



Tax and Legal Newsletter

The OECD releases the final package of measures for a coordinated international approach to reform the international tax system under the OECD/G20 BEPS Project

Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits “disappear” for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

BEPS Action Plan sets forth 15 actions to address BEPS in a comprehensive and coordinated way. These actions will result in fundamental changes to the international tax standards and are based on three core principles: coherence, substance, and transparency. For more detailed information please visit <http://www.ey.com/GL/en/Services/Tax/OECD-base-erosion-and-profit-shifting-project>

A brief overview of the 15 Actions released on the 5th of October is set out below.

Action 1 - Addressing the Tax Challenges of the Digital Economy

This report sets out an analysis of the tax challenges that the digital economy poses for international taxation. The report describes, among other things, rules and implementation mechanisms to enable efficient collection of value-added tax (VAT) in the country of the consumer in cross-border business-to-consumer transactions. The report also discusses and analyses options to deal with the broader tax challenges raised by the digital economy, noting the need for monitoring developments in the digital economy over time.

Action 2 - Neutralise the Effects of Hybrid Mismatch Arrangements

This report sets out a common approach which will facilitate the convergence of national practices through domestic and treaty rules to neutralise hybrid instruments and entities which exploit differences in tax treatment to achieve double non-taxation, including long-term deferral. This will help to prevent double non-taxation by eliminating the tax benefits of mismatches and to put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid.

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Action 3 - Strengthen CFC Rules

The report sets out recommendations in the form of building blocks of effective Controlled Foreign Company (CFC) rules. The recommendations are not minimum standards, but they are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries. It identifies the challenges to existing CFC rules posed by mobile income such as that from intellectual property, services and digital transactions, and allows jurisdictions to reflect on appropriate policies in this regard.

Action 4 - Limit Base Erosion via Interest Deductions and Other Financial Payments

The report recommends a common approach to facilitate the convergence of national rules in the area of interest deductibility. The common approach aims at ensuring that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities and fostering increased coordination of national rules in this space.

Action 5 - Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

The Action 5 report sets out a minimum standard based on an agreed methodology to assess whether there is substantial activity in a preferential regime. In the context of IP regimes such as patent boxes, consensus was reached on the "nexus" approach. This approach uses expenditures in the country as a proxy for substantial activity and ensures that taxpayers benefiting from these regimes did in fact engage in research and development and incurred actual expenditures on such activities. The same principle can also be applied to other preferential regimes. The results of the application of the elaborated substantial activity and transparency factors to a number of preferential regimes are included in the report.

Action 6 - Prevent Treaty Abuse

The Action 6 report includes a minimum standard on preventing abuse including through treaty shopping and new rules that provide safeguards to prevent treaty abuse and offer a certain degree of flexibility regarding how to do so. The report also contains the policy considerations to be taken into account when entering into tax treaties with certain low or no-tax jurisdictions.

Action 7 - Prevent the Artificial Avoidance of PE Status

The report includes changes to the definition of permanent establishment in Article 5 of the OECD

Model Tax Convention, which is widely used as the basis for negotiating tax treaties. These changes address techniques used to inappropriately avoid the tax nexus, including via replacement of distributors with commissionaire arrangements or via the artificial fragmentation of business activities.

Actions 8-10 - Assure that Transfer Pricing Outcomes are in Line with Value Creation

Under Action 9, contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Action 10 has focused on other high-risk areas, including the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

The combined report also contains guidance on transactions involving cross-border commodity transactions as well as on low value-adding intra-group services.

Action 11 - Measuring and Monitoring BEPS

Action 11 assesses currently available data and methodologies. A dashboard of six BEPS indicators has been constructed, using different data sources and assessing different BEPS channels. The report concludes that going forward, enhancing the economic analysis and monitoring of BEPS will require countries to improve the collection, compilation and analysis of data.

Action 12 - Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements

The Action 12 report provides a modular framework of guidance drawn from best practices for use by countries without mandatory disclosure rules which seeks to design a regime that fits those countries' need to obtain early information on aggressive or abusive tax planning schemes and their users.

Action 13 - Re-examine Transfer Pricing Documentation

This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity.

Action 14 – Make Dispute Resolution Mechanisms More Effective

The report develops solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

Action 15 – Develop a Multilateral Instrument

The Action 15 report explores the technical feasibility of a multilateral instrument to implement the BEPS treaty-related measures and amend bilateral tax treaties. Therefore, to facilitate negotiations for such an instrument a mandate has been developed for an

ad-hoc group, open to the participation of all countries.

Implementation of BEPS Project

Some of the revisions may be immediately applicable such as the revisions to the Transfer Pricing Guidelines, while others require changes that can be implemented via tax treaties, including through the multilateral instrument. Some require domestic law changes, such as the outputs of the work on hybrid mismatches, CFC rules, interest deductibility, Country-by-Country Reporting, and mandatory disclosure rules, etc.

We will continue monitoring developments and will inform you on further changes in tax legislation.

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