International tax: Reflections on 2019 and hot topics for 2020

9 December 2019

With you today

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Agenda

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02 ATAD & MLI

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Welcome & introduction

Melissa Geiger

ATAD & MLI

Kashif Javed & John Addison

What is the multilateral instrument (MLI) about?

1. **Modifies existing bilateral tax treaties to implement the tax treaty-related BEPS measures, without the need to individually renegotiate each treaty bilaterally**

2. **Effective for taxable periods beginning on or after six months after date MLI enters into force for both parties (earlier for WHT)**

3. **The MLI allows states to decide which treaties are 'covered' under the MLI**

PPT rule

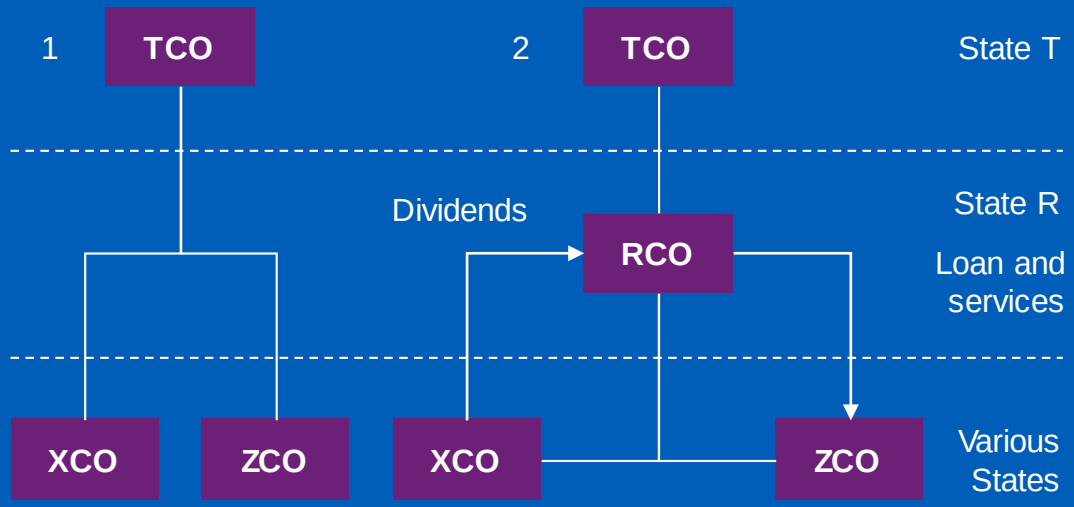
Treaty benefits

… shall not be granted ... if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was ***one of the principal purposes*** *of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit … would be in accordance with the object and purpose of … this Convention*

Principal purpose test rule (PPT Rule)

Regional HQ providing services

A holding company (TCO) of a multinational group establishes a regional company (RCO) in State R in order to provide services to local operating companies in neighbouring countries. The services include management, financing, treasury, and some other non-financing related services. RCO is established in a country with a number of favourable non-tax benefits (e.g. skilled labour force, reliable legal system, etc.) as well as a comprehensive double tax treaty network. The management of XCO and ZCO report into the board of RCO who sets its subsidiaries targets and KPIs



Why it matters

01 ATAD II is effective in all EU Member States from 1 January 2020

02 ATAD II is a minimum standard that all EU Member States must adopt

03 Each EU Member State may implement the rules differently

04 Non-EU countries are considering ATAD II style rules or have already implemented rules with similar features

05 Part of a wider shift in similar but not identical tax initiatives; creating more complexity between countries.

ATAD II overview

ATAD II extends the scope of ATAD and broadly applies to deny deductions or tax income where a tax mismatch arises, which involves:

- At least one taxpayer that is subject to corporate income tax in an EU Member State; and
- An element of hybridity

What are the rules aimed at?

Examples of when mismatches may arise:

- A payment from a subsidiary to a parent is treated as a deductible interest payment by the subsidiary, but exempt dividend income in the parent
- A payment is treated as deductible, but is made to a branch, the profits of which are exempt from tax
- A payment is treated as deductible, but the corresponding income is subject to a special rate due to a local regime (e.g. an IP incentive regime)
- A payment is treated as deductible in two territories, for example due to a US check-the-box election

EU implementation status

ATAD II implemented	Draft legislation published	Currently unknown
— Belgium	— Austria	— Croatia
— Czech Rep	— Bulgaria	— Greece
— Denmark	— Cyprus	— Latvia
— Germany	— Estonia	— Lithuania
— Italy	— Finland	— Malta
— Slovakia	— France	— Portugal
— UK	— Hungary	— Romania
	— Ireland	— Spain
	— Luxembourg	
	— Netherlands	
	— Poland	
	— Slovenia	
	— Sweden	

BEPS 2.0

Matthew Herrington & James Sia

Recap on the OECD's timeline to date

Mar 2017

G20 Mandate
BEPS Inclusive Framework to prepare a report/Task Force on the Digital Economy

Mar 2018

OECD Interim report
In-depth analysis of value creation across business models and identification of tax challenges

Jan 2019

OECD Policy note
Identification of two pillars and four approaches to be explored on a 'without prejudice basis'

Feb 2019

Consultation paper
Issued on 13 February 2019

March 2019

Public consultation
Paris, 13-14 March 2019

May 2019

OECD's Programme of Work paper
Issued on 31 May 2019

June 2019

Update to the G20 Finance Ministers
Japan, 8-9 June 2019

G20 Finance meeting
17-18 October 2019

October 2019

OECD Digital taxation update paper
9 October 2019

November 2019

Public consultation
21-22 November 2019

OECD's programme of work - Overview

1

Revised Pillar One

- Grants greater taxing rights to market jurisdictions
- Broadly focusses on large consumer facing business
- 'Unified approach' uses three tier mechanism:
  - Amount A: share of deemed residual profit allocated to market jurisdictions using a formulaic approach based on sales
  - Amount B: fixed remuneration for baseline marketing and distribution functions taking place in the market jurisdiction
  - Amount C: an allocation based on traditional TP rules where in-country functions exceed the baseline activity compensated under Amount B may apply
- Effective dispute resolution procedures will be critical for all aspects of profit reallocation proposals under the unified approach

OECD's programme of work - overview (cont.)

2

Revised Pillar Two

Globe proposal' extraneous – Headquarter residence might 'tax back' low-taxed profits:

— Income inclusion rule (and switch-over rule)
— Undertaxed payments rule and subject to tax rule

Options and issues:

— Coordination between the rules
— Simplification
— Thresholds
— compatibility

What comes next?

December 2019

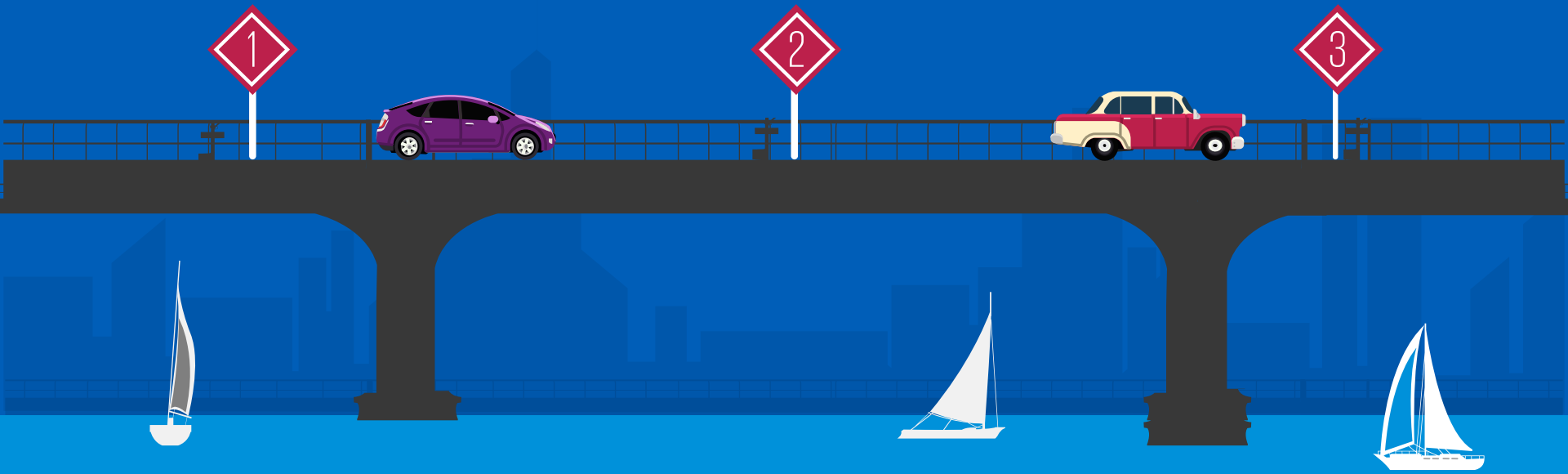
Public Consultation on Pillar Two

January 2020

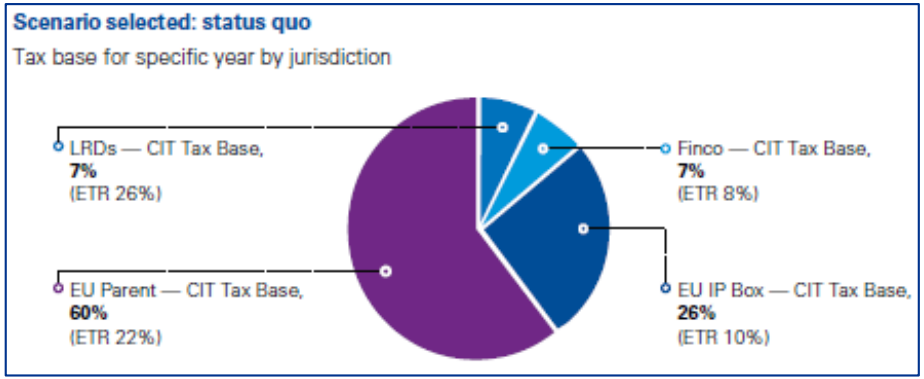
Political declaration expected from OECD

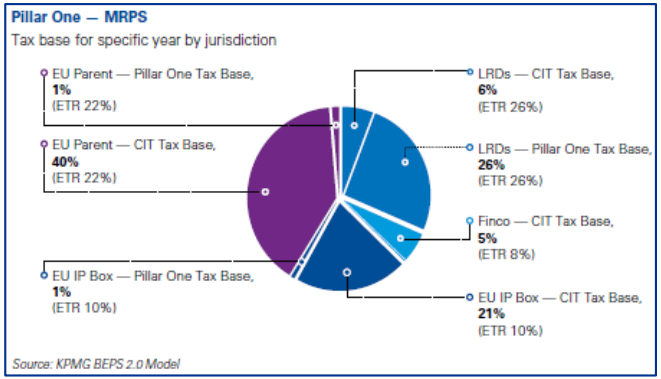
End 2020

Final report

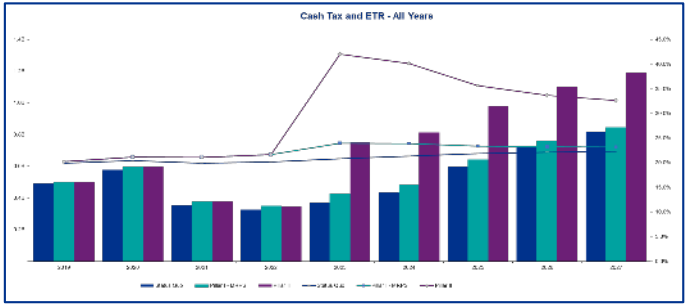


KPMG BEPS 2.0 Model





Scenario comparison of Cash Tax and ETR for 2019-2027



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DAC6

Janette Wilkinson & Nicolas Gurteen

DAC6 in a nutshell

Sets minimum standard for reporting on:

- Cross-border arrangements
- By intermediaries (or in some cases taxpayers)
- When ‘made available for implementation’, ‘ready for implementation’, or at the first step of implementation
- For all taxes of any kind with the exception of: VAT; customs duties; excise duties and compulsory social contributions
- Within a set of so-called ‘hallmarks’ (sometimes with a main benefit test)
- Some countries are already going beyond the minimum standard (e.g. Poland)
- No materiality or SME exemption

Focus on key dates

Tracking of transactions over 'catch up period'

01

25 June 2018

Entry into force

02

31 December 2019

Domestic law final

03

1 July 2020

30 day requirements starts

04

31 August 2020

Catch up report due

05

31 October 2020

First information exchange between tax authorities (quarterly thereafter)

Examples of challenges associated with EU MDR

Challenges

- Managing differences in implementation
- Obtaining information from business units on arrangements
- Stakeholder engagement and definition of responsibilities
- Managing intermediaries and ensuring consistency of disclosure
- Managing compliance burden

How to approach your next steps

1. Assessment of risk areas | **II. Identification and reporting** | **III. Embedding compliance**

1

Assessment meeting and identification of stakeholders

Impact analysis workshop to agree list of transactions and initial assessment

2

Stakeholder workshop to educate, discuss impact for specific business areas and obtain buy in

Review of “look back” transactions

3

Framework design for ongoing assessment/ audit process

Design of policy/ protocol for intermediaries

Documentation of processes designed to be shared with tax authorities

4

Embedding framework in the business, including roles and responsibilities

Tracking of transactions considered and actions taken

5

Guidance and process instructions

Consideration of local implementation and variance needed to deal with it

6

Training materials for the business

Annual review of process and transactions disclosed

ORIP

Sarah Churton & Nicolas Gurteen

Offshore receipts in respect of IP ('ORIP')

1 January 2018 | 6 April 2019 | 4 November 2019 | 31 December 2019

ORIP rules apply to UK-derived amounts "accruing" after 6 April 2019

Non-treaty resident → Related or third party → Related or third party → Related or third party → UK customer

- **IP rights**
- Provision of goods, services or IP rights
- Provision of goods or services
- Provision of goods or services
- Provision of goods or services

Gross IP-related income derived from UK sales subject to UK income tax (20%)

- Very limited substance exemption
- Tax exemption (50% threshold)
- UK sales de minimis (£10 million)
- Limited reseller "look through"
- Specified territory exemption

US tax reform update

Howard Wiener

Overview of US international tax framework

163(j) Limit on interest deduction
- Related and unrelated party debt
- 30% of EBITDA (EBIT in 2022)

BEAT Section 59A
- Imposes additional tax
- Based on limiting deductibility of deductible payments to foreign persons

Other Income – 21%
- US and Foreign source income that is not FDII or GILTI or eligible for DRDs

FDII – 13.125%
- Income from sale, leases, licenses, and dispositions of property to foreign person for foreign use
- Income from services to person outside the US / LFDII section 250(b) @ 13%

Distributions
- PTI
- Participation Exemption (section 245A)
- Subject to tax if hybrids of inverted companies

Branch Income – 21%
- Current inclusion
- Separate basket
- 10 year carryforward
- Cannot get FDII

Sub F – 21%
- Foreign base company income and 956
- Current inclusion at 21%
- General and passive baskets
- 10 year FTC carryforward

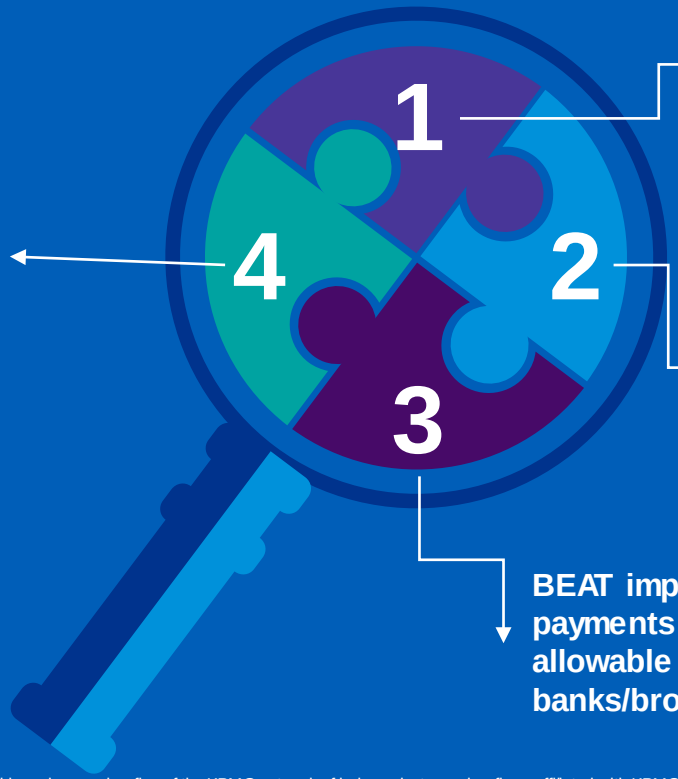
Exempt Income – 0%
- FOGEI
- 10% QBAI
- High Tax sub F income (elective)

GILTI – 10% (13.125%)
- CFC income that is not exempt or sub F
- Current inclusion with 50% deduction
- 80% FTC haircut
- Separate basket
- No FTC carryforward

Base erosion anti-abuse tax (BEAT) - Overview

Targeted base erosion payments do not include

- Reductions in gross receipts, including COGS (unless paid to inverted group members)
- Payments to the extent subject to US tax (e.g. withholding)
- Payments for intercompany services that qualify to be charged at cost
- Qualified derivatives payments



Imposes a 10% minimum federal income tax (12.5% after 2025)

Applies to taxpayers with prior 3-yr average annual gross receipts of at least $500 million

BEAT imposed where Base erosion payments in the tested year exceed 3% of allowable deductions (2% for banks/broker-dealers)

Update on newly proposed BEAT regulations (1/2)

- **No carve-out for payments taxed subject to US Tax** (e.g. to GILTI or subpart F).
- **Relief for non-recognition transactions** - Exclusion for depreciable property transferred from foreign related party non-recognition transactions (e.g. contribution to capital).
- **Aggregate group members with different tax years** - Computations made on the basis of the taxpayer's tax year and the tax year of each member of its aggregate group that ends with or within the applicable taxpayer's tax year (the "with-or-within method").
- **Currency losses** - For purposes of the base erosion percentage, currency losses exclude from the denominator are excluded from the numerator.

Update on newly proposed BEAT regulations (2/2)

- Expand TLAC securities exception.
- **Exception for groups with de minimus banking and securities dealer activities** - The additional 1% add-on to the BEAT rate will not apply to a taxpayer that is part of an affiliated group with de minimus banking and securities dealer activities.
- **No Rate blending for FY 2018 -** The rate for any tax year beginning in calendar year 2018 is 5% (no blending).
- **No expansion of the SCM Method.**
- **Anti-abuse rules finalized largely unchanged** - The final regulations add new examples aimed at clarifying the "principal purpose" standard and treatment of ordinary course transactions.
- **Applicability dates** - The final regulations apply to tax years ending on or after December 17, 2018.

PDCF

Jenni Cooper

Why has HMRC launched the PDCF?

1. Continued wide lack of BEPS compliance identified e.g.:
   - Incorrect assumptions made
   - Failure to reflect 'what is actually happening on the ground'
   - Implementation failures
   - Failure to update TP policies

2. Time limits for DPT Preliminary Notices

3. Co-operative Compliance preferred

HMRC risk indicators

General

- Contractual allocation of risk inconsistent with control over risk.
- Fragmentation of valuable integrated functions in the pricing model.

Sales, marketing and distribution

- Important regional functions taking place in the UK with associated profits routed overseas.
- UK entities performing key account management functions.

Supply chain

- Supply chains with entities in low tax territories.
- Payments made to procurement or sourcing hubs with limited functionality or for group synergies.

R&D

- Valuable R&D functions described as low value.

Intangibles

- Accumulation of residual profits in a (low tax) IP holding entity with low value functions.
- UK entities performing key functions related to IP.

Setting the scene

1

Profit Diversion investigations:

— Our recent experience

2

Detailed PDCF Disclosure Report requirements e.g.:

— Employee interviews

— Contemporaneous communications and documents e.g. e-mail review

— Analysis of behaviours and conclusions on penalties

3

How does the PDCF differ?

Options for taxpayers

Range of options, dependent on specific fact and risk patterns e.g.:

BEPS compliance risk assessment

Design and implement BEPS compliant tax models

Obtain advice on potential exposures

Advance pricing agreements and mutual agreement procedures

Proactively engage with HMRC

Register for the PDCF

KPMG can assist with all of the above options, and services can be provided under legal advice privilege where appropriate

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Q&A

Thank you

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