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OECD's Project on Base Erosion & Profit Shifting

International tax reset

Skatt og velferd, 26 januar 2016

Rolf J. Saastad

Introduction and background

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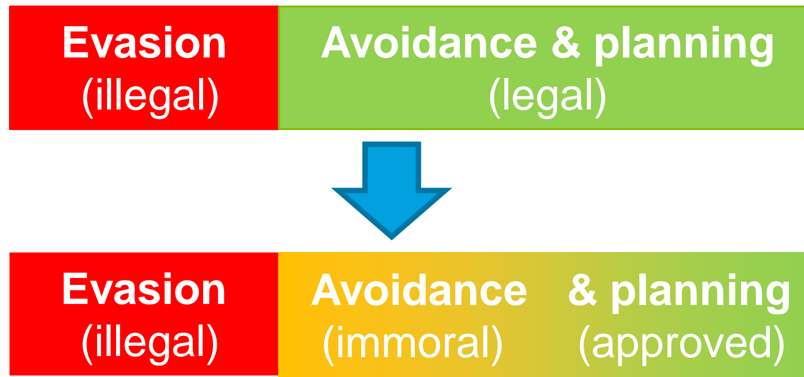
Background

The tax environment

- Increased introduction of morality into tax in recent years



OECD definitions:

*"**Evasion** -- A term that is difficult to define but which is generally used to mean illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities."*

*"**Avoidance** -- A term that is difficult to define but which is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow"*

*"**Tax planning** -- Arrangement of a person's business and /or private affairs in order to minimize tax liability."*

- Debate on morality heightened by the financial crisis and political pressure:
  - *Belt tightening, tax increases, and wider tax reforms*
  - *Multinational enterprises seen as paying (or being able to choose to pay) little tax; unfair burden on individuals and national businesses*
  - *International tax rules seen as out-dated*

- Tax issues (e.g. BEPS and source versus residence) part of a wider narrative around the developed versus developing world

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Background

Non-Governmental Organization and media attention -> tax as a boardroom item

The Sun: «Google's 'massive, immoral tax avoidance exposed'»

"Starbucks 'chooses' to pay tax for first time in five years"

"We are not accusing you of being illegal; we are accusing you of being immoral"

Flere utbygginger kan ryke

Frykter nye skattehopp

Skattejakten

På skattejakt i splittet EU

Regjeringen tetter skattehull

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Background
Non-Governmental Organization and media attention -> tax as a boardroom item

Statoil-sjefen Helge Lund kutter skatten med 600 mill. kroner i Belgia.
FOTO: MARK EARTHY

Statoil og Statkraft kutter skatten med 1 mrd.

De to statselskapene sparer skatt ved å sluse hundrevis av milliarder gjennom sine belgiske internbanker. Statkraft låner penger tilbake til Norge etter først å ha sendt dem til Belgia.

Sigurd Bjørnestad
Publisert: 13.aug. 2013 12:46 Oppdatert: 13.aug. 2013 12:49

Statsselskapene Statoil og Statkraft sparte i fjor 1 milliard kroner i norsk skatt ved å utnytte belgiske skatteregler.

14. mai i år innleder statsminister Jens Stoltenberg på Arbeiderpartiets skatteseminar i Oslo.

Han forteller hvordan selskapene låner penger i land med høy skattesats og dermed får høy verdi av rentefradraget. Samtidig flytter selskapene inntektene til land med lave skattesatser. Han peker på den norske skattesatsen på 28 prosent på bedrifter som høy sammenlignet med andre land.

Annonse
FORLENG SOMMEREN
1 uke Fly og hotell fra 998,-
apollo
55 personer anbefaler dette.

Belgisk og norsk skatt

Oljefondets Yngve Slyngstad og Finansdepartementet organiserer fondet slik at skatteregningen i utlandet blir minst mulig.
FOTO: Svein Erik Furulund

Oljefondet kutter skatten ved å flytte penger via Luxembourg

Både Oljefondet og DNB bruker selskaper i Luxembourg for å betale minst mulig skatt. Å gjøre forretninger gjennom Luxembourg åpner for det statsbanken DNB kaller «skatteoptimale løsninger.»

Sigurd Bjørnestad

Både den delvis statseide storbanken DNB, Oljefondet og Finansdepartementet tenker skatt når de skal gjøre internasjonale forretninger. Oljefondet og DNB bruker selskaper i Luxembourg for kutte skatten helt lovlig.

Oljefondets eiendomsinvesteringer i USA, Storbritannia og kontinental-Europa var 37 milliarder kroner ved utgangen av 1. kvartal i år.

Norges Banks behov
Oljefondets eiendommer i kontinental-Europa er eid gjennom det heleide datterselskapet NBIM S.à r.l. som er lokalisert i Luxembourg. I fondets årsrapport for 2011 står det i en liten artikkel med tittelen "Lav skatt":

Hvorfor vises denne annonsen?
Belgia
Av Ombudstvedt, Sven
"Belgia - Notater fra et langt opphold i hjertet av Europa" er en fortelling om mat, drikke, sjokolade, politikk og ...
Vår pris: 275,- 223,-
Kjøp
akademika

Statsminister Jens Stoltenberg varslet i sin 1. mai-tale at regjeringen kommer med nye tiltak mot internasjonale konsern som flytter overskudd ut av Norge for å unngå skatt.

Stoltenberg ga i sin tale på Youngstorget uttrykk for sterk bekymring over at flernasjonale konsern driver omfattende skattetilpasning. De plasserer gjeld i land med høy skatt og vide mulighet for å trekke fra gjeldsrenter, mens overskudd plasseres i land med lav eller ingen skatt.
- Slik unngår de å betale skatt, eller betaler veldig lite skatt. Dette uthuler skattesystemet og undergraver finansieringen av fellesskapet, advarte Stoltenberg.
Skatteplanlegging er et voksende internasjonalt problem. Statsministeren sa at vi trenger mer internasjonalt samarbeid, mer åpenhet og mer innsyn for å bekjempe problemet.
- I tillegg trenger vi å gjøre endringer i vårt eget skattesystem. Vi skal ikke øke det samlede skattenivået. Hensikten er å få et mer rettferdig system, der de som har mest, bidrar mest. Og et system med færre hull, som bidrar til å sikre arbeidsplassene og sosial rettferdighet, sa han.
Statsministeren varslet flere tiltak og nye initiativ.
Regjeringen vil legge fram forslag om innstramming av rentefradrag på lån mellom selskaper i samme konsern.
I revidert nasjonalbudsjett, som kommer i neste uke, fremmer regjeringen forslag om innsyn i advokaters klientkontoer for å sikre skattemyndighetene like godt innsyn i disse kontoene som i bankkontoer.
Statsministeren la vekt på å fullføre det nordiske skatteparadisprosjektet, som går ut på å få til avtaler som sikrer informasjon om norske pengeplasseringer i skatteparadiser. Norge vil også forsterke arbeidet i Organisasjonen for økonomisk samarbeid og utvikling, OECD, for å forhindre skattetilpasning.
Norge overtar formannskapet i OECD i mai.
- Vi vil gjøre arbeidet for å sikre skattegrunnlaget til en hovedsak under vårt formannskap, sa Stoltenberg

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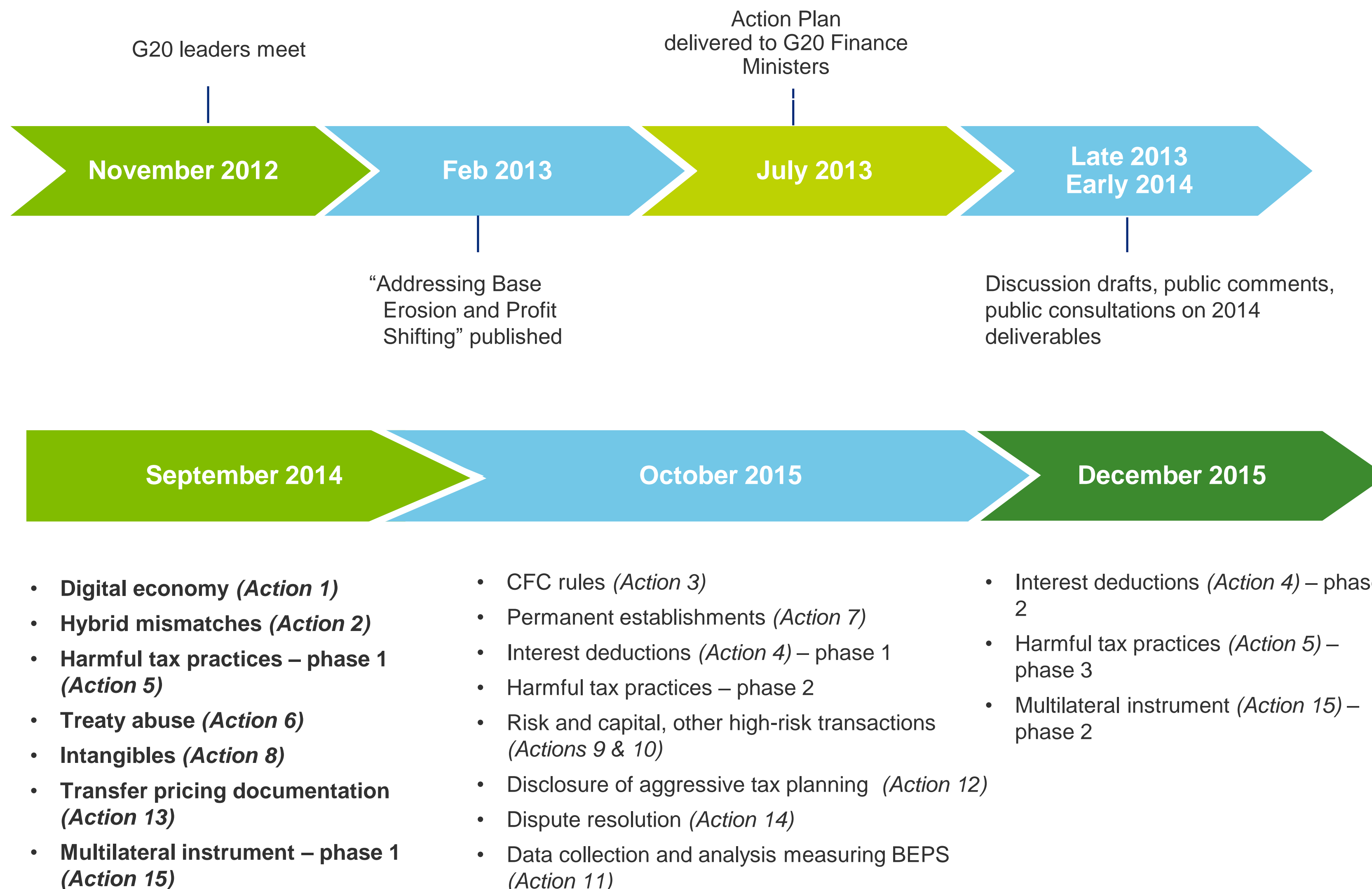
Background

Progress to Date



September 2014

- **Digital economy *(Action 1)***
- **Hybrid mismatches *(Action 2)***
- **Harmful tax practices – phase 1 *(Action 5)***
- **Treaty abuse *(Action 6)***
- **Intangibles *(Action 8)***
- **Transfer pricing documentation *(Action 13)***
- **Multilateral instrument – phase 1 *(Action 15)***

October 2015

- CFC rules *(Action 3)*
- Permanent establishments *(Action 7)*
- Interest deductions *(Action 4)* – phase 1
- Harmful tax practices – phase 2
- Risk and capital, other high-risk transactions *(Actions 9 & 10)*
- Disclosure of aggressive tax planning *(Action 12)*
- Dispute resolution *(Action 14)*
- Data collection and analysis measuring BEPS *(Action 11)*

December 2015

- Interest deductions *(Action 4)* – phase 2
- Harmful tax practices *(Action 5)* – phase 3
- Multilateral instrument *(Action 15)* – phase 2

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Introduction

USD 100,000,000,000 – 240,000,000,000

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Introduction

What is “base erosion and profit shifting” (BEPS)?

“The divorce between the location of the profits and the location of the value creation.”

(Pascal Saint-Amans, January 2014)

- OECD policy: *“No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.”*

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Introduction

The BEPS challenge

- **Action 11 findings**
  - New OECD research finds global net annual revenue loss of 4-10% of Corporate Income Tax at 2014 levels, around NOK 800 – 2000 billion
  - Main indicators report evidence of BEPS:
    - The profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average
    - The effective tax rates paid by large MNE entities are estimated to be 4 to 8.5 % lower than similar enterprises with domestic-only operations
    - The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio

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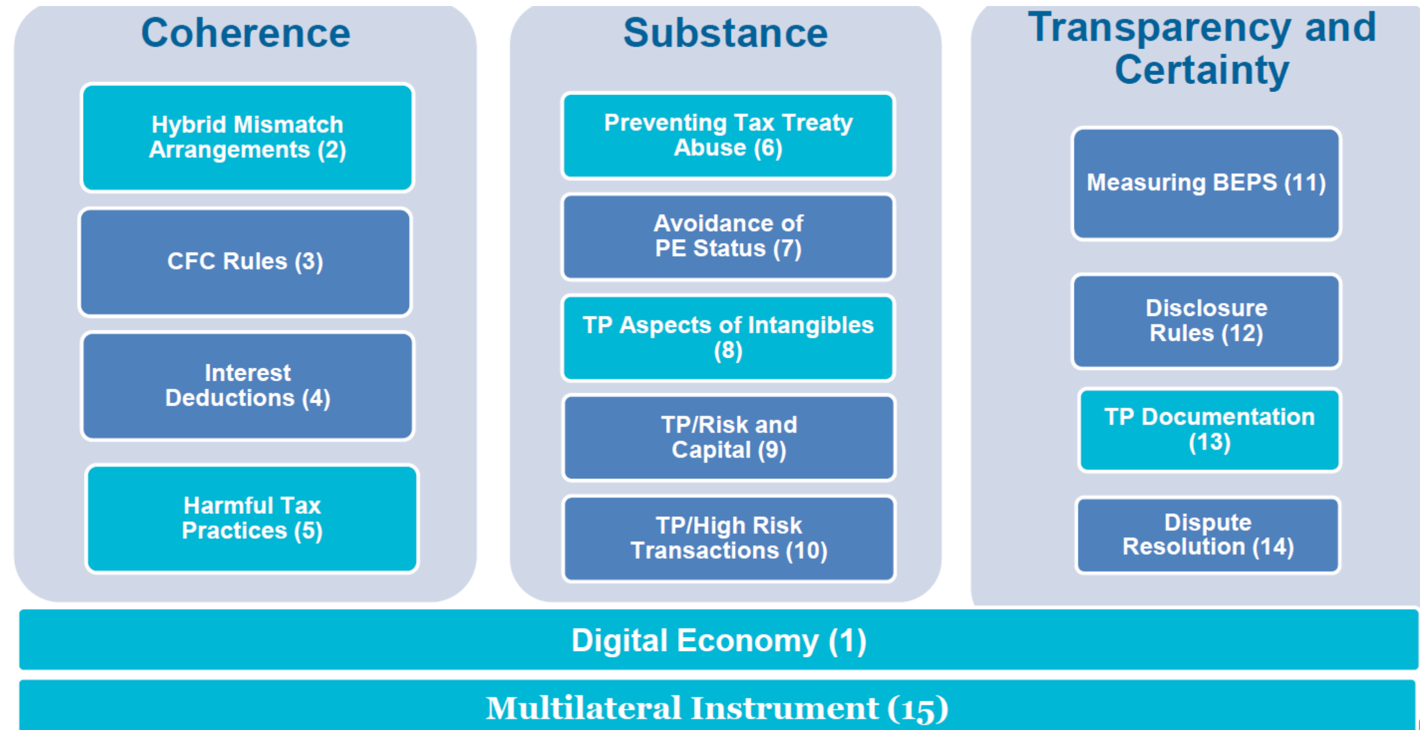
Introduction

What is OECD's BEPS project?

- Work was initiated in 2012 by G20 to combat BEPS, with the OECD mandated to lead the initiative
  - 2013: action plan adopted
  - 2014: report on 7 actions
- A political response - perception that BEPS causes governments to lose substantial corporate tax revenue
- Biggest change to the international tax system for years



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Introduction

Which countries participate?

34 OECD member countries and 2 OECD Accession countries (*)		
AUSTRALIA	HUNGARY	POLAND
AUSTRIA	ICELAND	PORTUGAL
BELGIUM	IRELAND	SLOVAK REPUBLIC
CANADA	ISRAEL	SLOVENIA
CHILE	ITALY	SPAIN
CZECH REPUBLIC	JAPAN	SWEDEN
DENMARK	KOREA	SWITZERLAND
ESTONIA	LUXEMBOURG	TURKEY
FINLAND	MEXICO	UNITED KINGDOM
FRANCE	NETHERLANDS	UNITED STATES
GERMANY	NEW ZEALAND	*COLOMBIA* *
GREECE	**NORWAY**	*LATVIA* *

8 other G20
ARGENTINA
BRAZIL
CHINA
INDIA
INDONESIA
RUSSIA
SAUDI ARABIA
SOUTH AFRICA

Other	
ALBANIA	MALAYSIA
AZERBAIJAN	MOROCCO
BANGLADESH	NIGERIA
COSTA RICA	PERU
CROATIA	PHILLIPINES
GEORGIA	SENEGAL
JAMAICA	SINGAPORE
KENYA	TUNISIA
LITHUANIA	VIETNAM

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Implementation of BEPS measures

Changes in OECD guidelines and domestic legislation

- **Changes in OECD's transfer pricing guidelines**
  - Implementation of measures on pricing of intangibles, intragroup services, cost-contributing arrangements and commodity transactions
  - Adopted directly in the OECD's transfer pricing guidelines with immediate effect
  - The guidelines has direct impact on Norwegian taxpayers through the Norwegian Tax Act section 13-1 (4)

- **Changes in domestic legislation**
  - Several measures to be implemented in domestic legislation
  - Recommendations versus minimum standards

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Implementation of BEPS measures

Tax treaty changes through multilateral treaty – Action 15

- **Changes in tax treaties – the introduction of a multilateral treaty (action 15)**
  - Several measures call for changes in the OECD Model Tax Convention and bilateral tax treaties in force
  - As there is more than 3000 tax treaties in force, a renegotiation of all treaties to implement BEPS measures would take decades
  - OECD propose to implement the changes through a multilateral treaty open for all countries
    - So far 90 countries has reported that they intend to participate
    - Inaugural meeting next month
    - The treaty is expected to be open for signature by the end of 2016
  - The treaty will change all treaties between parties committing to the treaty
  - The treaty will have alternative solutions, opt-ins and opt-outs

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Implementation of BEPS measures

Norwegian approach

- **Appears to be very positive and eager to implement**
- **Changes proposed in the 2016 Budget released on October 7**
  - Tightened interest limitation rules – from 30 % of EBITDA to 25 % of EBITDA
  - Hybrid rule – exemption method not to apply if distribution is deductible for the payer
- **St melding 4 " Bedre skatt" – further work in 2016 and implementation 2017 onwards**
  - Interest limitation rules – to include interest to unrelated parties, possibly also % of EBITDA
  - CFC – NOKUS
  - Hybrids
  - Permanent establishments
  - Exemption method
  - CbC reporting

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Action 2
Neutralising the Effects of Hybrid Mismatch Arrangements

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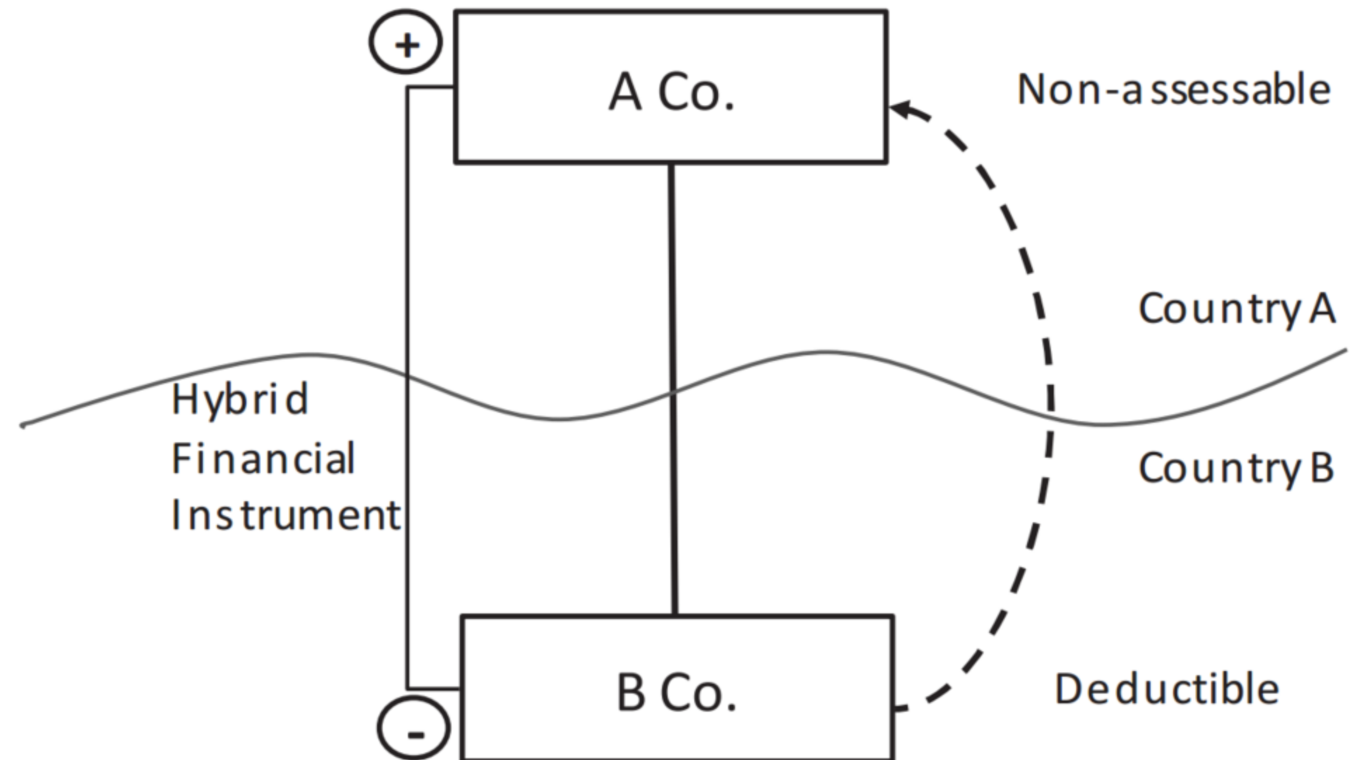
Action 2 – Neutralising Hybrid Mismatch Arrangements

Example - D/NI arrangements - hybrid financial structures

- Recommendation:
  - Deny deduction in payer country
  - Defensive rule: Tax in payee country



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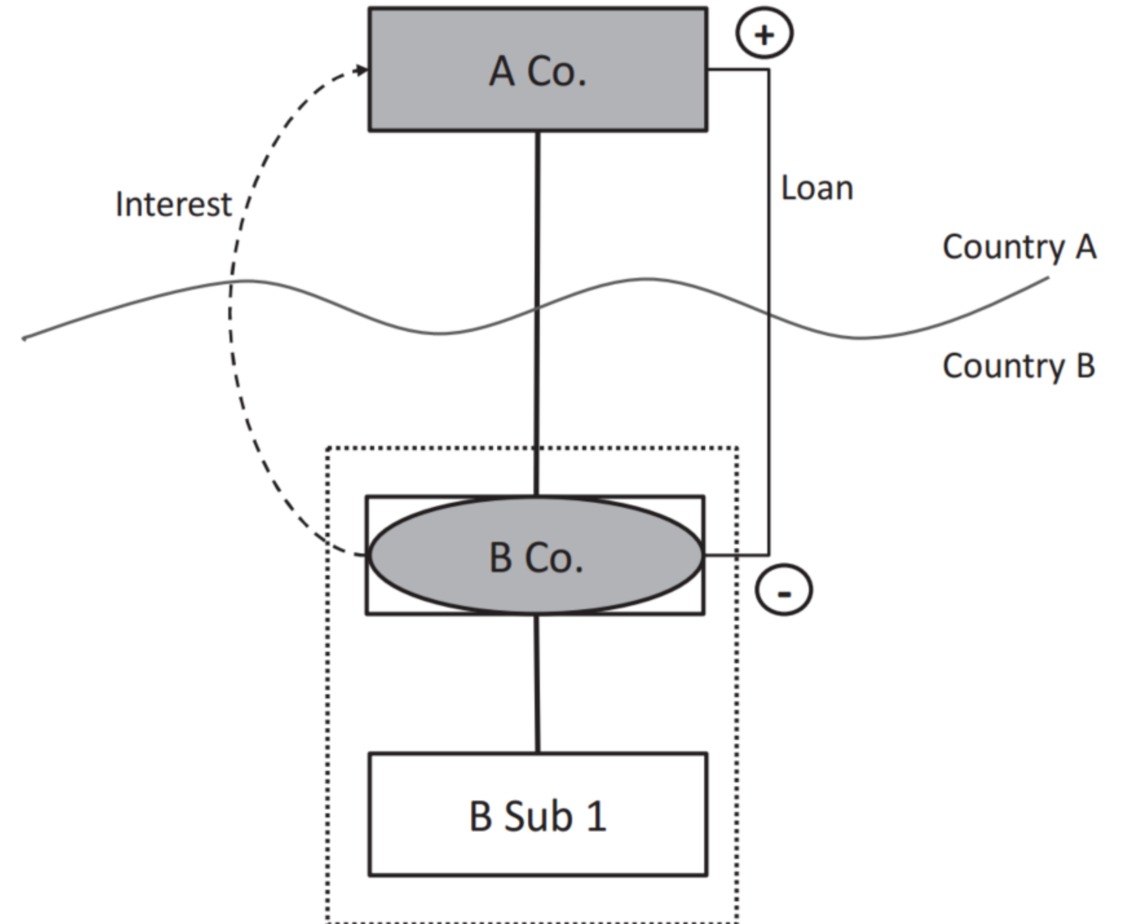
Action 2 – Neutralising Hybrid Mismatch Arrangements

D/NI arrangements – hybrid financial structures – Disregarded payments made by a hybrid payer

- An entity (subsidiary) is seen as a separate tax subject (opaque) in its country of residence whereas it is seen as transparent (non-existing for tax purposes) in the parent company jurisdiction. Loan from subsidiary to parent co. seen as non-existing in parent co

- Recommendation:
  - Deny deduction in payer country insofar as the income is not set off against the same income in both countries
  - Defensive rule: Taxable in payee country



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Action 3
Designing effective Controlled Foreign Company (CFC) rules

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Action 3 – Designing Effective CFC rules

General

- Recommendations for implementation of domestic “Controlled Foreign Corporation” (CFC) regulation in order to avoid profits being shifted to low tax countries
- The current Norwegian CFC regulations are to a large extent in line with the recommendations
- Recommended building blocks:
  - Definition of a CFC – entities and required control
  - CFC exemptions and thresholds – de minimis and effective tax rate
  - Definition of income
  - Computation of income – which jurisdictions rules, losses
  - Attribution of income
  - Prevention and elimination of double taxation – credit, exempt dividends, CFC in multiple countries
- CFC Rules within EU

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Action 3 – Designing Effective CFC rules

Some differences where we might expect adjustments in the Norwegian regulations

- The definition of companies that may be considered as CFC companies extended to also include partnerships and permanent establishments (PE)
  - *Partnerships included in the event the partnership is not taxable on a current basis in the parent company (e.g. due to different entity treatment), plus include income of transparent entity owned by a CFC*
  - *PE's included where the foreign entity has a PE in another country (typically where the income of the PE is exempted) and where the parent jurisdiction exempts income of the PE*

- The threshold for levying CFC taxation set at control - above 50 % ownership. Change in Norway less likely

- The recommendation sets out different ways for definition of CFC income related to categorization of income and/or related to activity. Change in Norway possible, but less likely.

- Limitation of usage of losses in the CFC, however wider that the current Norwegian system; might be set off toward the CFC entity or other CFC entities within same jurisdiction

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Action 4
Limiting base erosion involving interest deductions and other financial payments

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Action 4 – Limiting interest deductions
General

- The purpose of OECD´s Final report on Action 4 is to limit base erosion involving interest deductions and other financial payments
- The report is a recommendation regarding best practice, not a mandatory minimum standard
- There is significant room in the recommendation for countries to adjust the principles. Thus, it is unlikely that relatively uniform rules will be adopted by the different countries
- The main elements have been included in the Final report. Outstanding items to be completed in 2016 are:
  - Finalise design of the group ratio carve-out
  - Special rules for banking and insurance
- Action is likely to take effect from 2017 or later

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Action 4 – Limiting interest deductions
Definition of interest

- The recommended interest limitation rules will apply both to interest paid to related parties and to third parties such as banks
  - Current Norwegian rules only apply to interest paid to related parties
  - The Scheel proposal included interest to third parties, but the purpose was then to finance a generally reduced tax rate – not to fight base erosion and profit shifting

- OECD recommend a wide definition of interest and should include:
  - Interest on all form of debts
  - Payments economically equivalent to interest
  - Expenses incurred in connection with the raising of finance
  - The recommendation especially mention items like foreign exchange gains and losses connected to financing, arrangement fees, guarantee fees, imputed interest on convertible bonds, financial lease payments etc.

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Action 4 – Limiting interest deductions

Who should the rules apply to?

- At a minimum, the rules should apply to all entities that are part of a multinational group
- Entities within the same country may be treated as one entity or separately
- EU/EEA members states will have to include entities in domestic groups
- Standalone entities may be included
- Countries may introduce thresholds to exclude entities from the rules
  - Based on net interest expenses below a certain threshold
  - Recommended to apply the threshold collectively for all group entities within the same jurisdiction to avoid fragmentation
- Option to exclude third party debt to finance certain public-benefit projects

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Action 4 – Limiting interest deductions

A fixed ratio rule should be applied

- The recommendation for interest restrictions provide that countries should limit interest deductions to a fixed percentage of earnings before interest, tax and depreciations (EBITDA)
- Measured on net interest expenses
- The EBITDA should be based on tax figures
- Benchmark fixed ratio - a best practice corridor of 10-30 % of EBITDA
- Within the best practice corridor, a majority of groups with positive EBITDA should in principle be able to deduct all of their net third party interest expenses
- When determining the country´s benchmark fixed ratio, some relevant factors are:
  - Higher benchmark if no “fall back” group ratio rule in the local rules
  - Higher benchmark if no carry forward/carry back of unused interest
  - Higher benchmark if the country has high interest rates compared to other countries
  - Higher benchmark if applied also to domestic entities
- Based on the factors, Norway is not expected to end up at 30 %

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Action 4 – Limiting interest deductions
Optional fall back – a group ratio rule

- Groups with net third party interest/EBITDA ratio above the benchmark fixed ratio will not be able to deduct all net third party interest expenses
- OECD therefore recommend to combine a fixed ratio rule with a group ratio rule. Only net interest expenses that exceeds both benchmarks should be disallowed
- A two stage test:
  1. Determine group ratio: Net third party interest expense / group EBITDA = Group Ratio
     - Based on consolidated financial statements, possibly adjusted and with 10 % uplift on interest
  2. Apply group ratio to an entity: Group Ratio x entity EBITDA = limit on net interest deduction
     - EBITDA based on tax figures or accounting EBITDA
- Impact of loss making entities to be analysed
- Further technical work to be done on the group ratio rule to be completed in 2016

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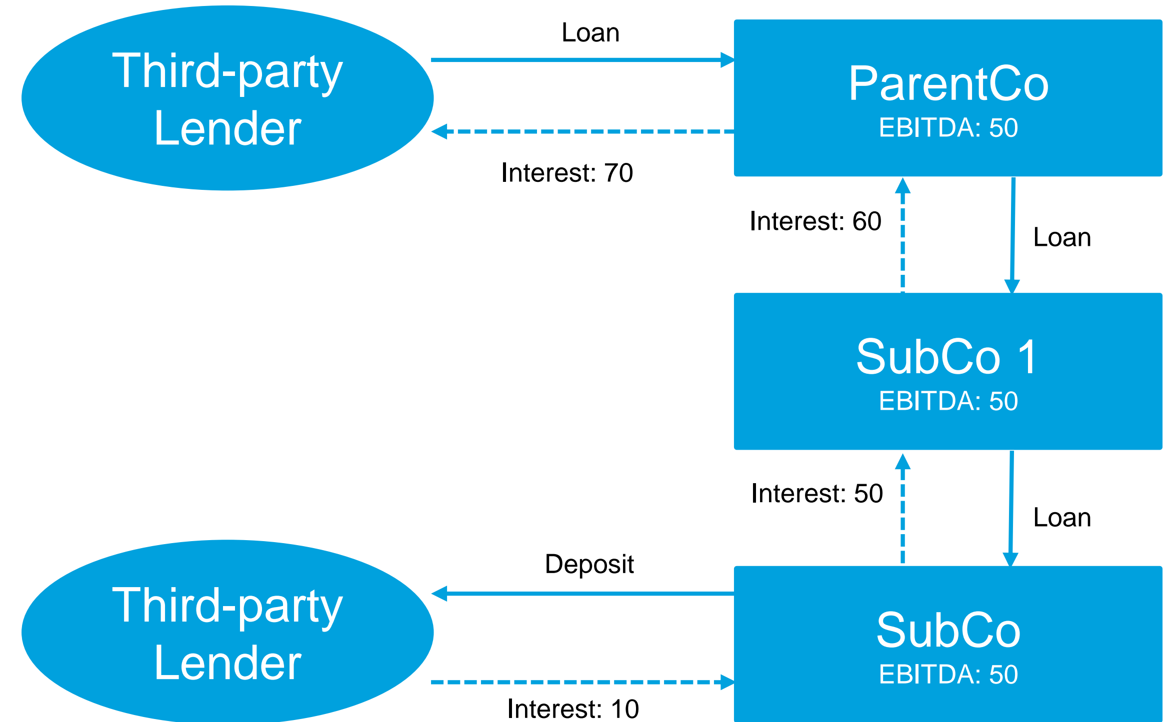
Action 4 – Limiting interest deductions

Example

Norwegian rule	ParentCo	SubCo 1	SubCo 2	Group
EBITDA	50	50	50	150
Net interest expenses	10	10	40	60
25% of EBITDA	12.5	12.5	12.5	37.5
Deductible interest	**10**	**10**	**12.5**	**32.5**

Group Ratio rule	ParentCo	SubCo 1	SubCo 2	Group
EBITDA	50	50	50	150
Net external interest expenses	*70*	*0*	*-10*	*60*
Net interest expenses	10	10	40	60
40%* of EBITDA	20	20	20	60
Deductible interest	**10**	**10**	**20**	**40**

* 60/150 = 40%



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Action 4 – Limiting interest deductions

Volatility and double taxation

- Using average EBITDA may reduce volatility, but increases complexity and is only presented as an option
- No requirement, but a country may choose to allow:
  - To carry forward disallowed interest expenses
  - To carry forward disallowed interest expenses and unused interest capacity
  - To carry forward and carry back disallowed interest expenses
  - Could be combined with limits in term of time and/or value

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Action 6
Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

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Action 6 – Tax Treaty Abuse

- Misuse or “treaty shopping” has been one of the main factors and focuses through the BEPS project. The background is that it is assumed multinational groups use its existing structures or new structures to flow e.g. dividend, interests, royalties and other cross border transactions via an optimized route of companies to avoid high gross taxes on the transactions by taking advantage of “better” tax treaties (to lower the total tax burden for the multinational group). Special rules are suggested to limit so called “tax treaty abuse”

- Preamble – avoid double taxation, not exclude taxation – the main objective is to avoid double taxation (which also exist today with e.g. narrow tax credit rules) but not double tax – so a more balanced approach is needed – it is the “misuse” that is the aim for the changes, not legit structures (see also changes related to tax credit rules)

- Actions;
  - Special and general anti avoidance rule (LOB (Limitation of Benefit) and PPT (Principle Purpose Test))
    - LOB – traditional anti avoidance rule, but a bit “old fashioned” as it has developed into more and more strict and detailed regulation for when the LOB clause is triggered even though it was originally meant to be a wider anti avoidance rule
    - PPT – a more general and wider rule that focus on the motive for the specific transaction route – can be said to be a more modern rule and maybe more in line with Norwegian anti avoidance rules

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Action 7
Prevent the Artificial Avoidance of Permanent Establishment (PE) status

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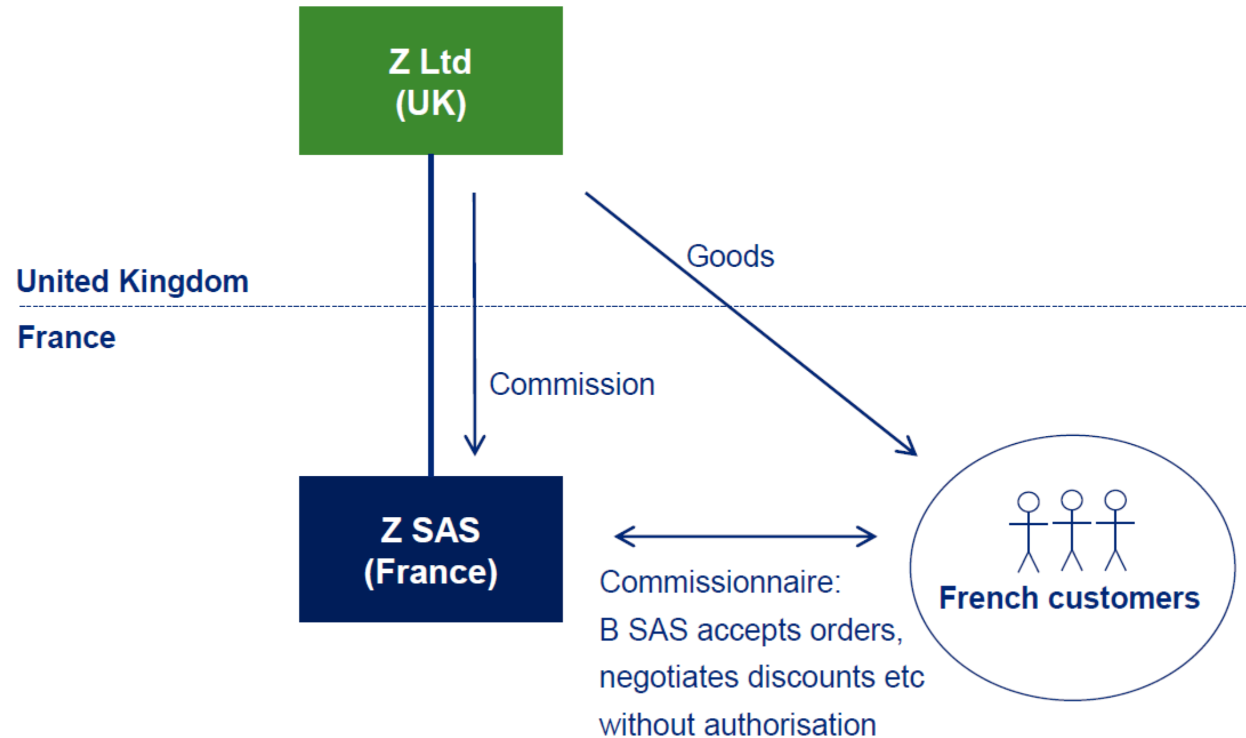
Action 7 – Prevent the artificial avoidance of PE status

Commissionaire arrangements

Example:



Z SAS does currently not create a PE for Z Ltd.

Solution:
Change the wording in MTC Article 5.5

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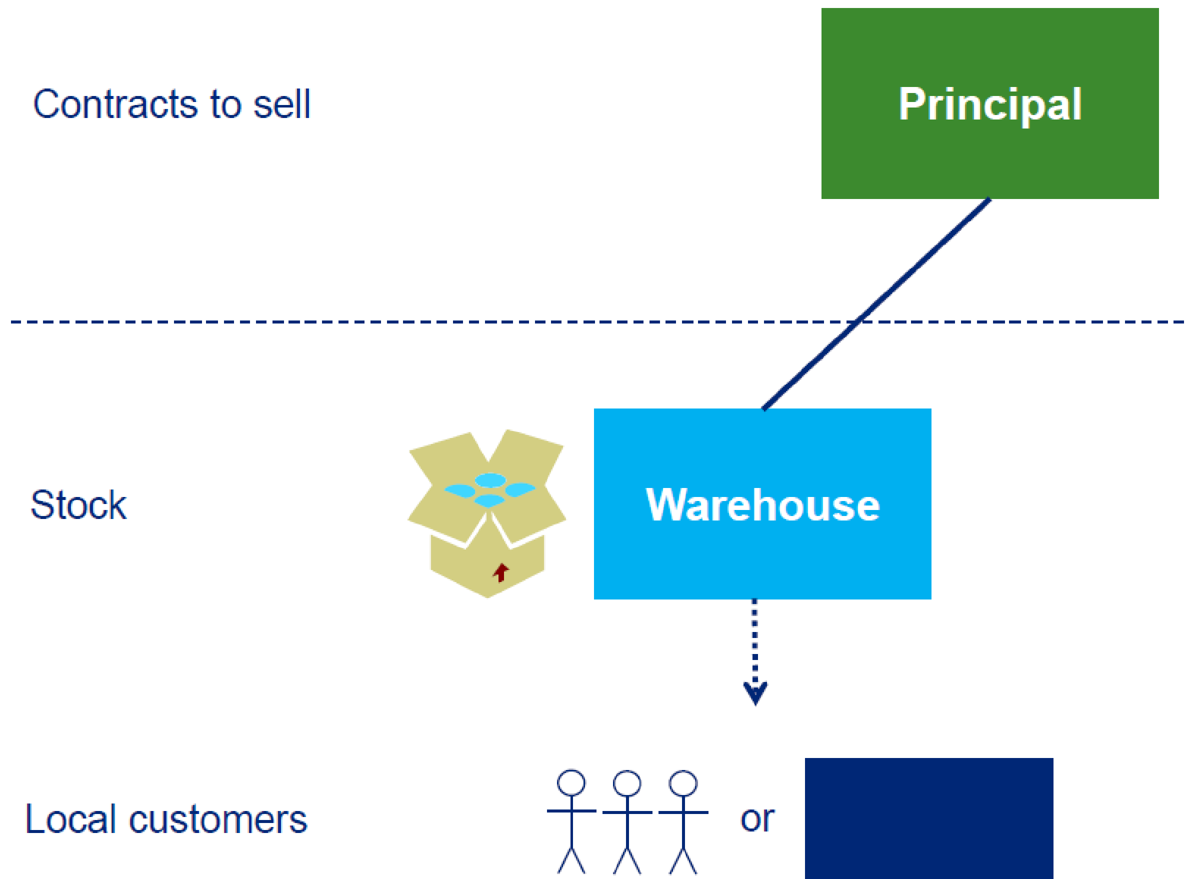
Action 7 – Prevent the artificial avoidance of PE status

Specific activity exemptions

Example:



Warehouse does not currently create a PE for Principal

Solution:
Change the wording in MTC Article 5.4

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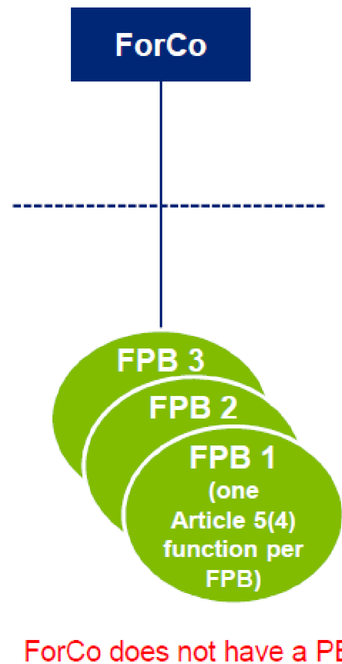
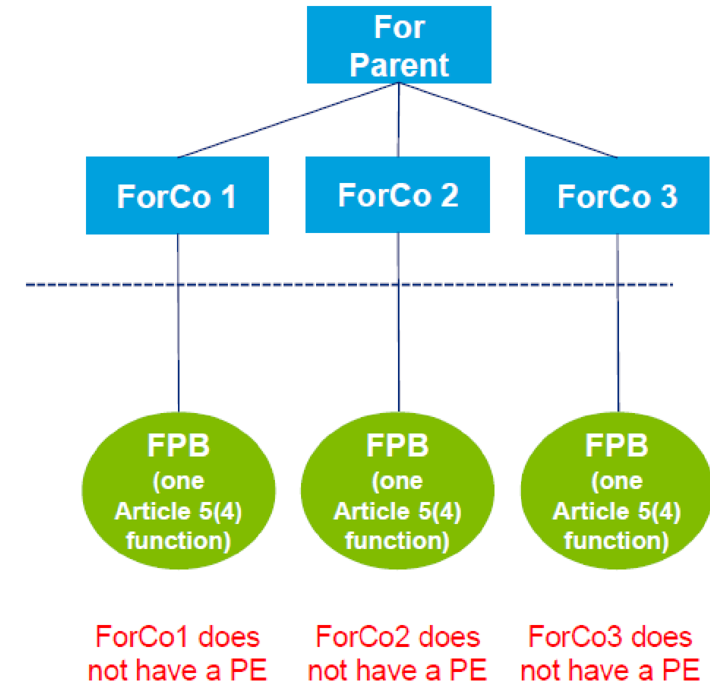
Action 7 – Prevent the artificial avoidance of PE status

Specific activity exemptions – Fragmentation

Example A:
One entity with several, separate Fixed Place of Business with different activities



Example B: Separate legal entities, each with a separate FPB



These examples do not currently create PEs

Solution:
Change the wording in MTC Article 5.4

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Action 7 – Prevent the artificial avoidance of PE status

Splitting up contracts

- Splitting up contracts between related parties in relation to the specific 12 month period for creating "construction PEs" in Article 5. The current Commentary tackles splitting contracts within one entity, but not where a contract is split between group entities

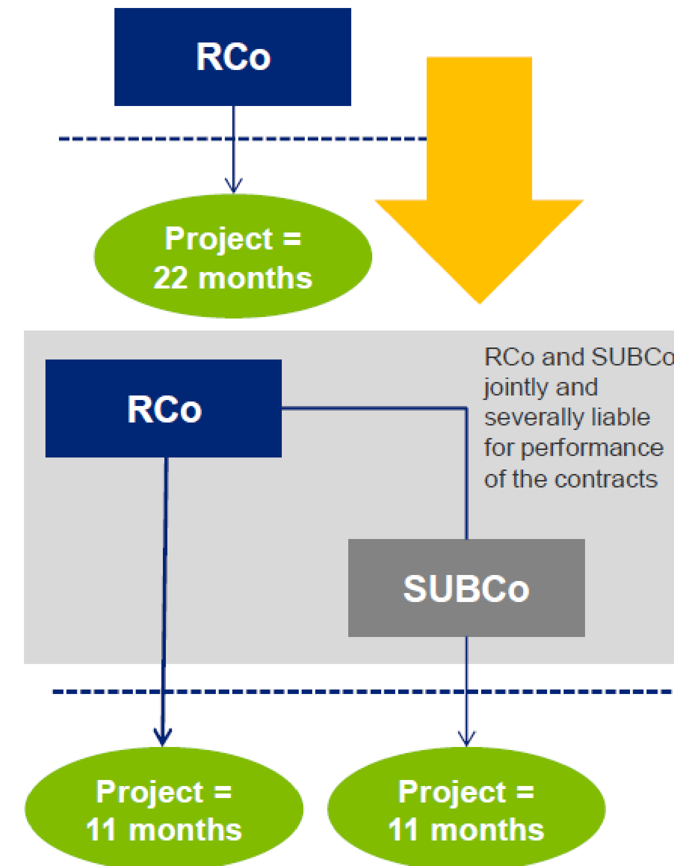
N.B. *Period can be shorter than 12 months, depending on the specific treaty and activity (e.g. offshore)*

- Example on the right does not currently create PE

Solution:

- Change the wording in MTC Article 5.3

Example:



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Action 12
Mandatory Disclosure Rules

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Action 12 – Mandatory Disclosure Rules

General

- A Modular Design for mandatory early disclosure of tax schemes in order to tighten loopholes and influence promoters as well as taxpayers
- Affects “promotors” (anyone involved in the design, marketing and/or implementing of tax schemes) as well as taxpayers
- Recommendations for thresholds and hallmarks
- Reporting when made available and/or implemented (depending on whom reports)
- No preapproval implied
- Sanctioned by fines based on tax saved and/or fees
- Recommendations for international schemes
  - Thresholds and hallmarks
  - Knowledge must be sought

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Deloitte.

Rolf J. Saastad
Partner / Advokat

Deloitte Advokatfirma AS
Dronning Eufemias gate 14
Postboks 221 Sentrum
0191 Oslo

Mobile: 907 47 556
rsaastad@deloitte.no

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