining revised standards for transfer pricing documentation and a template for country-by-country reporting of income, earnings, taxes paid and certain measures of economic activity.

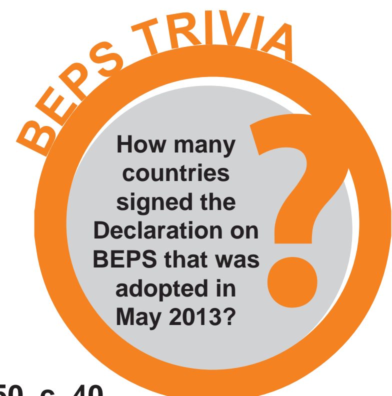
Objectives

The Report identifies the following objectives of transfer pricing documentation:

1. Ensuring that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between AEs and in reporting the income derived from such transactions in their tax returns.

2. Providing tax administrations with the information necessary to conduct an informed transfer pricing risk assessment.

3. Providing tax administrations with useful information to employ in conducting an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction.



a. 80 b. 50 c. 40

See answer on page 32

Three-tiered approach

To achieve these objectives, countries should adopt a **standardized three-tiered structure** comprising:

Master File

Available to all relevant country tax administrations, this provides a high-level overview or a "blueprint" of the MNE group business, containing the following details:

(a) MNE group's organisational structure

(b) Description of the MNE's business(es)

(c) MNE's intangibles

(d) MNE's intercompany financial activities

(e) MNE's financial and tax positions.

Though taxpayers should present the information in the master file for the MNE as a whole, organisation of the information presented by line of business is permitted where well justified by the facts, e.g. where the structure of the MNE group is such that some significant business lines operate largely independently or are recently acquired. In such a case, centralised group functions and transactions between business lines should be properly described and the entire file comprising all business lines should be available to each country.

Local File

To be prepared by the local taxpayer, this provides detailed information relating to specific intercompany transactions, supplementing the master file and focusing on information relevant to the transfer pricing analysis relating to transactions between a local country affiliate and AEs in different countries, which are material in the context of the local country's tax system. Such information would include details as to:

a) Management structure of the local entity

b) Business and business strategy pursued by the local entity

c) Material controlled transactions and the transfer pricing study including identification of AEs, FAR analysis, most appropriate method, tested party, comparables, existing APAs, etc.

d) Financial information including annual local entity financial accounts for the concerned fiscal year, information and allocation schedules and summary schedules of relevant financial data for comparables.

Country-by-Country Report

This requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates. It also requires a listing of all Constituent Entities for which financial information is reported, including the tax jurisdiction of incorporation, different from the tax jurisdiction of residence, as well as the nature of the main business activities carried out by that Constituent Entity.

Guidance on Compliance Aspects

- *Contemporaneous documentation* - If it is reasonably demonstrated that no comparable data exists or that the cost of locating such data would be disproportionately high, the taxpayer should not be required to incur costs in searching for such data.
- *Time frame* - The best practice is to require that the local file be finalised no later than the due date for the filing of the tax return for the fiscal year in question. The master file should be reviewed and, if necessary, updated by the tax return due date for the ultimate parent of the MNE group. In case of the country-by-country report, if the final statutory financial statements and relevant other financial information are not finalised until after the due date for tax returns, the date for completion of the report may be extended to 1 year following the last day of the fiscal year of the ultimate parent of the MNE group.
- *Materiality* - Individual country transfer pricing documentation requirements should include specific materiality thresholds that take into account the size and the nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, in addition to the overall size and nature of the MNE group. Individual countries should objectively establish their own materiality standards for local file purposes, based on local conditions.
- *Retention of documents* - Taxpayers should not be obliged to retain documents beyond a reasonable period consistent with domestic law requirements at either the parent company or local entity level.
- *Frequency of documentation updates* - The master file and local file should be reviewed and updated annually. If operating conditions remain unchanged, tax administrations may determine that searches in databases for comparables supporting the local file be updated every 3 years.
- *Language* - The language in which documentation should be submitted should be established under local laws. Countries are encouraged to permit filing of transfer pricing documentation in commonly used languages where it will not compromise the usefulness of the documents.
- *Penalties* – Penalty should not be imposed on a taxpayer for failing to submit data to which the MNE did not have access. But an assertion by a local entity that other group members are responsible for compliance is not a sufficient reason for that entity to fail to provide required documentation.

DISSECTING BEPS ACTION PLANS

- *Confidentiality* - Tax administrations should ensure that there is no public disclosure of trade secrets, scientific secrets or other confidential or commercially sensitive information. If disclosure is required in court proceedings, it must be ensured that information is disclosed only to the extent needed. Reference is made to the OECD Guide "Keeping It Safe" on the protection of confidentiality of information exchanged for tax purposes provides guidance on the rules and practices that must be in place to ensure the confidentiality of tax information exchanged under exchange of information instruments.

Continued on page 32

BEPS QUOTES

"We urge you to keep foremost in mind that economic growth and broadly-shared prosperity flow from eliminating barriers to trade and investment and avoiding the creation of new barriers" - **Louis Chênevert, Chief Executive of United Technologies Corporation, in his letter to U.S. Treasury Secretary Jack Lew.**

The proposed three-tiered documentation framework imposes a risk of 'overload of information' and may not actually facilitate proper risk assessment. The proposition of providing 'equal' information on the entire global operations of the MNE to the tax administration in each country irrespective of the nature and size of operations of the MNE in that country, appears clearly excessive and onerous.

1.1.2 BMR point of view*

On the Guidance released by OECD

OECD's decision to amend the Discussion Draft based on the representation from the MNE's and other business groups is a welcome move and will have a positive impact in reducing the burden of the MNEs. However, more clarity and guidance is required on aspects such as flexibility on the source of financial information as MNEs should ordinarily be allowed to directly extract information from the entity-level financial statements, and consolidate such information at the country level. Further, OECD could also provide guidance in reconciling the data disclosed in the CBCR template with the Master File or Local File, where there are differences in the manner of disclosure or differences in the accounting practices followed by group entities.

Compliance cost and burden

The proposed three-tiered documentation framework imposes a risk of 'overload of information' and may not actually facilitate proper risk assessment. The proposition of providing 'equal' information on the entire global operations of the MNE to the tax administration in each country irrespective of the nature and size of operations of the MNE in that country, appears clearly excessive and onerous. It is of utmost importance that a balance is struck between the information required for risk assessment and the potential compliance burden of the MNE.

Although OECD has limited the information requirement details with a view to minimise the burden of MNEs relative to the discussion draft, it should be envisaged that the documentation requirements are limited to serve the purpose of a TP risk assessment. That said,certain additional disclosures introduced in Annex I to the CBCR, such as the description on taxpayer's five largest products and/or service offerings by turnover, description of the capabilities of the principal locations providing important services introduced in the Guidance Report have far-reaching effects. Finally, it is essential that the CBCR comes out with transitional provisions. MNEs will take time to pull data together across legal entities and present such information accurately and consistently. It should be clarified that no additional burden should be imposed on the MNEs by different tax administrations to certify the authenticity and reliability of the information provided.

TP audits ought to be initiated selectively based on proper evaluation, and not as a norm. In all circumstances, it should be mandatory for Revenue Authorities to share their risk assessment, or the norms of such assessment, with taxpayers to maintain transparency, especially in cases where the case is eventually selected for audit.

*Contributed by Suchint Majmudar, Partner, BMR & Associates LLP.

Confidentiality and use of information

The CBCR template and the Master File contain confidential or sensitive information of the MNE. A major concern with the CBCR is that the reporting template of CBCR could result in a potential misuse of information by inexperienced and/or overzealous first level auditors to allege tax avoidance.

Local country administrations ought to consider that the CBCR data should be made accessible only to a specialist Panel of tax administrators who would be responsible for selecting cases based on risk assessments. Although this is a country-specific administrative matter, reference has been made to the "OECD Guide on the protection of confidentiality of information exchanged for tax purposes" in the Guidance.

Mechanism for sharing of information

The Guidance contemplates obligating the parent MNE to share the entire CBCR template with all its subsidiaries for local tax administration reporting purposes. The requirement for mandatory sharing of the CBCR template with local tax administrations would not always be commercially desirable, leaving aside confidentiality concerns.

It is expected that OECD will review the mechanism for sharing information and will come out with guidance in the forthcoming months. As a recommendation, extracts of the CBCR template and the Master File should be sought only from the tax administration of the country having jurisdiction over the parent MNE, under the automatic information exchange treaty network, after establishing relevance.

Preparation and submission of documentation for risk assessment

TP audits ought to be initiated selectively based on proper evaluation, and not as a norm. In all circumstances, it should be mandatory for Revenue Authorities to share their risk assessment, or the norms of such assessment, with taxpayers to maintain transparency, especially in cases where the case is eventually selected for audit. To this end, the CBCR is expressly intended to serve to assess BEPS-related risks.

Guidance on comparable companies

OECD's recommendation in the Guidance that the benchmarking searches be updated every 3 years rather than annually is a positive move as it provides some relief to the MNE in maintaining voluminous documentation. This is specifically beneficial for the firms carrying out low-value intercompany transactions.

However, questions may arise when the comparability analysis is challenged by the Revenue Authorities and the MNE is confronted with a different set of comparable companies, or in jurisdictions where the data set is evolving and hence dynamic.

Impact of CBCR on India

Documentation has been India's forte since the inception of TP rules in 2001. Elaborate guidance around documentation has been provided and augmented with the introduction of Circular No 6 of 2013 (R&D Circular). In fact, the advancement to the Safe Harbor and Advance Pricing Agreement regimes has only augmented the need for maintenance of documentation, albeit in more specific ways.

Therefore, India which is already quite sophisticated in its documentation rules, is likely to take up this action with renewed enthusiasm. Certain companies that have outbound investments from India are already adopting the Master File and Local File approach in some shape or form and seeing benefits emanating from it, particularly in the context of determining TP policies and enforcing them in the course of benchmarking and TP studies.

While the Guidance allows the taxpayer to update the comparable companies in the local file once in three years, rather than annually, the Indian TP Regulations require the taxpayer to update the comparable companies in the TP documentation annually. However, the India Budget 2014 provides companies with a benefit to use multi-year data, comprising the data of comparable companies pertaining to a period not more than two years prior to the relevant financial year.

CBCR is also likely to be a subject of keen interest for Indian Revenue Authorities to seek to correlate economic value adding activities with compensation being earmarked thereto. That said, the CBCR in isolation, bereft of group TP and value chain structure, could be arbitrarily (mis)used to make out a case for profit shifting without adequate understanding and basis.

India is also quite open to the liberal use of the exchange of information protocol in its treaties and the formal ability to extract portions of the Master File and use such information at the local level is likely to be exploited by the Indian Revenue Authorities to keep BEPS at bay. Therefore, the documentation action is one item where there would need to be more definitive rules defined in terms of the proposed multilateral instrument that would curtail the access to the Master File or other Local File to only relevant information, so that potentially sensitive information does not land in the wrong hands.

CBCR is also likely to be a subject of keen interest for Indian Revenue Authorities to seek to correlate economic value adding activities with compensation being earmarked thereto. That said, the CBCR in isolation, bereft of group TP and value chain structure, could be arbitrarily (mis)used to make out a case for profit shifting without adequate understanding and basis.

1 DISSECTING BEPS ACTION PLANS

1.2 ACTION PLAN 8: GUIDANCE ON TRANSFER PRICING ASPECTS OF INTANGIBLES

The report contains final guidance on Transfer pricing guidelines relating to location savings and other local market features, assembled workforce and group synergies. It also contains guidance on identifying intangibles and on determining arm's length conditions alongwith several examples.

The report also contains interim guidance on allocation of returns derived from intangibles in view of strong links between section on returns derived from intangibles and 2015 work on risk, re-characterisation, capital and possible special measures (Actions 8-10). OECD states that Guidance will be finalised taking into consideration issues such as excessive capitalisation, 'cash-box' owners of intangibles with low functionality, mere contractual allocation of risk, dealing with hard to value intangibles.

1.2.1 Taxsutra Brief

After the revised discussion draft on transfer pricing aspects of intangibles was released in July 2013 and public comments were received by October 2013, OECD published the Report on [1]Action Plan 8 on September 16, 2014 so as to align transfer pricing outcomes with value creation in the area of intangibles. The Report clarifies the definition of intangibles, provides guidance on identifying transactions involving intangibles and provides supplemental guidance for determining arm's length conditions for transactions involving intangibles. The Report also contains guidance on the transfer pricing treatment of local market features and corporate synergies.

Where reliable local market comparables are available, specific comparability adjustments for location savings should not be required. When reliable local market comparables aren't present, determining the existence and allocation of location savings among group members and any consequent comparability adjustment should be based on an analysis of all relevant facts and circumstances, including FAR analysis of the AEs.

Amendments to Chapter I (Arm's Length Principle) – The amendments contained in this Report as regards Chapter I relate to the additional relevant factors that need to be considered during the comparability analysis, that may warrant comparability adjustments:

Location Savings: While evaluating differences between geographic markets and in determining appropriate comparability adjustments, certain issues may arise in relation to the consideration of cost savings attributable to operating in a particular market.

To determine how such 'location savings' are to be shared between AEs, it is necessary to consider:

- whether location savings exist;
- the amount of such savings;
- whether (and to what extent) they are retained by group members, or passed on to independent customers or suppliers;
- how independent enterprises operating under similar circumstances would allocate any retained net savings, where they are not fully passed on.

[1]Representing the first instalment of the transfer pricing work mandated by the BEPS Action Plan, this Report contains final revisions to Chapters I, II and VI of the 2010 OECD Transfer Pricing Guidelines.

Note – India's position as reflected in the United National Transfer Pricing Manual (Chapter 10) is different. India believes that price determined based on local comparables will not take into account benefit of location savings and hence, it is not an arm's length price. India believes that allocation of location savings should be made with reference to what independent parties would have agreed in comparable circumstances. However, with the G20 signing off on the New Intangilbles Guidelines, can India's view point be any different now?

Assembled Workforce - Where it is possible to determine the benefits or detriments of a unique assembled workforce (i.e. uniquely qualified or experienced work force) vis-a-vis the workforce of enterprises engaging in potentially comparable transactions, adjustments may be made to reflect the impact of the assembled workforce on the ALP of goods / services.

Other local market features - While some features of the local market in which business operations occur may give rise to location savings, others may give rise to comparability concerns not directly related to such savings. **Where comparable uncontrolled transactions in the local market can be identified, specific adjustments for features of the local market should not be required.** Where reliable local market comparables can't be identified, it is necessary to consider:

- whether a market advantage or disadvantage exists;
- increase or decrease in revenues or costs, vis-à-vis those of comparables from other markets, that are attributable to the local market advantage / disadvantage;
- the degree to which benefits / burdens of local market features are passed on to independent customers or suppliers and;
- how independent enterprises operating under similar circumstances would allocate such net benefits/burdens, where they aren't fully passed on.

It is relevant to note that location savings & other local market features do not constitute intangibles, but are rather comparability factors.

Amendment to Chapter II (Transfer Pricing Methods) –The detailed amendment to Chapter II will be revised and updated as part of the 2015 work on BEPS.

DISSECTING BEPS ACTION PLANS

Group synergies- When synergistic benefits (i.e. benefit from interactions or synergies amongst group members) or burdens of group membership arise purely as a result of membership in an MNE group, without any deliberate concerted action of group members, such benefits of group membership need not be separately compensated or specifically allocated among members. But where a structural advantage or material synergistic benefit or burden can be clearly identified and is attributable to deliberate concerted group actions, a comparability adjustment is likely to be warranted.

Continued on page 36

BEPS QUOTES

While we support the BEPS Project, it is necessary to underline that the concerns of developing countries regarding BEPS may be different from those of developed countries. These concerns are required to be taken on board in a more consultative manner, while developing consensus on the various issues.

Smt. Nirmala Sitharaman, Minister of State for Finance at the G-20 Finance Ministers' Meeting on International Tax in Cairns, Australia on Sept 21, 2014.

1.2.2 BMR point of View*

Return on intangibles

For India, the precedence of economic ownership over legal ownership, as asserted by the Revised Guidelines on Transfer Pricing Aspects of Intangibles ("RGI"), is significant in order to protect its tax base since it is home to companies which may perform functions and assume risks related to the intangible without legally owning the intangible. Also, the RGI identifies key functions, assets and risks which would entitle an entity to the intangible related return. This supplements the existing guidance provided in Circular 6/2013 issued by the Central Board of Direct Taxes ("CBDT") to identify whether the Indian R&D centers should be entitled to a share in the intangible related return.

Further, the observations of the RGI regarding distinction between funding related return and intangible related return are critical since almost all contract R&D activities undertaken in India (by captives) are funded by the foreign principal. OECD's observation in the RGI that funding alone should not entitle a taxpayer to an intangible related return assumes significance in assisting the Indian Revenue to lay a legitimate claim on the intangible related return accruing from Indian operations, provided the Indian entity performs the key functions, owns the key assets and assumes key risks related to the development, enhancement, maintenance and protection of intangibles. In such a scenario, the RGI provides that the compensation to the entity performing the key R&D functions may comprise a share in the total anticipated return from the intangible which would mean that something similar to a profit split method, and not a comparable based margin method, may have to be considered for computation of the arm's length margin.

It is suggested that India issues guidance on marketing intangibles, illustrating various situations wherein the Indian entity can incur significant marketing expenditure, and where it should receive reimbursement of marketing expenditure, or offset it otherwise, by linking it to the functional characterization of the taxpayer. India should seek support from the RGI and the US TP Regulations which include illustrations to provide guidance on the issue.

*Contributed by Suchint Majmudar, Partner, BMR & Associates LLP.

Incidentally, Circular 3 of 2013 that was issued by CBDT (before it was substituted by Circular 6) earlier provided that a R&D centre had to cumulatively satisfy all the conditions (broadly articulating that that the important functions, risk, and assets should be performed, owned and controlled by the overseas group entity) prescribed in the Circular to be treated as a low risk centre and where it failed even one of the said conditions, the profit split method had to be adopted. However, the said Circular 3 has since been withdrawn and the present Circular 6 does not require the cumulative satisfaction of the conditions for an entity to be treated as a low risk centre. Further, the profit split method is not mandated by the Circular 6. However, with the RGI, this debate could be rekindled if the Indian R&D centre is said to be engaged in any significant functions as detailed above.

Marketing Intangibles

Although the Indian Regulations do not contain guidance on the issue of marketing intangibles, the Indian transfer pricing administration, in its comments in the UN TP Manual, has observed that Indian subsidiaries engaged in distribution of products are generally claimed as carrying no risk or limited risk by the parent MNE. Accordingly, the Indian Revenue has taken a view that the such Indian entities engaged in marketing activity, which incur excessive advertisement and marketing expenses, and bear risks and perform functions beyond what an independent distributor with similar profile would incur or perform for the benefit of its own distribution activities, should be compensated separately for the said function. It is further commented in the UN TP guidelines that such compensation should be in the form of reimbursement of the excess advertisement and marketing expenditure incurred by the Indian entity along with markup. Alternatively, it is commented in the UN TP guidelines that the Indian entity should be allowed to share in the profit related to marketing intangibles.

Considering the comments of the Indian transfer pricing administration in the UN transfer pricing manual, the debate on marketing intangibles can be viewed in the context of functional characterization of the taxpayer (low-risk or entrepreneur). Under arm's length conditions, a low-risk entity would typically not incur significant marketing expenditure. On the other hand, an entrepreneur would have the liberty to perform significant marketing efforts and benefit from the same through the economic ownership of marketing intangibles. However, a view is also canvassed by the Indian Revenue authorities that the compensation for the development of marketing intangible would be applicable irrespective of whether the distributor is bearing full risk or the limited risk, since the Indian distributor would in any case not be the legal owner of the intangible.

It has also been debated in the past rulings if it would be a sufficient compensation if a distributor developing marketing intangibles earns higher distribution profits or gets other concession such as royalty free license of intangibles or should there be independent compensation towards the development of intangibles. In this regard, the RGI suggests that independent compensation would not always be necessary and the distributor can also be compensated by way of increased profits on distribution by other modes such as reduction in the price of the materials purchased, reduction in royalty payment. In other words, no transfer pricing adjustment would be necessary, in terms of the RGI, if the distributors' profits are sufficiently higher to cover the expected compensation towards the development of intangibles over and above the comparable profits earned by normal distributors. This is the contrary view taken in the case of BMW India and is consistent with the RGI. That said, it is noteworthy that the

OECD did have the benefit of having decisions such as those in the cases of Maruti Suzuki and LG Electronics to consider and its guidance and examples do draw upon similar analogies.

It is suggested that India issues guidance on marketing intangibles, illustrating various situations wherein the Indian entity can incur significant marketing expenditure, and where it should receive reimbursement of marketing expenditure, or offset it otherwise, by linking it to the functional characterization of the taxpayer. India should seek support from the RGI and the US TP Regulations which include illustrations to provide guidance on the issue. In addition to dealing proactively with litigation, such a measure will also go a long way in reaching APAs that are filed on this matter.

Location Savings

In most of the TP Documentation in India, local comparables are selected to determine the arm's length return. Hence, in these cases, the question of further attribution on account of location savings does not arise. This view has also been expressed by the Delhi Tribunal in the case of GAP International India Private Limited[2] and by the Finnish Supreme Administrative Court[3].

However, in its comments in the UN Manual on TP, India has expressed a contrary view opining that local comparables alone may not extinguish further attribution on account of location savings. Tax Officers continue to be guided by these comments and make TP adjustments on account of location savings. It is noteworthy to add that even the Rangachary Committee, established to analyse taxation issues in the IT sector, has mentioned in its Report that the Committee was divided on the issue whether local comparables alone can resolve concerns regarding location savings. The guidance in the RGI should enable the Indian Revenue to align itself with the internationally accepted principle that where local comparables are selected for benchmarking, nothing further needs to be attributed on account of location savings.

Intangible valuation

Until recently, the Indian transfer pricing regulations permitted the tax payer to use only the five prescribed methods. In the absence of flexibility in selection of transfer pricing methods, the tax payer often encountered difficulties in applying the prescribed methods for intangible transactions. The Indian Revenue however has now introduced a new sixth transfer pricing method, in terms of which any method that takes in to account the price that would have been charged between unrelated parties can be used for the purpose of determination of the ALP.

While the Indian courts in the past have equated the valuation approaches adopted by the tax payers as an equivalent of the CUP method, the new method may explicitly permit the use of methods that are commonly used for financial valuations. The Indian Revenue could consider developing more specific criteria that could effectively serve as safe harbor in respect of industry growth rates and Beta factors, to facilitate agreement on valuation.

Hard-to-value Intangibles

The RGI contemplates special measures such as commensurate-with-income-rule and valuations in the case of such hard-to-value intangibles. While these can be considered, as a method of last resort, one must not lose sight of the possibility of comparable uncontrolled transactions and making adjustments to such transactions.

2 # FACE TO FACE :

INTERVIEW WITH PASCAL SAINT-AMANS BY ARUN GIRI (Group Editor, Taxsutra) & MUKESH BUTANI (Managing Partner, BMR Legal)

Pascal Saint-**Amans** is the Director of the OECD's Centre for Tax Policy and Administration.

Arun Giri: My first question Pascal, you said during the webcast that “we are half way there”. So I wonder when you say half way, does it mean half way in terms of the action plans rolled out or half way in terms of the consensus achieved or half way in terms of work done by OECD.

Pascal Saint-Amans: It’s very simple, it means we are halfway in terms of delivering the actions called in the roll out of the action plan. The action plan provides for 15 actions to be delivered between September 14 and December 15. We have delivered the first batch of them according to the time schedule and we will be delivering 8 next in 2015. So it’s very basic, we are half way there because we need to deliver the other half of the measures.

Mukesh Butani: My question is on the delivery. Despite BEPS being commissioned by G20, there are mixed responses. For example, UK had been quick to respond to adoption of Country by Country Reporting. India has been supportive. But there are concerns raised by US who have not taken to BEPS in a kind manner. How do you respond to that and how do you plan to achieve a common ground and yet not leave countries who will ask for more. I mean, is this the common denominator or the highest standard.

Pascal Saint-Amans: Well, first let me say that, we are in a process where countries have to agree by consensus on the interpretation of international laws. We are here to try to reach an agreement, which means that you have negotiations and then you have compromises. And also, I am happy to say that what we have presented to G20 over the weekend is something which is agreed. So there are no divergent views. India, US, but also European South Africa, Korea, Japan and all the countries, the 44 countries which are on this project, have fully agreed, to the seven measures, that we have presented to them. Hence, this is an outcome of discussion and negotiation: now there could be a downside which is well..they have agreed because it’s very low and empty and that’s why there is an agreement. And I can tell you and you can tell by reading the measures that it’s not the case. We have strong political support, from all these countries, through a top-down approach. It comes from the leaders, through the finance ministers. There is a real good political dynamic to achieve ambitious outcome. And that’s what we are doing. So, in spite of the differences of the countries, in spite of the divergence of interests, there is strong agreement on the need to put an end to double non-taxation, and to do it in a way which is agreeable by all the countries, is what we are achieving.

Arun Giri: We will now go into specific issues. The first one is on digital economy. And this was one of the mark-key points which the OECD had identified when you launched the BEPS initiative last year. It was on top of the concern list of G20. If you, in your own words, as yet unresolved, the report,

FACE TO FACE : INTERVIEW WITH PASCAL SAINT-AMANS

the first deliverable cause, the digital economy as an economy in itself. There is no conclusion on the virtual PE and your proposals, the options you put forward range from the bandwidth or the bit tax on websites and bandwidth use, the introduction of withholding tax on digital transaction and even significantly replacing the concept of permanent establishment with the 'significant presence' test. If you could take us though his a little more in detail Pascal and is OECD struggling to come up with a solution on this single most critical issue for both the developed and the developing countries?

Pascal Saint-Amans: well, first, I would not necessarily agree with you that it is the single most critical issue. One of the findings of the report which is once again fully agreed by all the countries, is that the digital economy is the economy itself. It is true, key features of the digital economy might exacerbate BEPS concerns (e.g. the lack of physicalpresence, the heavy reliance on intangibles). But again, the digital economy is the economy itself. So I would not agree that this is the single most critical issue. This is part of the broader landscape and one of the findings is the digital tax. Addressing this issue would not be relevant because after few years it would be completely outdated due to the fact that the whole economy is in the process of digitalisation. Reaching the solution in one sector, well, you will just lose it. And I think it's a very important finding. It's not a statement of failure to say "oh we don't know how to do it, we won't…". Indeed, we have understood that the challenges raised by the digitalisation of the economy, go much beyond the so called digital economy. The second statement of the report, which I think is extremely important, says that BEPS is exacerbated in the area of the digital companies. And we certainly shouldn't give up or say "well there is nothing to do because it's too complex" but rather we should address this challenges and the report says that other actions included in the action plan, in particular those relate to intangibles, definition of permanent establishment, treaty shopping, hybrid mismatches, [CFC rules], will be key in supporting the responses to BEPS with regard to the digital companies. In other words, when we will have completed the actions and these actions will be implemented, we will address BEPS for the digital companies as well. The third statement of the report is about some quick fixes which can be made in addition to other actions. In particular, in the area of VAT where, currently, we are completely deprived of guidance on how to deal with the supply of digital services and in the area of permanent establishment, where in terms of definition it was maybe fine a century ago when the preparatory or auxiliary activities were carved out even when you had delivery of goods and warehouse. This, when you don't have much physical presence, is clearly a challenge which needs to be addressed. So overall, we are just coming out with a report, which may say "well nothing new" except that this report reflects the common understanding. Hence, this common understanding is let's not rush to introduce internet taxes on new forms of taxes for a new sector which is clearly identifiable but rather [adopt the approach that] this is a big challenge, as the economy itself is digitalised and, therefore, we need to embrace the issue of BEPS also from a digital perspective in a comprehensive manner and make sure that other actions actually solve the problem with regard to the pure digital players.

> " Locating all the profits in an entity just because it has the legal ownership [of the intangibles] and capital, is not something which is the right thing to do. In another words, the rules agreed that the arm's length principle has not been designed to come up with that outcome."

Mukesh Butani: Before we get to the entire issue of Transfer Pricing and Country by Country

FACE TO FACE : INTERVIEW WITH PASCAL SAINT-AMANS

(CBC) reporting, on intangibles. BEPS report says that depending on the facts the arm's length compensation is required to be provided by the legal owner to other associated enterprise who are performing or controlling functions related to development, enhancement or maintenance of the intangible. Some in the industry believe that this undermines the concept of legal ownership. Does it mean that OECD has taken a stance and does it expect that in the framework, all G20 nations will have to embrace the concept of economic ownership? My follow-up question is on new concept of 'hard to value' intangibles, that has been coined by BEPS — does OECD have any special measures in mind to deal with it? What are your specific thoughts on 'hard to value' intangibles?

Pascal Saint-Amans: We should step back one second on the objectives of the BEPS project. The objective of BEPS project is to put an end to double non-taxation, particularly by realigning the location of the profit with the location of the real activities. In another words, to put an end to situations where all the profits are located in a jurisdiction where nothing is happening apart from the pure ownership of intangibles. And this objective, I think is clearly stated in the explanatory statement which is a politically endorsed document, agreed by all the 44 countries, which clearly says, that the time of 'cash boxes' is over. Locating all the profits in an entity just because it has the legal ownership [of the intangibles] and capital, is not something which is the right thing to do. In another words, the rules agreed that the arm's length principle has not been designed to come up with that outcome. Based on that we need to come up with solutions to fix the current situation where you can locate your excess return in an entity which is the legal owner [of the intangibles] and which has [excessive]capitalisation. How do you address that? We have made a significant progress in terms of explaining the implementation of arm's length principle in the area of intangible. We have come up with the definition of intangibles. It is true however, that the core part of this action 8 is still into brackets, not because there is no agreement, but because there is another action to be finalised which is action 9. Action 9 is about risk and capitalisation which is related to the handling of intangibles from a Transfer Pricing perspective. Coming to your question, on 'hard to value' intangibles and economic approach, I think, we need to reach consensus. In another words, countries will have to come to an agreement which will satisfy the objective of not allocating the excess return to a cash box. But at the same time, without creating uncertainty or situations where tax administrations could take arbitrary decisions which would not be compatible with what others are doing. So, a more economic approach is definitely necessary but this approach must be compatible with respect to the contract. Now, what we need to do in the coming year is to solve this tension between the need for a more economic approach, and the respect of the contract. That is what we are going to do by articulating the discussion on Action 8 and the paragraph which is still into bracket and by developing special measures, which will include hard to value intangible, to make sure that cash boxes cannot be allowed to the excess return but at maximum to the weighted average cost of capital. We need to come up with right technical solutions which would provide certainty to the investors and tax administrations that profits will go where the value is created, and not into entities which, again, are only and purely legal entities not doing anything which is related to value creation.

> " What I think is good from a business perspective is that there has been agreement on a standard template [for the CbC reporting]. If this had not been the case, businesses could have been confronted with as many CbC reporting templates as the number of countries in the world or at least the big countries."

FACE TO FACE : INTERVIEW WITH PASCAL SAINT-AMANS

Mukesh Butani: On TP documentation, there is still a view that there is onerous cost burden being imposed on tax payers for maintaining the three tier documentation. You have left it to countries to determine their own materiality standards and there is a concern about the confidentiality and the fact that some of the documentation may be commercially sensitive to be made available to the tax authorities beyond the headquarters. Are there any thoughts as to how the BEPS project will help, address or alleviate difficulties which the taxpayers have expressed on the Transfer Pricing documentation, in particular?

Pascal Saint-Amans: The answer is yes. We are mindful of the costs of compliance of the decisions which are taken and beyond the cost of compliance, there is the administrability of the measures. The measures must be easily implemented by tax administrations, shouldn't leave room for arbitrary decisions. Now, as regards the documentation and country by country reporting, there is an agreement on the need of CbC reporting as a risk assessment tool for tax administrations. And what I think is good from a business perspective is that there has been agreement on a standard template [for the CbC reporting]. If this had not been the case, businesses could have been confronted with as many CbC reporting templates as the number of countries in the world or at least the big countries. And it is true that it will require a unilateral extra-territorial legislation to get information which is beyond each country's reach. But with the template, we know that unilateral extraterritorial legislation can be effective especially with big markets like China, India, Brazil, the US, Europe. And the businesses may have faced the situations of several different CbC reporting templates. While here we have one agreed by 44 countries, I think this is great. Second, we have been mindful of the cost of compliance and we have heard that some companies can only adopt a top-down approach because of the consolidation of financial data, while some others can only adopt a bottom-up approach because of their accounting system. And that's why the decision has been taken to leave this up to the companies. Either the top-down or the bottom-up approaches are allowed. There is flexibility but when companies have opted for one methodology, they should stick to it to make the instrument comparable from one year to another. And I think this is something which is extremely important. Third, we also heard about the confidentiality of the information and the need to protect it and this was one of the conditions posed by some countries to agree on CbC reporting template. Actually, I must say that this was not really disputed. What matters for the member countries is that the information must be with the tax administrations. Now, all that said, we need to move further to develop the practical implementation guidance, with the procedures on how to supply the information to the tax administrations and how tax administrations will protect the confidentiality of the information. This is something we are working on and we will be working on in the coming weeks. The goal is that country by country reporting compliance can be sealed as quickly as possible. Ideally, the reporting should start in 2017. We also need to define the personal scope of the CbC reporting, for example, by providing some exemptions for small and medium size companies. Finally, we need to make sure that the obligation is proportionate to what is at stake.

Continued on page 29

BEPS QUOTES

With the release of the seven 2014 deliverables, we caution against governments acting too rapidly to implement recommendations into domestic tax legislation until further implementing guidance has been provided and the interactions with future action items is understood.

This would risk creating a series of disparate rules that could negatively impact trade and investment. **The Business and Industry Advisory Committee to the OECD (BIAC's) Media Release on Sept 17, 2014**

SHOOTING STRAIGHT

Mr. Philip Baker, Queen's Counsel, UK

One has to admire the sheer scale of the launch of the OECD/G20 September 2014 outcomes from the BEPS Project. Seven reports were published on 16th September, totalling just over 700 pages. These reports had been produced on time, endorsed by the OECD Committee on Fiscal Affairs and by all 44 OECD/G20 countries participating in the BEPS Project. The launch of the outcomes was accompanied by press briefings, executive summaries, and a webcast. The coordination of the outcome of so much work creates a clear expectation that the promised outcomes in 2015 and 2016 will all appear equally on time.

However impressed one may be with the process, it is still appropriate to stand back and ask critically what has been achieved and what is yet to be completed. In some senses, the 2014 outcomes reflected the easiest part of the Project. Certain of the work – such as that on Transfer Pricing and Intangibles – was already well-advanced before the BEPS Project started. Some of the reports reflect areas where getting governments to agree was never likely to be particularly difficult, for example in terms of countering Treaty Abuse. Some of the outcomes show that the participating governments are still a long way from reaching agreement: this is true, for example, in connection with the Digital Economy, and with the work on Harmful Tax Practices.

The coming year is going to be one where the Action Points are far more contentious, and in which it may prove significantly more difficult to move towards an agreed outcome, including on those 2014 outcomes where no consensus has yet been reached. Particularly difficult topics for the year ahead include: Strengthening CFC Rules, Interest Deduction, and applying the Harmful Tax Practices analysis to non-member countries. Multi-national businesses are also now much more aware that the project could produce very costly outcomes for them, and they are more mobilised to lobby against some of the outcomes.

The impressive output of the 2014 Outcomes should not blind one, of course, to the criticisms that have been made by many people of the BEPS Projects overall. The Project is still narrow in its focus, essentially looking only at the direct tax treatment of a relatively small (but highly significant) number of multinational corporations: there is a world of tax policy and of international tax rules outside the scope of the Project, which may affect literally billions of people, to which the project is not engaged.

It would be uncharitable not to recognise that the 2014 outcomes show that a lot of progress has already been made. For example, on Country by Country Reporting, it seems clear that multinational

groups and countries have reached a reasonable compromise. Similarly, with regard to Treaty Abuse, there does appear to be a consensus that states will be required to adopt a minimum level of protection against abuse, either in the form of anLoB clause or a Principal Purpose provision. With regard to patent boxes, it looks as if the proponents of the transfer pricing approach are losing ground, though they may not yet have given up the fight.

The impressive output of the 2014 Outcomes should not blind one, of course, to the criticisms that have been made by many people of the BEPS Projects overall. The Project is still narrow in its focus, essentially looking only at the direct tax treatment of a relatively small (but highly significant) number of multinational corporations: there is a world of tax policy and of international tax rules outside the scope of the Project, which may affect literally billions of people, to which the project is not engaged. One should also remember that the BEPS Project is essentially politically driven, and is being rushed through to meet the political timetable, with the danger of adopting sub-optimal outcomes. While the project focuses on the direct taxation of multinationals, the possibility exists that there will be significant collateral damage: a good example of this is the Treaty Abuse proposals where the focus on BEPS seems to have been used to drive forward a miscellaneous agenda of anti-avoidance measures, many of which have nothing to do with base erosion or profit shifting at all. The Project is also driven by a rear-guard action to safeguard the OECD's dominant role over international taxation, and to fight off claims from more representatives bodies, such as the United Nations, to take over the work of coordinating international policy on tax matters. It also hides the fact that the OECD and G20 countries may represent 85% of the world's GDP, but they do not represent anything like 85% of the world's population, and that the poorest developing countries are only indirectly included in the process.

If one were to seek to highlight one development which is perhaps the most promising, it is the work on a Multilateral Instrument. For many years now the problem of how to streamline the amendments of large number of bilateral tax conventions has been an issue. If a Multilateral Instrument is developed which has this specific purpose of amending large numbers of bilateral treaties, this may prove to be the most significant long term outcome of the Project.

By Sanjiv Malhotra, Partner, BMR & Associates LLP

Concept of location savings and locational specific advantages

Broadly, location savings are the cost savings that an MNE realizes as a result of relocating from a high-cost to a low-cost jurisdiction. This typically includes savings relating to labour, rent, raw material costs, taxes and any other cost advantages accruing in the low tax cost jurisdiction. From a TP perspective, only the (net) cost savings because of price differences in various factors of production that may be realized by a MNE on account of relocation of some of its operations from a 'high-cost' to a 'low cost' location should be factored.

To set a proper analytical framework, it is critical to distinguish between location savings and the broader concept of Locational Specific Advantages. The term (net) location savings focusses on one aspect of locational advantages ie the net reduction in costs attributable to relocation. Location-specific advantages, on the other hand is a much larger term and takes into cognizance the existence of other location-specific characteristics that may lead to an advantage for the MNE, and is not necessarily attributable to relocation from a high cost to a low cost jurisdiction. Location-specific advantages (LSAs) encompass not just production factors but also distribution and market related features, which enable the MNE to increase its sales and margins in the subject geographical location. Any incremental profit derived from the exploitation of LSAs is known as "location rent".

A word of caution, mere existence of LSA's does not automatically translate to supernormal profits for a MNE or 'location rent' in the current context. A further analysis is required, on whether the MNE actually enjoys a competitive edge in the market due to exclusive or special access to the LSAs, and the realistic alternatives available to the MNE to translate such advantage into supernormal profits, managing competitive pressures. Only where the existence of net locational savings and location rents is established from a TP perspective, the question around their allocation arises.

OECD's guidance on allocation of location savings

The recently issued Guidance on Transfer Pricing Aspects of Intangibles, issued as a part of OECD / G20 Base Erosion and Profit Shifting (BEPS) Project emphasises this quite explicitly and recommends determination of the existence and the quantum of location savings as the first step. It also necessitates adequate consideration to the extent to which location savings have been retained by the MNE group or passed on to independent customers or suppliers, with due regard to the manner in which independent enterprises operating in similar circumstances would have retained location savings.

The OECD re-asserts its views expressed in the July 2013 Revised Discussion Draft on Transfer Pricing Aspects of Intangibles:

- Location savings is a concept around comparability and not necessarily an intangible.
- Comparability adjustment is not required where appropriate local comparables are available and can be used to identify ALP.
- Where such comparables are not available, allocation of location savings and comparability adjustments should be made having regard to the FAR analysis of each party and their respective bargaining power.

OECD has further clarified that the guidance provided in the OECD Transfer Pricing Guidelines with respect to treatment of location savings in the context of a business restructuring should apply to all situations wherein location savings are present. This final guidance from the OECD pursuant to the BEPS initiative, should ideally assist in clinching some fundamental interpretations on the issue of location savings.

Indian view

India's view on the concept of location savings and their allocation as narrated under Chapter 10 of the United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual) is aggressive on more than one count. The Indian Revenue authorities (RA) appear to propagate a wider definition of location savings and claim a long list of LSA's offered by the country as enumerated in Para 10.4.7.2 of the UN TP Manual:

- Highly specialized skilled manpower and knowledge;
- Access and proximity to growing local/regional market;
- Large customer base with increased spending capacity;
- Superior information networks;
- Superior distribution networks;
- Incentives; and
- Market premium.

Naturally, Indian RA's proposed solution on allocation is somewhat contradictory to the OECD view. India's views as summarised in the UN TP Manual bring out the following points:

- It focuses on the concept of allocation of incremental profits from location savings and other LSAs.
- It advocates use of profit split method (PSM) where uncontrolled transactions are not available.
- Even where local comparables are available, there can be a need to allocate net location savings between the parties over and above the price per the local comparables.

The Indian RA issued an administrative circular in 2013 on use of PSM, particularly in the context

of captive R&D facilties set-up in India. The circular provided that in case TNMM or CUP method are proposed, upward adjustments interalia, for transfer of intangibles, location savings and location specific advantages should be considered. However, the subject circular was withdrawn shortly diluting the preference to PSM, as indicated earlier.

Way forward

To its credit, the OECD has clearly distinguished location savings from an intangible, but critics may not be satisfied with the simplistic view dealt by the OECD. The OECD BEPS paper provides limited guidance on how in real world would such savings be split (especially where appropriate third party data is not available).

In the present scenario, local country regulations and customer contracts, many a times, mandate full disclosures of the ultimate source country for a product or a service. These mandates are driven by diverse concerns; from data privacy / protection to human rights. Thus, in many situations, the consumers of such goods and services are well aware about the existence of the low cost jurisdictions in the supply chain. In addition, as low cost hubs emerge, there is more competition in the market based on product pricing as sellers have an ability to reduce their prices to sell more. Both these reasons (over a period of time) lead to diminution of location savings.

Somewhere this has shades of economic theory wherein super profits (say due to cost arbitrage) disappear over a period of time because of correction in demand and supply (also represented by Average Revenue (AR) and Marginal Cost (MC) curves). Thus, in theory, firms will continue to produce on the MC curve till the prices move down and the super profits (generating from location savings amongst others) are passed to the customers. The existence and quantification of location savings (at a particular point of time) has to be a fact driven exercise.

New Zealand Inland Revenue's website captures this issue in a rather mature manner, which is somewhat assuring for the tax payer:

"Although we currently have no issues on hand we're aware that the treatment of location savings, particularly the value attributed to location savings vis-à-vis other factors, is an area of growing contention globally. We're concerned that in some cases the value arising from location savings is hypothetical and not borne out when comparisons are made with comparables. We see this as another area where the arm's length outcome can only be properly determined by reference to the specific facts of the case, and recommend taxpayers contact us if experiencing difficulties."

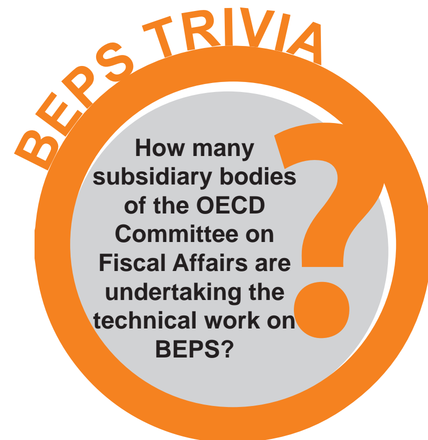
India (comparatively) hasn't seen many disputes around location savings. There have been few judgments and the decision by the higher appellate authorities dismissing allocation of higher profits to the Indian entity in case of Li Fung and GAP are the more celebrated ones. The Delhi High Court in the case of Li Fung came to the conclusion that the Indian RA had failed to demonstrate to what extent the AE benefitted from locational advantages before arbitrarily rejecting the taxpayer's economic analysis. At the field officer level, the issue of location savings / LSAs is not prominent and mostly restricted to high end captive centers and procurement entities, as captured by the administrative circulars issued by the Indian RA.

This is not to say that the issue is settled in India, the risk of future challenges continue for the following reasons:

OECD BEPS paper advocates use of guidance on location savings in all situations and not limited to those emerging from business restructuring. Hence, one may argue that relocation of functions may not be a trigger point for alleging additional returns (for Indian operations) for location savings.

OECD also recognizes "other local market features" may result in location savings and somewhere hinting at the concept of LSA as mentioned in the UN TP Manual.

If the aforementioned two points are read together then potentially all MNCs operating in India have a threat of being questioned on existence of location savings because at some level there may be a cost arbitrage by operating in India. In conclusion, the issue of location savings in emerging countries requires further debate and policy guidance from the administration such that taxpayers can consider it appropriately in their FAR analysis.



a. 11 b. 6 c. 2

See answer on page 35

FACE TO FACE : INTERVIEW WITH PASCAL SAINT-AMANS

Continued from page 21

Arun Giri: The next topic - "Treaty Abuse". Pascal just summarizing the three major recommendations in the BEPS report.

1. A limitation of benefits clause in the treaties on the line of those that you are recommending specifically you are saying that it could be modeled on the lines of the LOB clause in the USA treaties
2. The main purpose rule within the treaties
3. A minimum level of protection to prevent treaty abuse. Is it essentially introducing GAAR in the tax treaty and since this would entail amendment to thousands of tax treaties entered into between more than 90 or 100 countries, how is this going to be achieved?

Pascal Saint-Amans: It's not only the GAAR that we are introducing, we are also introducing the LOB and more importantly we have an agreement with all the countries, to introduce a Minimum Standard. That goes beyond having a model that countries will implement. We have a political commitment that all the countries will put an end to treaty abuse, by including in their treaties this minimum standard, which is flexible in terms of putting either a LOB or GAAR rule or an articulation of one of the other with domestic legislation. But there is an agreement that treaty abuse comes to an end. Now how should we implement these measures? There are two avenues, one is through the bilateral treaties and the other is linked to Action 15 which provides the possibility of negotiating a multilateral instrument, which will provide for the minimum standard and which will amend all the bilateral treaties automatically and simultaneously. Action 15's Report concludes that such a multilateral instrument is feasible and currently we are developing a mandate to gather a negotiation of such multilateral instrument, and the decision to start the negotiations will be taken in early 2015.

> " Arbitration is a way of deterrence for tax administrations to get better when they can't solve disputes through their MAPs. But I wouldn't say that arbitration is the only way to do and that if we don't have it we will fail. I think it would be extremely sad and wrong to say so."

Mukesh Butani: Since we are on multilateral instrument, my next question is the report indicates that by January 2015, the OECD and G-20 will consider a mandate for an international conference for negotiation of multi-lateral convention. There is also a reference about the term 'interested countries' who may wish to pursue and develop a multilateral instrument. Are you hinting at potential difficulties that you may have to get all countries on board and consensus with respect to multi national convention? Because I also heard you a while ago saying that the countries have agreed as a fundamental principle, that there would be a multi -lateral instrument.

Pascal Saint-Amans: One difficulty is that we need to wait for the decision to start that negotiation, since it's not taken yet. My next challenge is to make sure that this is agreed by countries. Second, a multilateral instrument would not be to re-invent the wheel, it would be just to streamline the implementation of the agreement on tax treaty measures to address BEPS. So the hard work is not about negotiating the multilateral instrument, the hard work is about agreeing on the BEPS

2 FACE TO FACE : INTERVIEW WITH PASCAL SAINT-AMANS

measures related to treaty abuse, which is done; hybrid mismatches, which is done; permanent establishment, which is not done yet; a possible improvement of mutual agreement procedures, which needs to be finalised. So we are already halfway there. As far as the multilateral convention goes, what needs to be engineered is the framework and that's new and that's challenging, but its technical, it's not really political. As regards to contents, well the content is to be decided within the BEPS measures. We take the assumption that, if there is an agreement on BEPS measures with regard to tax treaty then the question is how implement them quickly through a multilateral negotiation. It's not to reopen again the door for new negotiations of new tax measures but rather to streamline their implementation once these tax measures are agreed.

Mukesh Butani: Couple of questions which are specific to INDIA and this is a follow up to last week's meeting in Australia. We heard that the Indian Minister of State for Finance in her intervention, expressed concerns on the arbitration clause and this has been a bone of contention and India has been resisting mandatory or binding arbitration on mutual agreement procedure arguing that it will abdicate its judicial powers should it give such right in a tax treaty and that it will impact India's ability to apply domestic laws. Now doesn't this in some manner militate with the principle you articulated earlier on no double taxation. If India holds on to its view on arbitration and disputes do not get settled through the ordinary mutual agreement procedure, how will you handle such situation? This may not be specific to India but, it could be any other country in the G-20 grouping.

Pascal Saint-Amans: And beyond the G-20 grouping.

Mukesh Butani: Absolutely

Pascal Saint-Amans: We have Action 14 which is a commitment from countries to improve the way they handle double taxation through mutual agreement procedures and we are mandated to explore all possibilities to change the approach. The Indian position is not isolated. There is a number of countries against arbitration for good and bad reasons; very often they have bad reasons but sometimes they have good reasons. This position doesn't come as a surprise! Now, if we take the assumption that we will solve matters only through arbitration, it would be a pretty negative approach, and that's not the case. I think we need to move towards arbitration for all those willing to get there and I think there are a growing number of countries willing to get there. Arbitration is a way of deterrence for tax administrations to get better when they can't solve disputes through their MAPs. But I wouldn't say that arbitration is the only way to do and that if we don't have it we will fail. I think it would be extremely sad and wrong to say so. Instead I think we need to unlock the problems that countries face when doing mutual agreement procedures and we can unlock this through political attention. Competent Authorities very often don't come to terms because they are not obliged to come to terms and because nobody really cares. But the tax community cares, we have plenty of conferences and all that but it's never on radar screen of Ministers. Now it is on Ministers' radar screen. I can understand India saying we don't want arbitration. But saying so a Minister will probably agree that he needs to eliminate double taxation if not by arbitration, at least by making sure that the competent authorities are really committed to do so. In terms of being transparent, it would be important revealing the number of cases of double taxation, the number of years needed to solve double taxation and the reasons why double taxation is not solved. In addition, I think it would be extremely important promoting arbitration as a way to find the keys to unlock the current roadblocks. This might be a very down to earth trivial process but unlike the previous attempts such as the

development of MEMAP 10 years ago or so, this time we may come up with the political support/ attention which should oblige the country to really pay attention to this issue and put pressure on the competent authority. We will be engineering the mechanism which, in true respect of the sovereign interest of each country, obliges them, in practice, to be much more efficient than they are today.

Arun Giri: Last question .. What if the United States does not buy into the BEPS outcome? That is a billion dollar question; many are still having in their mind. Are you confident that all the 44 countries involved in this project and especially the G-20 everyone will sign on the dotted line in the near future ?

Pascal Saint-Amans: Arun, they have signed. So, it's not a question. The 7 measures which we have provided are endorsed by all the countries. Now, you may have another question which is - what happens if they don't implement these measures? This is a different question and my response is that the BEPS project is about providing countries, which want to protect their tax bases, with instruments to protect their tax bases. If you don't want to protect your tax base and you don't create BEPS for other countries it is too bad just for you. It's your choice, as long as it has no spillover on the others. Do we need the US to change its policy and its tax laws? NO! The BEPS project will have an impact on all the countries who are willing to protect their tax base. Would it be better if the US changes its tax laws? Definitely! [First of all] for the US and they are fully aware of that.

Arun Giri: Thank you so much Pascal for your time.

Mukesh Butani: Thank you Pascal..we really appreciate.

Pascal Saint-Amans: Thank you.

BEPS QUOTES

"If you abuse our tax system, you abuse the trust of the British people. And my message to those companies is clear: we will put a stop to it. Low taxes, but low taxes that are paid. Part of our effort to reduce our deficit."
- George Osborne - Chancellor, UK

1 DISSECTING BEPS ACTION PLANS

Continued from page 8

Note – The Report clarifies that since the mechanisms described in this Chapter are new and untested, there is a need to actively review their implementation. It is mandated that countries participating in the BEPS project will carefully review the implementation of these new standards and will reassess by the end of 2020 whether modifications to the content of these reports should be made to require reporting of additional or different data. The Report also states that additional work will be undertaken over the next several months to identify the most appropriate means of filing the required information with and disseminating it to tax administrations.

Key changes in the final guidelines vis-à-vis the draft guidelines issued In January 2014 are as follows:

➤ The Country-by-Country Report is now a separate file which has been carved out of the Master File, changing the approach to a 'three-tiered' one from 'two-tiered'.

➤ The requirement of filing the master file in English has been removed.

➤ Certain changes have also been made to the information required to be furnished in the master file, local file and country-by-country report:

- For instance, in the Master File (under the heading of description of MNE's business), the revised guidelines have defined material supply change transactions to include the MNE group's 5 largest products and/or service offerings by turnover.
- In the Local File, (under controlled transactions with regard to intercompany charges), the revised guidelines require further details of intra-group payments and receipts for each category of controlled transactions involving the local entity (i.e. payments and receipts for products, services, royalties, interest, etc.) broken down by tax jurisdiction of the foreign payer or recipient.
- In the Country-by-Country Template, the revised guidelines have toned down reporting requirements and have provided reporting of data in two tables - Table 1 includes details of revenue earned from related & unrelated parties, etc and Table 2 provides a list of all Constituent Entities of the group included in each aggregation per tax jurisdiction and various business activities carried out by them.

BEPS TRIVIA

answer is 40. 39 countries plus EU

5 NEWS WRAP UP

This section provides brief news updates on BEPS from around the world, during the last couple of months.

July 2014

In this report on "Impact of BEPS in Low Income Countries" - Part 1 [prepared for the G20 Development Working Group (DWG) on the Impact of BEPS in Low Income Countries], OECD drew together the experiences of developing countries and international organisations on the main sources of BEPS in developing countries and how these relate to the OECD/G20 BEPS Action Plan. The Report identifies the relative significance to developing countries of each of the 15 Actions contained in the BEPS Action Plan, stating that developing countries have also identified a number of issues, such as tax incentives, that are of concern to them but which are not addressed in the Action Plan.

August 05, 2014

In its Final Report to the G20 DWG, OECD submitted a Roadmap for participation of developing countries in the process of automatic exchange of information. Drawing on the Global Forum's extensive consultations with developing countries, the World Bank Group, other international organisations and civil society, the Roadmap provides an approach to ensuring developing countries can overcome obstacles in implementing the new standard.

August 13 2014

OECD published Part 2 of the Report on Impact of BEPS in Low Income Countries, which recognises that the risks faced by developing countries from BEPS and the challenges faced in addressing them, may differ to those faced by advanced economies. The Report sets out areas where additional guidance and tools are required to ensure that the BEPS outcomes fully benefit lower capacity countries.

September 1, 2014

Singapore's tax authorities released a consultation paper setting out additional proposed guidance on transfer pricing documentation so as to align Singapore's transfer pricing documentation guidance with Action 13 of the OECD's BEPS

Action Plan. Among other things, the additional proposed guidance relates to the clarification of "contemporaneous" transfer pricing documentation, introducing compliance exemptions for small and medium-sized enterprises and for taxpayers who have applied the safe harbour mark-up for eligible routine services, and requesting additional information to be furnished at group and entity levels.

September 04, 2014

Upon request from the United Nations Committee of Experts on International Cooperation in Tax Matters, International Chamber of Commerce (ICC) submitted its views on the taxation on hybrid entities to feed into the UN's work on the UN Model Convention. ICC encouraged the UN Committee to feed the views of non-G20, non-OECD members into the OECD's BEPS project.

September 16, 2014

On September 16, 2014, OECD released a series of deliverables (the 2014 deliverables) addressing 7 focus areas in its Action Plan on BEPS. The documents released consisted of a brief explanatory statement, final reports on Action 1 – Digital Economy and Action 15 - Multilateral Instrument, an interim report of Action 5 – Harmful Tax Practices and draft reports on Action 2 - Hybrid Mismatch Arrangements, Action 6 – Treaty Abuse, Action 8 – TP for Intangibles and Action 13 – TP documentation and CbC reporting. The reports released were described by Pascal Saint-Amans (who leads OECD's tax work) as reflecting agreement by the participating countries on the present status and future steps to be taken on the covered Actions, while the draft recommendations were described as "soft legislation" containing the countries' consensus and commitment to rules to be developed to address the matters on which those Actions dealt.September 20, 2014
Financial Secretary to the Treasury, David Gauke, announced that UK-based multinationals will have to report to HMRC where they make profits and pay taxes around the world, making UK the first of 44 countries to formally commit to implementing the new country-by-country reporting template unveiled by the OECD.

In a meeting of the G20 Finance Ministers and Central Bank Governors in Cairns, Australia, the OECD and its Global Forum on Transparency and Exchange of Information have been mandated to develop toolkits to support developing countries addressing BEPS and to launch pilot projects to assist them to move towards automatic exchange of information. The OECD will report to the G20 Leaders in November on its plan to deepen the involvement of developing countries in the OECD/G20 BEPS project and ensure that their concerns are addressed.

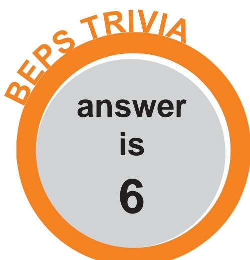
5 NEWS WRAP UP

September 2014

Minister of State for Finance from Indian Government, Nirmala Sitharaman, made an intervention at the G-20 meet and raised concerns of developing countries with regards to BEPS. Welcoming new standards on automatic exchange of information, she called for implementation with a common timeline, fully reciprocal arrangement, changes in domestic legislations as also technical & financial assistance for developing countries. She stated that India supports BEPS project but 'underlines' that "concerns of developing countries regarding BEPS may be different from those of developed countries…"; She also stated that introduction of mandatory and binding arbitration in the Mutual Agreement Procedure of the Tax Treaties is a major concern and it impinges on the sovereign rights of developing countries in taxation and also limits their ability to apply their domestic laws for taxing non-residents and foreign companies.

September 26, 2014

Almost 300 senior tax officials from more than 100 countries and international organisations met in Paris on 25-26 September 2014 during the 19th Annual Global Forum on Tax Treaties to discuss solutions to unintended double non-taxation caused by BEPS. Following up on the discussions at the 2013 Annual Meeting and the regional consultations on BEPS, participants examined the first set of tax treaty-related recommendations developed under the OECD/G20 BEPS Project and discussed the main tax treaty issues and options concerning the current work on the 2015 deliverables to be dispatched in September and December 2015.



ACTION PLAN - 8

Continued from page 14

Replacement of Chapter VI of the Transfer Pricing Guidelines - Chapter VI discusses Special Considerations for transactions involving intangible property. The guidance contained in Chapter VI is not intended to have relevance for other tax purposes such as definition of royalty, customs purposes, recognition of income, capitalisation of intangible development costs, amortisation, etc.

Identifying Intangibles - In these Guidelines, the word 'intangible' is intended to address something which is not a physical or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer, would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Accounting characterization, availability and extent of legal, contractual or other forms of protection and separate transferability are not decisive criteria for identifying an 'intangible' for TP purposes.

The definition of "marketing intangible" is expanded so as to define it as an intangible that relates to marketing activities, aids in the commercial exploitation of a product or service, and/or has an important promotional value for the product concerned, including patents; know-how and trade secrets; trademarks, trade names and brands; rights under contracts and government licences; licences and similar limited rights in intangibles; goodwill and ongoing concern value; group synergies, and; market specific characteristics.

Ownership of intangibles and transactions involving their development and exploitation - The framework for analysing transactions involving intangibles involves the following:

i. **Identifying the legal owner of intangibles** based on the terms and conditions of legal arrangements, including relevant registrations, licence agreements, other relevant contracts, etc;

➤ When no written terms exist, the terms must be inferred from the conduct of the parties and the economic principles that govern relationships between independent enterprises. If no legal owner is identified, then that group member who controls decisions concerning the exploitation of the intangible and has the practical capacity to restrict others from using the intangible will be considered the legal owner.

ii. **Identifying the parties** performing functions, using assets and assuming risks related to developing, enhancing, maintaining, protecting and exploiting the intangibles through the functional analysis;

➤ *Functions* - For self-developed intangibles, the important functions may include design and control of research and marketing programmes, direction of and establishing priorities for creative undertakings, control over strategic decisions regarding intangible development programmes, and management and control of budgets.

➤ *Assets and Funding* – Use of assets that require payment of appropriate compensation may include intangibles used in R&D or marketing, physical assets, or funding. A party that provides funding, but does not control the risks or perform other functions associated with the funded activity, generally does not receive anticipated returns equivalent to those received by an otherwise similarly-situated investor who performs and controls important functions and bears and controls important risks.

- Risks - Particular types of risk that may have importance in a functional analysis relating to transactions involving intangibles include risks relating to development, product obsolescence, infringement and product liability and similar risks. Where one party to a transaction is both contractually allocated risk and performs the functions controlling those risks while the other party bears the costs that arise from the risks, then an adjustment may be necessary to reflect actual sharing of risks and the appropriate allocation of relevant costs.

- Unanticipated ex post returns – The entitlement of any member of the MNE group to profit or loss relating to unanticipated events (ex post, income or loss) will depend on the terms and conditions of relevant contracts and on the functions performed, assets used and risks assumed in connection with these unanticipated events.

iii. **Confirming the consistency** between conduct of the parties and the terms of the relevant legal arrangements regarding intangible ownership through a detailed functional analysis;

iv. **Identifying the controlled transactions** related to the development, enhancement, maintenance, protection and exploitation of intangibles in light of the legal ownership of the intangibles and the conduct of the parties, including their contributions to the creation of value;

v. **Determining ALP for these transactions** consistent with each party's contributions of functions performed, assets used, and risks assumed;

vi. **Recharacterising transactions as necessary to reflect arm's length conditions.**

The Report then describes the application of these principles in commonly occurring fact patterns.

Transactions involving the use or transfer of intangibles - There are 2 general types of transactions where the identification and examination of intangibles will be relevant:

i. Transactions involving transfers of intangibles or rights in intangibles - It is essential to identify with specificity the nature of the intangibles and rights in intangibles that are transferred between AEs. Inits supplemental guidance on this subject, the Report provides that **transfer pricing methods that seek to estimate the value of intangibles based on the cost of intangible development are generally discouraged**, and that the **CUP method** (where reliable comparable uncontrolled transactions can be identified) and **transactional profit split method** (where it is not possible to identify reliable comparable uncontrolled transactions) are most likely to prove useful. Profit split methods can be applied to the sale of full rights in intangibles, transfers of partially developed intangibles and where limited rights in fully developed intangibles are transferred in a license or similar transaction. **Valuation techniques**, especially those that estimate the discounted value of projected future cash flows derived from the exploitation of the transferred intangible, may also be used as a part of one of the five approved methods, or as a tool that can be usefully applied in identifying ALP.

   In case of 'hard-to-value' intangibles i.e. when valuation is highly uncertain at the time of the transaction, one possibility is to use anticipated benefits (taking into account all relevant economic factors) as a means for establishing the pricing at the outset of the transaction. If pricing based on anticipated benefits alone does not provide an adequate protection against the risks posed by

the high uncertainty, shorter-term agreements may be adopted or price adjustment clauses may be included to protect against subsequent unpredictable developments.

ii. Transactions involving the use of intangibles in connection with the sale of goods or the provision of services - Where the tested party does not use unique and valuable intangibles and where reliable comparables can be identified, ALP can be determined on the basis of one-sided methods including CUP (relative to the tested party), resale price, cost plus and TNMM methods. Where reliable uncontrolled transactions can't be identified, transactional profit split methods may be used.

Note: The following work contained in this Report, and as adverted to above, are still at the interim stage and will be finalized in 2015 in connection with other BEPS related work as they are interrelated.

➤ Ownership of intangibles and transactions involving their development, enhancement, maintenance, protection and exploitation

➤ Application of profit split methods

➤ Arm's length pricing for hard-to-value intangibles

Other aspects of the Report remain largely unchanged vis-a-vis the revised discussion draft released in July 2013.

6 NEUTRALISING THE EFFECT OF HYBRID MISMATCH ARRANGEMENT – A STEP TOWARDS RIGHT PATH

Amod Khare
Partner, BMR & Associates LLP

Pavan Kakade
Director, BMR & Associates LLP

Background

Hybrid arrangements can be understood as arrangements which are characterised differently by different countries resulting in a tax benefit to either one or all of the parties to the arrangement. The use of hybrid arrangements in international tax planning has created tremendous opportunities and provided an ability to tax payers to create substantial tax benefits. The growing significance of such arrangements has attracted the attention of the revenue authorities worldwide who regard such benefits as artificial and illegal. The OECD has also recognised the effects and impact of such arrangements on the erosion of tax base of countries.

It is important to note that the current report of the OECD focusses on the corporate tax implications of the hybrid arrangements. However, the OECD should also provide guidance on the transfer pricing implications arising from the recharacterisation of payments under the hybrid mismatch arrangements.

The impact of hybrid arrangements has been discussed in a number of OECD reports wherein the OECD has suggested several policy options to countries to reduce the impact of such arrangements. Taking this initiative forward, the OECD in its Action Plans on Base Erosion and Profit Shifting ('BEPS') has included a specific action plan on 'Neutralise the Effects of Hybrid Mismatch Arrangements' ('the Action Plan')

Analysis of the action plan and report released by OECD

The OECD in the Action Plan has called for the development of model treaty provisions and recommendations regarding design of domestic rules to neutralise / eliminate the effect of hybrid instruments and entities. The Action Plan further states that this may be achieved by:

(a) Undertaking changes to OECD Model Tax Convention to ensure hybrid instruments and entities are not used to obtain undue benefit under tax treaties;

(b) Amend domestic law provisions to prevent exemption or non-recognition of payments that are deductible by the payer;

(c) Amend domestic law provisions to deny deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules)

NEUTRALISING THE EFFECT OF HYBRID MISMATCH ARRANGEMENT – A STEP TOWARDS RIGHT PATH

(d) Amend domestic law provisions to deny deduction for a payment that is also deductible in another jurisdiction; and

(e) Where necessary, guidance on co-ordination or tie-breaker rules to be provided if more than one country seeks to apply such rules to a transaction or structure.

Consequent to the Action Plan, the OECD released a report outlining its recommendations on the above aspects.

1. Part I - Recommendations for the design of domestic laws

- The recommendations of the OECD have covered three categories of hybrid mismatch arrangements:
  - o Hybrid financial instruments are instruments which are classified differently in different jurisdictions resulting in a payment deductible in one country which is not considered as a taxable receipt in the other country.
  - o Hybrid entity payments are those where the payer is classified differently in different jurisdictions resulting in either a double deduction for a payment in two jurisdictions or that of a deduction being granted in one jurisdiction but no inclusion of the receipt in income in the other jurisdiction.
  - o Reverse hybrid are arrangements where an intermediary is interposed in the transaction and the differences in the characterisation of the intermediary results in a deduction in one jurisdiction but no inclusion in income in the other jurisdiction. Imported mismatches are arrangements where the intermediary is a party to a separate hybrid mismatch arrangement and the income inclusion from one arrangement is set off against a deduction from the other arrangement.
- The OECD has also provided illustrations with respect to the operation of each of the above hybrid mismatch arrangements.
- The OECD has devised its recommendations for the above categories by determining rules which are divided into primary rule and defensive rules
- The primary rule is the basic rule which should apply in a jurisdiction to counter the benefit from the hybrid mismatch arrangement. The defensive rule is the rule which should apply if the jurisdiction responsible to apply the primary rule fails to do so. Thus, the primary rule would apply whenever a hybrid mismatch arises and the secondary or defensive rule would apply in circumstances where the primary rule did not apply in the counterparty's jurisdiction.
- The objective of devising primary and defensive rules is to avoid the risk of both jurisdictions considering the arrangement as a hybrid mismatch arrangement and applying the principles as recommended in the discussion paper.

6 NEUTRALISING THE EFFECT OF HYBRID MISMATCH ARRANGEMENT – A STEP TOWARDS RIGHT PATH

- Below is a summary of the recommendations suggested by the OECD in the domestic laws:

Category	Hybrid element	Type of mismatch	Primary rule	Defensive rule
Hybrid Financial Instruments & Transfers	Differences in tax treatment of the instrument mean that payments under the instrument have a different character in different jurisdictions	Deduction but no corresponding income	Payer jurisdiction denies deduction	Payee jurisdiction includes payment as income
Hybrid entity payments	Differences in the tax treatment of the entity or arrangement mean that payments made by the entity or under the arrangement are characterised differently under the laws of two or more jurisdictions.	Deduction but no corresponding incomeDouble deduction	Payer jurisdiction denies deduction. Parent jurisdiction denies deduction	Payee jurisdiction includes payment as income. Payer jurisdiction denies deduction.
Reverse hybrids	Differences in the tax treatment of the entity mean that payment is not included in income by the payee	Deduction but no corresponding income	Payer jurisdiction denies deduction	
Hybrid Financial Instruments & Transfers	Hybrid Financial Instruments & Transfers		Payer jurisdiction denies deduction	

2. Part II - Recommendations on treaty issues

- The OECD observed that as a tax avoidance measure, taxpayers have been structuring their set up in a manner wherein the taxpayers are resident in two countries and have been taking undue advantage of tax treaties in such cases. The OECD recognised that the current tie-breaker rule in the Model Convention is not sufficient to counter such structures. The OECD also recognised that the current provisions in the Model Convention restrict the applicability of treaty benefits only to partnerships which are fiscally transparent; however, there are other forms of entities which may be considered as fiscally transparent as per the domestic laws of a particular country. Accordingly, it is necessary to extend treaty benefit restriction to such other entities as well.

NEUTRALISING THE EFFECT OF HYBRID MISMATCH ARRANGEMENT – A STEP TOWARDS RIGHT PATH

- Towards meeting the above objectives, the OECD has recommended the following:
  - In order to ensure that dual resident entities are not used to obtain undue benefit of tax treaties, the OECD has recommended revising Article 4(3) of the Model Convention dealing with dual residency. The OECD has recommended moving from the place of effective management approach to a mutual agreement approach with certain select driving factors. The OECD has also recommended introduction of a rule in domestic law wherein an entity resident in another state under a tax treaty will not be considered as a resident under the domestic law of the other country.
  - Changes to Article 1 of the Model Convention and consequent amendment to the Model Commentary on Article 1 to state that income derived by an entity which is wholly or fiscally transparent under the tax law of either country, shall be considered to be income of a resident of a country but only to the extent that the income is treated for purposes of taxation by that country as the income of a resident of that country.
  - The OECD also analysed the impact of the recommendations made in Part I on provisions of Article 7 (with respect to allowability of deduction) and Article 24 (on non-discrimination). The OECD held that the recommendations should not affect the provisions of Article 7 and Article 24 and would supplement the same.

Conclusion and way forward:

The OECD in its report has mentioned that further work would be carried out to develop guidance in the form of a Commentary which will explain how these recommendations would practically work. The OECD has also stated that certain areas such as application of rules to issue of hybrid regulatory capital, require further discussion and that it wishes to reach an agreement on this issues along with release of the Commentary by September 2015.

Although the OECD Model Convention may be revised to incorporate the aforementioned recommendations of the OECD, the challenge would be for various countries to be able to achieve this by way of amendment to tax treaties. Further, although the OECD has also suggested changes in domestic tax laws of countries, this would require significant co-ordination to achieve the intended objective. Also, post incorporation of such recommendations in domestic tax laws, as observed by the OECD, co-ordination amongst the countries involved in such hybrid arrangements would be required to avoid double taxation by way of both countries applying the recommended rule. To achieve such effective co-ordination amongst multiple countries would be a great challenge.

Lastly, it is important to note that the current report of the OECD focusses on the corporate tax implications of the hybrid arrangements. However, the OECD should also provide guidance on the transfer pricing implications arising from the recharacterisation of payments under the hybrid mismatch arrangements.

Having said the above, the recommendations and steps taken by the OECD are a step towards the right path of preventing tax avoidance and protecting the tax base of each country. However, the recommendations are at a very nascent stage and would need to be developed after taking into account the practical challenges that may arise.

BEPS TIMELINE

Please visit - http://www.oecd.org/ctp/calendar-planned-stakeholders-input.pdf to view the detailed calendar for planned stakeholders' input until July 2015.

Month	Details
June 2012	G20 asks OECD at leaders' meeting to report on "the need to prevent base erosion and profit shifting"
February 12, 2013	OECD publishes first report "Addressing Base Erosion and Profit Shifting," listing 6 key pressure areas
May 29, 2013	Declaration on BEPS adopted at Ministerial Council Meeting in Paris
July 19, 2013	OECD publishes second report "Action Plan" on BEPS listing 15 action points with deadlines
July 30, 2013	OECD publishes revised discussion draft on Intangibles (Action 8)
September 6, 2013	G20 leaders endorse OECD's work on BEPS at Russian summit
October 22, 2013	OECD releases public comments on Intangibles (Action 8)
January 23, 2014	OECD presents first update webcast on 2014 deliverables
January 30, 2014	OECD publishes discussion draft on CbC Reporting (Action 13)
February 23, 2014	OECD releases public comments on CbC Reporting (Action 13)
March 14, 2014	OECD publishes discussion draft on Treaty Abuse (Action 6)
March 19, 2014	OECD publishes two discussion drafts on Hybrids (Action 2)
March 24, 2014	OECD publishes discussion draft on the Digital Economy (Action 1)
April 3, 2014	OECD presents second webcast on BEPS project update
April 11, 2014	OECD releases public comments on Treaty Abuse (Action 6)
April 16, 2014	OECD releases public comments on the Digital Economy (Action 1)
May 7, 2014	OECD releases public comments on Hybrids (Action 2)
May 26, 2014	OECD presents third webcast on BEPS project update
September 16, 2014	OECD releases first set of 7 BEPS deliverables including two final reports: (Action 1 – Digital Economy and Action 15 – Developing a Multilateral Instrument), one interim report (Action 5 – Countering Harmful Tax Practices) and four reports containing draft recommendations (Actions 2 – Hybrid Mismatch Arrangements, 6 – Preventing Treaty Abuse, 8 – TP issues on Intangibles and 13 – TP documentation and CbC reporting)
September 16, 2014	OECD also presents 4thwebcast on release of 2014 BEPS deliverables
January 2015	CFA to consider a draft mandate for negotiation of the multilateral instrument
September 2015	Completion of 8 action plans including CFC rules, artificial avoidance of PE status etc
December 2015	Completion of remainder action plans including harmful tax practices, development of a multilateral instrument, digital economy next steps etc

taxsutra

BMR Advisors

About Taxsutra

Launched in 2011, B2B portal - Taxsutra.com is a trusted online resource for corporate tax directors, policymakers and practioners. Taxsutra's instant news alerts & incisive analysis on both domestic and international tax, coupled with unique features like tax ring, Taxsutra Insight, Litigation Tracker, Taxsutra TV and blogs make it a "must-have" for every tax professional.

Given the increasing focus of tax administrations on Transfer Pricing, **www.tp.taxsutra.com** was launched in October 2011, as India's first exclusive exclusive portal on TP. Apart from a comprehensive database of over 1000 Indian TP cases, the portal offers several new editorial features including Case Tracker, International Rulings, APA Space, TP Talk, Expert Corner, TP Personalities and 'Around the World.' Taxsutra's thought leadership and continuous engagement with tax professionals has been on display through several unique initiatives/microsites/special coverage on burning tax issues, controversies and important developments, be it APA, the $2bn Vodafone tax case, BEPS, our roadblocked coverage of Union Budget and even some light tax banter with our microsite on Soccer World Cup & tax! Taxsutra has also championed various niche events and workshops. In 2013, Taxsutra also launched the portal on Central Indirect Taxes – **www.idt.taxsutra.com**

For details relating to subscription and pricing to Taxsutra's 3 quality portals, contact **sales@taxsutra.com**.

About BMR

BMR is a professional services organisation offering a range of Tax, Risk, M&A advisory for businesses of all sizes, at the local, national and international levels. We enhance value for clients by focusing on solutions that are innovative, yet practical and that can be implemented. We do this by blending domain expertise with analytical rigour, while maintaining an uncompromising focus on quality - and by hiring and nurturing high quality professionals with a passion for excellence. We are committed to making a difference to our clients and to our people, and we deliver this difference through the integrity of our efforts and by living our core values.

The firm, since its formation in 2004, has won the confidence of several Fortune 500 companies, medium and large Indian business houses and is their partner of choice. Our team of over 600 professionals has extensive functional and industry experience across service areas and is well-equipped to deliver world-class services to our clients. Our vision is to be the most admired professional services Firm serving clients globally. Our mission is to enhance our client's competitiveness, help people realise their aspirations and contribute to the community through innovation and entrepreneurship.

BMR and Community

The firm has a strong commitment to good citizenship and community service. We are as devoted to community work as we are to our client work.

BMR has offices across several locations in India.

www.bmradvisors.com

© TAXSUTRA All rights reserved
Designed by Ergon : 9920126456 www.ergonevents.in