IFA NORDIC CONFERENCE
21-22 April 2016

THE BEPS AFTERMATH
Recent Legislative Developments - An Increased Risk of Double Taxation
1. General remarks on the increased risk on double taxation after BEPS

2. Withholding tax and relief

3. EU and OECD GAAR

4. EU Anti-Tax-Avoidance Directive

5. Norwegian perspective on interest limitation and exit tax
Do the BEPS measures increase the risk of double taxation?

OECD Q&A:

“The aim of the measures is to realign taxation with economic substance and value creation, while preventing double taxation. The BEPS package represents the first substantial renovation of the international tax rules in almost a century. This renovation is necessary not only to tackle BEPS, but also to ensure the sustainability of a consensus-based system aimed at eliminating double taxation. As new rules always raise interpretation issues, Action 14 on improving dispute resolution is a key part of the BEPS Project.”
BEPS and Double Taxation

• The BEPS agenda

• Post BEPS world has led to strengthened tax legislation across the globe
  – All EU countries have agreed to implement OECD/G20 BEPS reports

• Risks of double taxation
  – “Over BEPS’ification” (even harder implementation)
  – Countries continue to introduce unilateral measures from BEPS momentum
  – Difference in implementation and interpretation
  – Continuously weak dispute resolution mechanisms
Withholding Tax and Relief
Tax credit for foreign voluntary tax

Voluntary tax issue:

- Will home country give a tax credit for a foreign tax which the taxpayer is not legally compelled to pay?

If yes: tax burden shifts from foreign country to home country

US: Only foreign tax credit for compulsory payments

Compulsory payments: taxpayer must have exhausted remedies to reduce foreign tax liability before claiming a foreign tax credit in the US:
- Administrative appeals
- Court proceedings
- MAP

Taxpayer has burden of proof
Tax credit for foreign voluntary tax

► Norway: A foreign tax credit will only be granted if the foreign tax is in accordance with a tax treaty, cf. Norwegian Tax Act § 16-27
  — Does this only apply to withholding tax rates, or will it also apply to other treaty issues, for example determination of whether there is a PE
  — Does this apply also to foreign country’s domestic tax rules, for example determination of allowable tax deductions

► Historically, the Norwegian authorities have taken a pragmatic approach to this rule
  — Credit for Brazilian withholding taxes

► Is this about to change?
Relief from double taxation | tax credits

- In principle, relief from double taxation through domestic tax credit systems
- Tax credit usually limited to home country tax on net foreign income,
- In practice, technical calculation of net foreign income means limited or no relief from double taxation:
  - Income is only characterized as foreign sourced if taxed abroad
  - No allocation of expenses to non-foreign sourced if this income is not subject to tax in Norway (e.g. dividends and capital gains)
  - Withholding taxes are imposed on gross amounts
- Example 1:
  - Foreign sourced interest income 200 subject to 10% withholding tax (20)
  - Interest payments 160 giving net income of 40 subject to 25% corporate tax (10)
  - Norwegian tax credit limited to Norwegian tax on net income, so foreign withholding tax is final tax
  - Effective tax rate of 50%
Danish Domestic Relief

- The net principle is used to determine the credit relief
- Foreign income is reduced by the related deductible costs – the net principle
- The amount of the relief depends on the deductibility of the costs related to the taxed income

\[
\text{Foreign net income} \times \frac{\text{Danish tax}}{\text{Global income}}
\]

- Withholding taxes levied at gross payments result in an increased effective global tax rate
- The net principle causes significant problems in ensuring effective double taxation relief
- Many cases are pending
EU and OECD GAAR
# New Danish International GAAR

<table>
<thead>
<tr>
<th>The Danish Assessment Act (Ligningsloven) § 3</th>
<th>Requirements (par. 1.):</th>
</tr>
</thead>
<tbody>
<tr>
<td>- International GAAR</td>
<td>- Word for word comparable to PSD</td>
</tr>
<tr>
<td>- Directives</td>
<td>- Arrangements or a series of arrangements,</td>
</tr>
<tr>
<td>- Tax treaties</td>
<td>- That have been put in place for the main purpose or one of the main purposes</td>
</tr>
<tr>
<td>- Implementing Parent-Subsidiary Directive GAAR</td>
<td>- Of obtaining a tax advantage,</td>
</tr>
<tr>
<td>- Expanded to the Interest and Royalty Directive and the Merger Directive as well.</td>
<td>- Which defeats the object or purpose of the directives, and</td>
</tr>
<tr>
<td>- OECD Principle Purpose Test (PPT) regarding tax treaties</td>
<td>- Which are not genuine having regard to all relevant facts and circumstances.</td>
</tr>
<tr>
<td>- Both are considered identical by the Minister of Taxation</td>
<td>Requirements (par. 3):</td>
</tr>
<tr>
<td>- Effective from 1 May 2015</td>
<td>- Reasonable to conclude,</td>
</tr>
<tr>
<td></td>
<td>- Having regard to all relevant facts and circumstances,</td>
</tr>
<tr>
<td></td>
<td>- That obtaining that benefit was one of the principal purposes,</td>
</tr>
<tr>
<td></td>
<td>- Of any arrangement or transaction, that resulted directly or indirectly in that benefit.</td>
</tr>
<tr>
<td></td>
<td>- Unless it is established that granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provision of the Convention</td>
</tr>
</tbody>
</table>
New Danish International GAAR

• Consequences:
  – Tax payer cannot obtain directive or tax treaty benefits
  – WHT on dividends, interests and royalties
  – Tax neutral restructuring

• Examples:
  – Beneficial owner classic?
  – Dividend stripping – financial institutions?
  – Location of production – election of country with tax treaty?
  – Joint ventures?
  – Collective Investment Vehicles?
  – Increase of ownership (e.g. 24 % to 25 %)?
The EU Anti-Tax-Avoidance Directive
Background and Introduction

- The international tax policy environment
  - Emphasizes the tendency to increased alignment in international corporate tax law
- EU Anti-Tax-Avoidance-Package (ATA-package) presented the 28/1 2016:
  - Package:
    - Recommendation on Tax Treaties
    - Amended Directive on mandatory exchange of information
    - External Strategy for Effective Taxation
  - Policy objectives:
    - Effective taxation: Ensuring tax is paid where the value is created
    - Transparency: Ensuring effective access to tax information
    - Addressing the risk of double taxation
  - The ATA-package is partly based on the research carried out in “Study on Structures of Aggressive Tax Planning and Indicators”. Working paper N. 61 2015 (Ramboll Management Consulting and CORIT advisory)
  - The ATA-Directive is essentially a carve out of the anti-tax-avoidance rules of the CCCTB
Background and Introduction

• Political process and timeframe:
  – Unanimity - TEUF article 115
    • Competence? (Professor Haslehner)
  – Enhanced cooperation procedure (minimum 9 states)
  – Time frame – summer 2016?

• Relation to OECD Base Erosion and Profit Shifting project (BEPS)
  – ATA-Package is the joint European Union’s coordinated answer to BEPS:
    • Ensuring EU-law conformity of ATA-rules
    • Creation of a better/fairer business environment?
Minimum Directive

• The proposal is intended as a minimum directive
  – MSs are obliged to ensure at least the level of protection as described in the directive
  – However, MSs cannot offer less restrictive rules
  – Consequently, MSs are allowed to apply more restrictive rules (Article 3)

• Based on the principle of subsidiarity and proportionality
  – A non-coordinated solution would “in fact only replicate and possibly worsen the existing fragmentation in the internal market and perpetuate the present inefficiencies and distortions in the interaction of a patchwork of distinct measures.”
  – The Directive “prescribe full harmonisation but only a minimum protection for Member States' corporate tax systems. Thus, the Directive ensures the essential degree of coordination within the Union for the purpose of materialising its aims.”
Minimum Directive

• Comments
  – Proportionality requires that the objectives are achieved – Are they?
    • Uniform implementation of BEPS
    • Reduce unfair tax competition
  – Some parts of the directive tends to aim at an internal market for direct taxation – Outside the Article 115 TFEU?
Subjective and Geographical Scope of the Directive (Article 2)

• Applicable to all taxpayers subject to corporate tax
  – Likely to include more taxable entities than the current EU company directives, including PE of third county entities
  – Variation between MSs
  – E.g. entities in principle subject to tax, although objectively exempt from corporate income tax

• Preferable an annex should be produced to the directive
Interest Limitation Rule (Article 4)

- Introduction of an interest limitation rule based on net borrowing costs
- The rule caps deduction at 30% of EBITDA, however, minimum 1 million EURO
- Escape clause:
  - Demonstrate that the ratio of equity over total assets equals or exceeds group-ratio
- Infinite carry-forward of surplus EBITDA and capped borrowing costs (Max 30% EBITDA)
- Financial undertakings are exempt (further analysis)
- Comment:
  - EBITDA rules are widely used as part of global tendency
  - Following BEPS recommendations
  - Domestic provisions not fully parallel should be carefully assessed
  - No corresponding reduction of the creditor
  - One common system with different levels (10-30%) or Ms free to have parallel systems?
  - NID? Possible to be granted higher interest deductions
  - Reduce fragmentation of internal market?
Norwegian interest limitation rule

- Net interest expense deductible if the total amount of net interest expense does not exceed NOK 5 million during the fiscal year, or if the interest is paid to a non-related party.

- Otherwise net interest expense paid to a related party is deductible only to the extent that internal and external interest expense combined does not exceed 25% of taxable EBITDA.

- External loans guaranteed by a related party of the borrower (tainted debt) may also be covered by the limitation.

- No group ratio escape clause.
Norwegian interest limitation rule

\[
\begin{align*}
\text{Ordinary taxable income (before interest limitation)} & \quad 200 \\
+ \quad \text{Tax depreciations} & \quad 40 \\
+ \quad \text{Net related party interest expenses} & \quad 160 \\
= \quad \text{Taxable EBITDA} & \quad 400 \\
\hline
\text{Interest limitations – 25% of taxable EBITDA} & \quad 120 \\
\text{Net related party interest expenses} & \quad 160 \\
\hline
\text{Increase in taxable income} & \quad 40^* \\
\end{align*}
\]

*may be carried forward 10 years*
Norwegian interest limitation rule

- If interest expense is not tax deductible, the corresponding interest income will still be taxable for creditor:
  - No corresponding tax exemption for Norwegian resident creditors
  - Non-resident creditors will be taxed under country of residence’ tax rules
- In the initial proposal for withholding tax on interest, no exemption for withholding tax when interest paid is not tax deductible because of interest limitation rule
Norwegian interest limitation rule

- Not possible to offset taxable income after application of interest limitation rule with losses carried forward:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary taxable income</td>
<td>200</td>
</tr>
<tr>
<td>Loss carried forward</td>
<td>(400)</td>
</tr>
<tr>
<td>Ordinary income (before interest limitation)</td>
<td>0</td>
</tr>
<tr>
<td>+ Tax depreciations</td>
<td>100</td>
</tr>
<tr>
<td>+ Net related party interest expenses</td>
<td>100</td>
</tr>
<tr>
<td>= Taxable EBITDA</td>
<td>200</td>
</tr>
</tbody>
</table>

- Interest limitations – 25% of taxable EBITDA: 50
- Net related party interest expenses: 100
- Increase in taxable income: 50
- Ordinary taxable income (after interest limitation): 50
- Losses carried forward to next year: (200)
Exit Taxation (Article 5)

- Exit tax on transfers of:
  - Assets from head office to PE in another MS or third country
  - Assets from PE to head office or to PE in another MS or third country
  - Tax residence to another MS or a third country
    - Exit tax upon subsequent transfer to third country from MS PE
  - PE out of a MS

- Deferral: Annual installment over at least five years

- Interest and guarantee

- Entry value equals market value in the recipient state (step-up)

- Comment:
  - Exit tax is not a BEPS action point – rooted in CCCTB discussions
  - No room for stricter domestic legislation with respect to EU MSs – only possible regarding third countries
  - ATA draft seems in conformity with the TFEU and corresponds to the existing domestic practices in some MSs
  - Risk of double taxation?
Exit Taxation (Article 5)

- Comment:
  - Why not accept market value determined by a MS outside EU when exit taxation covers transfer to MSs outside EU?
  - Why not also cover debts and obligations?
Norwegian exit and entry taxation

- Exit tax is levied when tangible or intangible assets are moved out of Norwegian taxing jurisdiction
- Taxable gain or tax deductible loss is the difference between the asset’s tax basis and fair market value
- When a tangible asset enters Norwegian taxing jurisdiction, the tax basis is determined as:
  - For residents within EEA/EU: owner’s cost price less depreciations according to Norwegian tax regulations until 1\textsuperscript{st} January in the year the asset enters Norwegian taxing jurisdiction
  - For residents outside of EEA/EU: owner’s cost price less linear depreciations (rate depends on category of asset) until 1\textsuperscript{st} January in the year the asset enters Norwegian taxing jurisdiction
- Norway does not allow step-up of tax basis to fair market value
Switch-over Clause (Article 6)

- Switch over from exemption-relief to credit-relief:
  - Participation exemption of distribution from third country entities
  - Participation exemption proceeds from disposal of shares in a third country entity
  - Income from a third country PE (principle of territoriality)

- Low taxation requirement:
  - Statutory corporate tax rate lower than 40% of the statutory tax rate in the MS of the taxpayer
  - Legal consequence: Taxpayer shall be subject to tax on the foreign income
  - Credit-relief for tax paid in third country (ordinary credit)

- Comment:
  - Aiming at too generously applied tax-exemption regimes
  - Not part of the BEPS project – rooted in CCCTB discussions
  - Harsh criticism (further than BEPS)
  - Amendments required in a number of MSs
Switch-over Clause (Article 6)

- Comment:
  - Normally a system used instead of CFC-legislation – why have two parallel systems; risk of double taxation? Achieve objectives?
  - Comparing tax rates of payer and distributor no common system is achieved
  - Tax base is not recognized
  - Do not recognize what the taxation would have been in MS if received the underlying direct (not through a third state)
  - Why is it harmful for the internal market to receive income that have been “low”-taxed outside EU?
GAAR (Article 7)

- Resembles the PSD GAAR – designed to reflect the artificiality tests of the ECJ
- Legal effect:
  - Arrangements etc. shall be ignored for the purposes of calculating the corporate tax
    - Calculated by reference to substance in accordance with national law
- Requirements:
  - "Arrangement or series thereof"
    - An arrangement may comprise more than one step or part
  - "Non genuine"
    - Not put into place for valid commercial reasons, which reflect economic reality
  - "That defeat the purpose or object of the otherwise applicable tax provision"
  - "Carried out for the essential purpose of obtaining a tax advantage"
- Comment:
  - Uncertainty in general as well as with respect to SAARs
  - Largely similar to BEPS action 6 (Principle Purpose Test)
CFC-Legislation (Article 8)

- **Legal effect:**
  - Parent company shall include the non-distributed income
  - Inclusion, in accordance with the parent’s entitlement to profit

- **Requirements:**
  1. Wide control test: > 50% of voting right, capital or profits
  2. Low tax requirement: Subsidiary's effective corporate tax rate < 40% of the effective tax rate in the state of the parent company
  3. Wide income requirement: > 50% is CFC income

- **EU/EEA exemption – Not wholly artificial**

- **Comment:**
  - Significant impact: 14 EU MSs do not have CFC rules
  - Included in BEPS project and CCCTB proposal
  - Broad scope:
    • Control (based on profit participation)
    • CFC income (real estate, intra group services, including external royalty income based on internal R&D)
    • Double tax relief not mentioned
    • “Significant people’s functions” vs. “significant people functions” BEPS?
    • No definiton of arm’s length
Hybrid Mismatches (Article 10)

• Hybrid entities:
  – Characterization in source state determines classification in home state within the EU
  – Requirement:
    • Different legal characterization of the same taxpayer
    • Leading to double deduction or deduction non-inclusion

• Hybrid instruments:
  – Characterization in source state determines classification in home state within the EU
  – Requirement:
    • Different legal characterization of the same payment
    • Leading to deduction non-inclusion

• Comment:
  – Different rule under BEPS – Payer denied deduction
  – If two states view itself as source state?
  – Risk of double taxation
Final Remarks

- Dispute resolution mechanism?
- Avoidance of double taxation?
- Amendments needed broadly across MSs
- Relationship to Tax Treaties:
  - Issues concerning tax treaties have not been included in the directive
  - However, directive would require changes to Tax Treaties
    - Superiority of EU-law
- Does the draft ATA-Directive fit its policy objective?
- Political expectations:
  - Dutch Presidency is pushing the agenda
  - Possible at all or with significant amendments?
- Pushing CCTB?