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BEPS in Asia doing business in a brand new tax climate.

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Who said this?

‘Recently more and more enterprises organized abroad by American firms have arranged their corporate structures (...) - so as to exploit the multiplicity of foreign tax systems and international agreements - in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.’

a. John F. Kennedy
b. George W. Bush
c. Barack Obama
John F. Kennedy:

‘Recently more and more enterprises organized abroad by American firms have arranged their corporate structures – aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven – so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.’

Special Message to the Congress on Taxation.
April 20, 1961
Agenda

1. Introduction

2. Panel discussion

3. Proposed investment structure – Japan

4. Proposed investment structure – China

5. Statements Myths vs. Reality
1. Introduction
Multinational companies currently being publicly criticized for their tax structures...
Recent press

Starbucks’s Tax Practices Draw European Scrutiny (WSJ)
Coffee chain paid less than 1% in corporate tax last year in the Netherlands, where its regional head office was based
The Telegraph (2012)

“George Osborne threatens big business with global tax crackdown”

“Britain has joined forces with Germany to declare war on tax dodging multinationals and called for an end to loopholes that have allowed them to siphon off billions in profits to tax havens. [....]”

2015: George Osborne to serve another term as UK Minister of Finance
Trend: “Fair Share” approach is gaining momentum
**Blurred line between Tax Evasion and Tax Avoidance**

- **Tax Avoidance**
  - Legal
  - Freedom versus morality
  - International planning opportunities
  - Harmful tax competition

- **Tax Evasion**
  - Illegal: Tax Fraud
  - Criminal offence
  - Mounting international exchange of information and coordination
### Overview main relevant developments

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<th>G20</th>
<th>• G20/G8, parliaments, NGO’s &amp; press</th>
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| OECD        | • BEPS Action Plan: root out inappropriate tax avoidance through 15 actions  
• Continuing and unprecedented stream of draft reports. Deliverables: fall 2015  
• Global exchange of info system: “Common Reporting Standard” |
| EU          | • State Aid scrutiny into tax ruling of multinationals in Luxembourg, Ireland, the Netherlands and Belgium  
• Anti-abuse and anti-hybrid provision in the Parent-Subsidiary Directive  
• Transparency initiatives: UBO-register, exchange of information on tax rulings  
• Last but not least: more anti-abuse provisions by harmonising the corporate tax base: CCCTB |
4 main themes to fight “inappropriate” tax avoidance

- Transfer Pricing
- Anti-Abuse
- Transparency
- Mis-matches
### Objectives through 15 actions

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<td>Modernization</td>
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<td>2</td>
<td>Hybrid Mismatch</td>
<td>Coherence / Anti-mismatch / anti-hybrid</td>
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<td>3</td>
<td>CFCs</td>
<td>Anti-abuse / Substance</td>
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<td>4</td>
<td>Interest Deductions</td>
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<td>5</td>
<td>Harmful Tax Practices</td>
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<td>6</td>
<td>Treaty Abuse</td>
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<td>7</td>
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<td>8</td>
<td>Transfer Pricing Outcomes</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Methodologies and data</td>
<td>Transparency</td>
</tr>
<tr>
<td>10</td>
<td>Mandatory disclosure</td>
<td></td>
</tr>
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</table>
| 11          | Transfer Pricing 
Documentation |         |
| 12          | Dispute resolution       |         |
| 13          | Multilateral Instrument  | Implementation |
EU is ‘overtaking’ the OECD

EU

State Aid investigations

Anti-abuse provisions in P/S Directive (intra group dividends)

IP Regimes: “Modified Nexus”

CCCTB (harmonising corporate taxable basis)

Transparency package

Anti Tax Avoidance Directive
Soft Law versus Hard Law

EU
Hard Law

OECD
Soft Law
Hard Law?
Threats and Challenges

- Less base erosion / Hybrid mismatches
- Transfer Pricing: same profit in more countries
- Upstream of profits: more tax leakage
- Increased costs of compliance
- More disclosure of wealth, UBO’s, etc.
- Risk of distortion of competition grows
EU Anti Tax Avoidance Directive

• On 28 January 2016, the European Commission published an anti-tax avoidance package which includes amongst others a proposal for an anti-tax avoidance directive (ATA Directive);

• The ATA Directive aims at implementing some of the BEPS actions to avoid an uncoordinated EU response to BEPS. The ATA Directive also provides for certain non-BEPS measures;

• On 5 July 2016 The ATA Directive has officially been adopted by the European Council;

• The provisions of the ATA Directive should be applicable and implemented as of 1 January 2019 (1 January 2020 for exit tax) in all EU Member States (27 after Brexit);
Quick overview: key ATA Directive measures

- interest limitation rule (art. 4)
- exit taxation (art. 5)
- general anti-abuse rule (art. 6)
- CFC rule (arts. 7 & 8)
- hybrid mismatches (art. 9)
Where do we stand today?

- BEPS
- Transfer pricing
- Hybrids
- CbC
- Treaty abuse
- EU
- Anti-abuse
- Panel discussion
- OECD
- CRS
- Transparency
- State aid
- Dispute resolution
2. Panel discussion
Within Nomura, the so-called residual profit split (RPS) method is utilized for Global Trading activities’ transfer pricing, the use of which is consistent with the OECD TP Guideline.

The RPS method would typically operate on a “waterfall” approach, as follows:

- Determine the pool of profit to be split
- Deduct the remuneration for any routine functions (BO and MO costs)
- Deduct the remuneration for any non-routine functions (return on capital and FO costs)
- Split the residual profit between trading locations based on appropriate allocation factor, e.g. trader compensation

We apply the RPS method calculation for each “integrated” trading unit.
According to the OECD, the changes to Art. 5(5) and 5(6) and the detailed Commentary thereon address commissionnaire arrangements and similar strategies by ensuring that the wording of these provisions better reflect the underlying policy.

Notwithstanding the original intention which prima facie sounds all good, this revision could inadvertently overkill the genuine activities conducted by global financial institutions, i.e. “global trading” activities where booking of trades is concentrated to one or a small number of booking entities, as a result of which capital is utilized effectively and efficiently by way of taking advantage of “diversification benefits” arising from holding a multiple classes of assets in one single basket.

This could potentially trigger the situation where a US booking entity may be determined to have a PE in HK, Singapore, Japan (or any other location where traders reside) by virtue of traders booking into that central booking entity, if these traders are supposed within that organization to book their trades into a hub booking entity only. The booking entity would be vulnerable to PE tax risks in every country that its traders are residing.

A TP solution, i.e. the fact that arm’s length remuneration is given to a trader’s location, may not solve all the issues, e.g. legal entity housing traders will be a different entity from the booking entity, so no offset of traders comp against TP income would not be allowable for local tax purposes.
2. Proposed investment structure - Japan
Proposed Investment Structure - Japan

[China / Mexico]  
- Manufacture Co
- Dividends
- Sale of Goods
- Royalties
- License
- Consideration
- Service Co
- Provide Services
- Fees

[US / Japan / Mexico]  
- Hold Co
- Dividends
- Sale of Goods
- Consideration
- End Customers

[Hong Kong / Singapore]  
- Parent Co
- 100%
- 100%
1. Parent Co is at the top of an international group that manufactures, distributes and sells goods. Parent Co is not a resident of a low-tax jurisdiction. It may be a resident of [the US, Japan or Mexico].

2. Parent Co developed a technology for goods some time ago and acted as a licensor of the technology for some time before assigning the technology and the existing licenses to Hold Co.

3. Hold Co is the owner of several patents transferred by Parent Co. Hold Co is a resident of a low-tax jurisdiction (e.g., [Hong Kong or Singapore]).
4. Hold Co grants a license to Manufacture Co for the manufacturing of goods.

5. Manufacture Co produces the goods and delivers them to Hold Co. Manufacture Co is not a resident of a low-tax jurisdiction. It may be a resident of [China or Mexico].

6. Hold Co sells the goods to the end customers in a country where Service Co resides. Service Co is not a resident of a low-tax jurisdiction. It may be a resident of [China or Japan].

7. Service Co provides customer support services in a country where it resides for the benefit of Hold Co. The negotiation of the terms of sale with the end customers is done by Hold Co.
Utilization of an Intermediary Corporation

- 95% of dividends received from foreign subsidiaries are exempt from corporate income taxation in Japan, if the parent corporation holds 25% or more of the outstanding shares of the foreign corporation for six (6) months or more.
- The rate of the withholding tax on dividends paid by China Sub is generally reduced by the tax treaty between China and Hong Kong.

(Assumption) The Japanese CFC rules will not apply in this case.
It seems that the BEPS discussions and the Japanese domestic GAAR go in the same direction.

- Treaty anti-abuse rules under BEPS Action Plan 6
  
  - Limitation of benefit (“LOB”)
    - Many treaties to which Japan is a party have already adopted the LOB.
  
  - Principal purposes test (or “PPT” rule)
    - If one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.
    - Beneficial ownership issues will be examined by the principal purpose test.
    - Only a few tax treaties to which Japan is a party (e.g., treaties with Hong Kong and Switzerland) have the principal purpose test.
Anti-abuse Rules to Cope with the Intermediary Corporation (cont’ d)

- Japanese domestic GAAR

- Even where there is no beneficial ownership, the Japanese tax authorities have not applied the domestic GAAR to deny tax benefits under the tax treaty.

- However, in a recent case, the Japanese tax authorities applied the domestic GAAR to deny an interest deduction by a Japanese company, arguing that the borrowing was unnecessary (Universal Music case).

- Will the domestic GAAR be applied to deny tax benefits under the tax treaty in the future?
  - A Japanese Court recently indicated that the principal purpose test could apply in a case where the Japanese domestic GAAR applies (Yahoo case).
Agent PE

Under BEPS Action Plan 7, it is proposed that the scope of the Agent PE is expanded to prevent base erosion arising from the commissionaire structure.

Proposed amendments to Articles 5(5) and (6) of OECD model convention

<table>
<thead>
<tr>
<th>Current Rules</th>
<th>Proposed New Rules</th>
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<tbody>
<tr>
<td>An enterprise shall be deemed to have a PE in Contracting State, if</td>
<td>An enterprise shall be deemed to have a PE in Contracting State, if</td>
</tr>
<tr>
<td>1. a person is acting in a Contracting State on behalf of an enterprise and</td>
<td>1. a person is acting in a Contracting State on behalf of the enterprise and,</td>
</tr>
<tr>
<td>has, and habitually exercises, an authority to conclude contracts in the</td>
<td>in doing so, habitually engages with specific persons in a way that results in the</td>
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<tr>
<td>name of the enterprise</td>
<td>conclusion of contracts</td>
</tr>
<tr>
<td>2. in the name of the enterprise.</td>
<td>2. a) in the name of the enterprise, or</td>
</tr>
<tr>
<td></td>
<td>b) for the transfer of the ownership of, or for the granting of the right to use,</td>
</tr>
<tr>
<td></td>
<td>property owned by that enterprise or that the enterprise has the right to use, or</td>
</tr>
<tr>
<td></td>
<td>c) for the provision of services by that enterprise.</td>
</tr>
<tr>
<td>3. However, an independent agent acting in the ordinary course of business</td>
<td>3. However, an agent of an independent status who is acting in the ordinary</td>
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<tr>
<td>is not treated as an agent PE.</td>
<td>course of business (excluding a person acting exclusively or almost exclusively on</td>
</tr>
<tr>
<td></td>
<td>behalf of one enterprise or associated enterprises) is not treated as an agent PE.</td>
</tr>
</tbody>
</table>
Condition of being Preparatory or Auxiliary

BEPS Action Plan 7 proposed a new rule that would make all the activities currently listed in paragraph 4 of Article 5 subject to the condition of being preparatory or auxiliary.

**Proposed amendments to Articles 5(4) of OECD model convention**

<table>
<thead>
<tr>
<th>Current Rules</th>
<th>Proposed New Rules</th>
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<tbody>
<tr>
<td>the term &quot;permanent establishment&quot; shall be deemed not to include:</td>
<td>the term “permanent establishment” shall be deemed not to include:</td>
</tr>
<tr>
<td>a) the use of facilities solely for the purpose of storage, display or delivery</td>
<td>a) the use of facilities solely for the purpose of storage, display or delivery</td>
</tr>
<tr>
<td>of goods or merchandise belonging to the enterprise;</td>
<td>of goods or merchandise belonging to the enterprise;</td>
</tr>
<tr>
<td>b) the maintenance of a stock of goods or merchandise belonging to the</td>
<td>b) the maintenance of a stock of goods or merchandise belonging to the enterprise</td>
</tr>
<tr>
<td>enterprise solely for the purpose of storage, display or delivery;</td>
<td>solely for the purpose of storage, display or delivery;</td>
</tr>
<tr>
<td>c) the maintenance of a stock of goods or merchandise belonging to the</td>
<td>c) the maintenance of a stock of goods or merchandise belonging to the enterprise</td>
</tr>
<tr>
<td>enterprise solely for the purpose of processing by another enterprise;</td>
<td>solely for the purpose of processing by another enterprise;</td>
</tr>
<tr>
<td>d) the maintenance of a fixed place of business solely for the purpose of</td>
<td>d) the maintenance of a fixed place of business solely for the purpose of</td>
</tr>
<tr>
<td>purchasing goods or merchandise or of collecting information, for the</td>
<td>purchasing goods or merchandise or of collecting information, for the enterprise;</td>
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<tr>
<td>enterprise;</td>
<td></td>
</tr>
<tr>
<td>e) the maintenance of a fixed place of business solely for the purpose of</td>
<td>e) the maintenance of a fixed place of business solely for the purpose of</td>
</tr>
<tr>
<td>carrying on, for the enterprise, any other activity of a preparatory or</td>
<td>carrying on, for the enterprise, any other activity;</td>
</tr>
<tr>
<td>auxiliary character;</td>
<td></td>
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<tr>
<td>f) the maintenance of a fixed place of business solely for any combination of</td>
<td>f) the maintenance of a fixed place of business solely for any combination of</td>
</tr>
<tr>
<td>activities mentioned in subparagraphs a) to e), provided that the overall</td>
<td>activities mentioned in subparagraphs a) to e), provided that such activity or,</td>
</tr>
<tr>
<td>activity of the fixed place of business resulting from this combination is</td>
<td>in the case of subparagraph f), the overall activity of the fixed place of</td>
</tr>
<tr>
<td>of a preparatory or auxiliary character.</td>
<td>business, is of a preparatory or auxiliary character.</td>
</tr>
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A Japanese court has already interpreted the existing tax treaty in accordance with the BEPS Action Plan 7.

- A US resident sold goods via internet to Japanese customers. He has a warehouse from which he delivers the goods. A few employees work at the warehouse.

- Japanese tax authorities deemed the warehouse as a PE of the US resident, arguing that the warehouse does not fall within the scope of “a) use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise.”

- Tokyo District Court ruled on May 8, 2015 against the tax payer saying that a preparatory or auxiliary character is necessary for the warehouse to be excluded from the scope of PE.
3. Proposed investment structure – China
China Investment Structures

Structure 1 (bare bone):

- Investor (U.S.)
- JVCo/WFOE
- Investor’s Affiliate

Overseas $ License PRC
China Investment Structures (Cont’d)

- Structure 2 (with an offshore intermediate holdco):

  - **Investor** (U.S. or Europe)
  - **Cayman/Hong Kong/ Singapore (Intermediate HoldCo)**
  - **Investor’s Affiliate**
  - **JVCo/WFOE**
China Investment Structures (Cont’d)

- **Advantages of the intermediate holding structure:**

  - **Hong Kong:**
    - Dividends at 5% (for shareholders owning at least 25%)
    - Interest at 7% (beneficial owner)
    - Royalties generally at 10%

  - **Singapore:**
    - Dividends at 5% (for shareholders owning at least 25%)
    - Interest at 7% (beneficial owner and bank)
    - Royalties generally at 10%

- **Typical Structure:**

```plaintext
BVI/Cayman/Netherlands

100 %

Intermediate Holdco
(e.g., Hong Kong, Singapore)

100 %

Offshore

Mainland China

100 %

Operating Co.

Dividends/royalties/interest
```
China Investment Structure (Cont’d)

- Structure 3 (with a China HoldCo):

  ![Diagram of Investment Structure]

  - Ultimate Parent
  - Intermediate Hold Co
  - China HoldCo
  - Parent’s Affiliate

  - License
China Investment Structure (Cont’d)

- **Structure 4 (with multiple offshore intermediate holdco):**

  ![Diagram of China Investment Structure](image)
Myths vs. Reality
Statement #1

The attitude of Multinational Entities (MNE) towards international tax planning has changed permanently since the press coverage of tax structures such as Starbucks, Google, Amazon etc. and the increased political interest in the theme.
There is no consensus among countries about taxable basis, tax rates and the “fair share” that countries should be entitled to. The EU, G20 and the OECD do not have any leverage to pursue member states to amend their legislation. The Action Plan will never succeed.
Statement #3

The goal of achieving a low effective tax rates by using international tax planning techniques by MNE's may be in accordance with current rules but is unethical and immoral.
Countries should guide their efforts in providing a better investment climate towards bringing new business operations rather than gearing towards holding companies and conduit companies and tax competition with other states.
Statement #5

*Holding and ‘intermediary’ companies, serviced by corporate service providers and without any “real” operational activities, will eventually disappear.*
Statement #6

*Hong Kong’s territorial system of taxation is not BEPS proof and will be amended in the next few years.*
Statement #7

BEPS will not have the impact and result the G20 / OECD intent to achieve, as countries will ‘cherry-pick’ from the various proposals the project has brought forth.
Statement #8

There is no future in international tax planning.