SJSU | LUCAS GRADUATE SCHOOL OF BUSINESS

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Non-U.S. International Tax News and Issues

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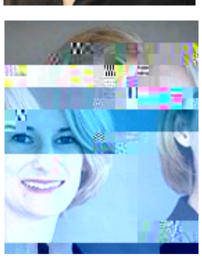

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Agenda

- OECD Developments
  - OECD Program of Work: Overview
  - Pilar 1: Profit allocation and nexus rules
  - Pillar 2: Global anti-base erosion proposal
- EU Developments
  - Digital tax proposals
  - Economic substance legislation
  - Disclosure rules
- Local Country Developments
  - Unilateral measures
  - Use of data by tax authorities

OECD Developments

Digital Taxation: Scoping the Issue

- Under current law, jurisdictions' right to tax business profits is generally based on physical presence within a country.
  - "Permanent Establishment" ("PE"): office or other fixed place of business
- The Internet permits companies to build their brand, develop an engaged customer base, and create value…
  - without physical locations, in many circumstances.
- Operations within a country, if required, can be limited to routine activities that some argue does not reflect the level of economic engagement within the country.

OECD Progress to Date

Policy Note

“Addressing the Tax Challenges of the Digital Economy”

- Issued in January 2019
- Sets out two-pillar approach

Program of Work

- Roadmap to work towards consensus solution to tax challenges posed by digitalization by end-2020
- Released on **May 31, 2019**, and endorsed by G20 Finance Ministers on June 8

Pillar 1: Profit Allocation and Nexus Rules

Proposed three-tiered profit allocation mechanism

Amount A: a share of an MNE's non-routine return attributable to market intangibles allocated to market jurisdictions using a formulaic approach

1. Identify the group's profits, potentially from consolidated financial statements
2. Identify "routine" profits to be excluded from allocation
3. Determine the split of remaining non-routine profits between the portion attributable to market intangibles vs. to other factors (trade intangibles, capital and risk), using a simplified convention such as a fixed percentage
4. Allocate the relevant amount, based on an allocation key such as sales

Amount B: a fixed return for baseline marketing and distribution functions that take place in a market jurisdiction

Amount C: an additional return in accordance with existing transfer pricing rules when a market jurisdiction can successfully establish – subject to robust and binding dispute resolution mechanisms – that there are more functions in the market jurisdiction than have been included in Amount B

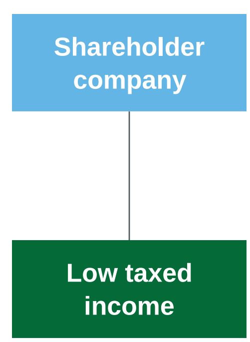
Pillar 1: Profit Allocation and Nexus Rules

Pillar 2: Global Anti-Base Erosion Proposal (“GloBE”)

- Global minimum tax
- Rules to permit countries to tax profits where income is subject to

Pillar 2: Income Inclusion Rule

- Requires a **shareholder** to bring income into account if income of controlled company not subject to tax at **a minimum rate**
- This rule would **supplement** rather than replace **CFC rules**
- **Switch-over rule** for exempt branches, or income derived from foreign immovable property



- Rule would operate as a **top up to the minimum rate of tax**
- Minimum rate will be a **fixed percentage tax rate**

  Specific fixed percentage rate not yet agreed

Pillar 2: Tax on Base-Eroding Payments

Undertaxed payments rule:

- **Denies a deduction**

EU Developments

EU Proposals on Digital Taxation

- Political pressure in Europe to change the tax rules around the digital economy has continued unabated.
- On March 21, 2018, the Commission released its package of proposals.

Draft directive: Interim proposal

- Directives affecting tax need unanimous approval from Member States before they can be adopted.
- Both draft directives set out a January 1, 2020 commencement date.

Economic Substance Legislation

- Under pressure from EU Code of Conduct Group, certain jurisdictions from EU "gray list" were required to enact economic substance legislation or face "blacklisting" by EU.
- In most cases, legislation effective as of January 1, 2019 with transitional relief for "grandfathered" companies expiring July 1, 2019.
- Further regulations and guidance are expected in many locations and it is possible that existing rules may change.

Anguilla	Bahamas	Bahrain	Barbados	Bermuda
BVI		Guernsey	Isle of Man	Jersey
Marshall Islands	Mauritius	Seychelles	Turks and Caicos	UAE

Economic Substance Legislation

- Although each jurisdiction is different, the legislation followed similar patterns in many jurisdictions and was based on guidance and requirements issue by the EU and OECD
- Three requirements to demonstrate economic substance:
  - Directed and managed test
  - Core income generating activities test
  -

DAC6: Summary

1

What is required to be disclosed?
Any “**cross border arrangement**” that contains one or more of the “**hallmarks**” listed in the Directive. These hallmarks are features in a tax planning arrangement that could potentially enable tax avoidance or abuse.

2

Who is required to make the disclosure?
The Directive is broad in scope. **Intermediaries** include any **EU** based person that **designs, markets, organises or makes available** for or **manages implementation** of a reportable cross- border arrangement. This includes lawyers, accountants, tax and financial advisers, banks.

3

When is the disclosure obligation triggered?
When the person arrangement / structure is first made available f[(a)-0.6(r)-1.on eeW(s)-5.-1.2(s)-5.3/3(

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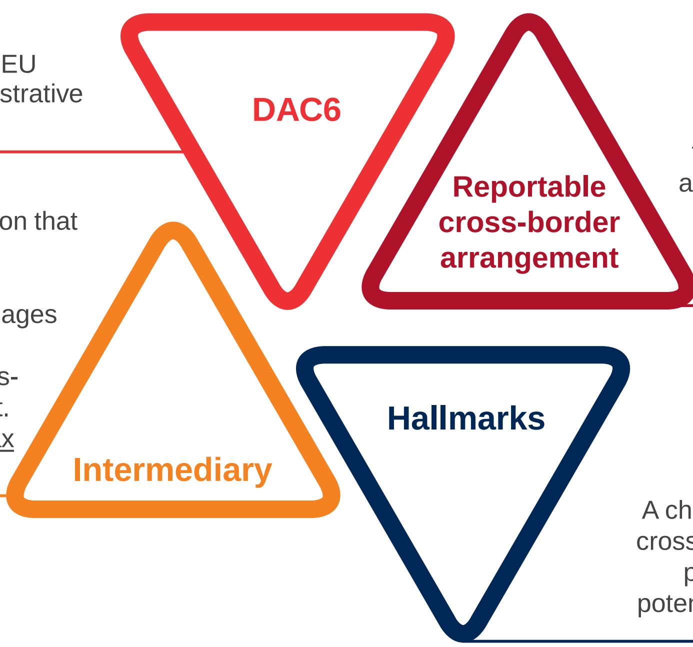
DAC6: Key Terms

Sixth update of the EU Directive on Administrative Co-operation

Any EU-based person that designs, markets, organises or makes available for or manages implementation of a reportable cross-border arrangement. Not necessarily a tax adviser!



An arrangement concerning either more than one Member State or a Member State and a third country that bears one or more of the “hallmarks” listed in the Directive.

A characteristic or feature of a cross-border arrangement that presents an indication of a potential risk of tax avoidance.

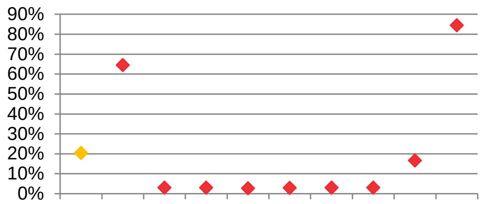
DAC6: It’s Already in Force!

Unilateral Measures:
French Digital Services Tax (“DST”)

Use of Data by Tax Authorities

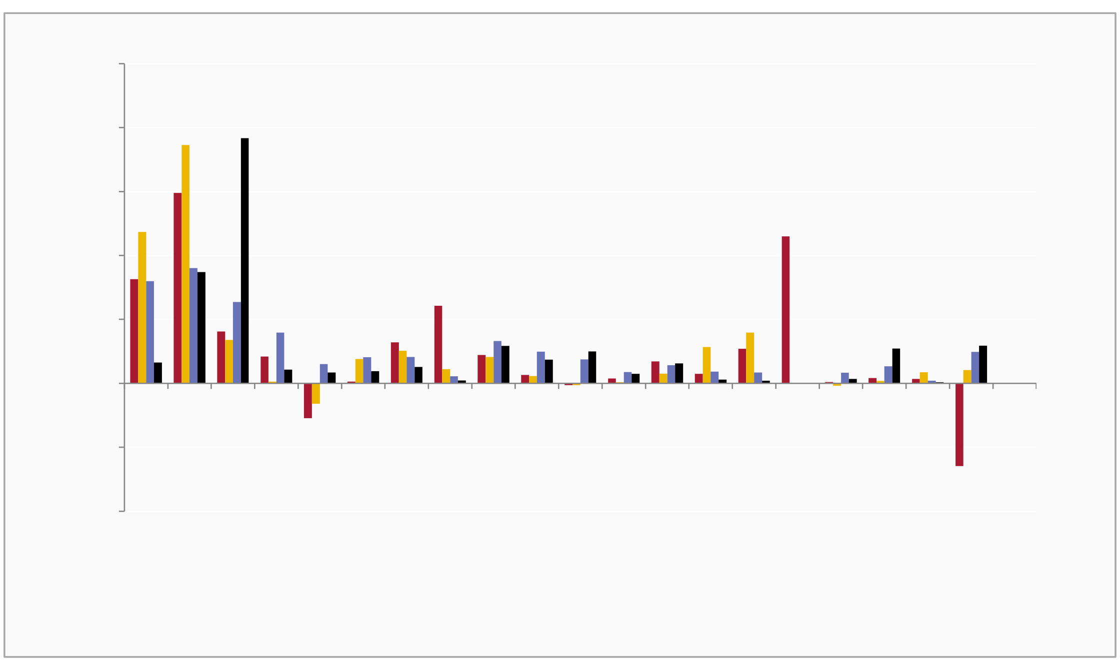
- Transparency initiatives such as Country by Country Reporting and DAC6 are giving tax authorities access to more information than ever before
- A number of jurisdictions are introducing programs to use this data to identify taxpayers of interest

Data Analytics



Key ratios:

- Revenue per employee by jurisdiction
- PBT per employee by jurisdiction
- Profit margin by jurisdiction
- ETR by jurisdiction
- Regional comparisons
- Y-o-Y fluctuations



Use of Data by Tax Authorities: Netherlands

- Dutch CbC team:
  - Includes a number of new FTEs as part of the Coordination Group on Transfer Pricing (“CGTP”)
  - Centralized risk assessment: assessment through data analytics, assessment by CbC team, CbC team (together with CGTP) contacts account team, CbC team/CGTP and account team approach taxpayer to further discuss
  - CbC report is “one of the tools”
- Expectation:
  - 150 Dutch ultimate parent entities
  - 3,000 Dutch constituent entities of non-Dutch ultimate parent companies

Use of Data by Tax Authorities: China

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Questions?