Anti-Avoidance Rules, Transfer Pricing and Advanced Pricing Agreements (APAs)

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Ho Chi Minh City, 14 May 2014

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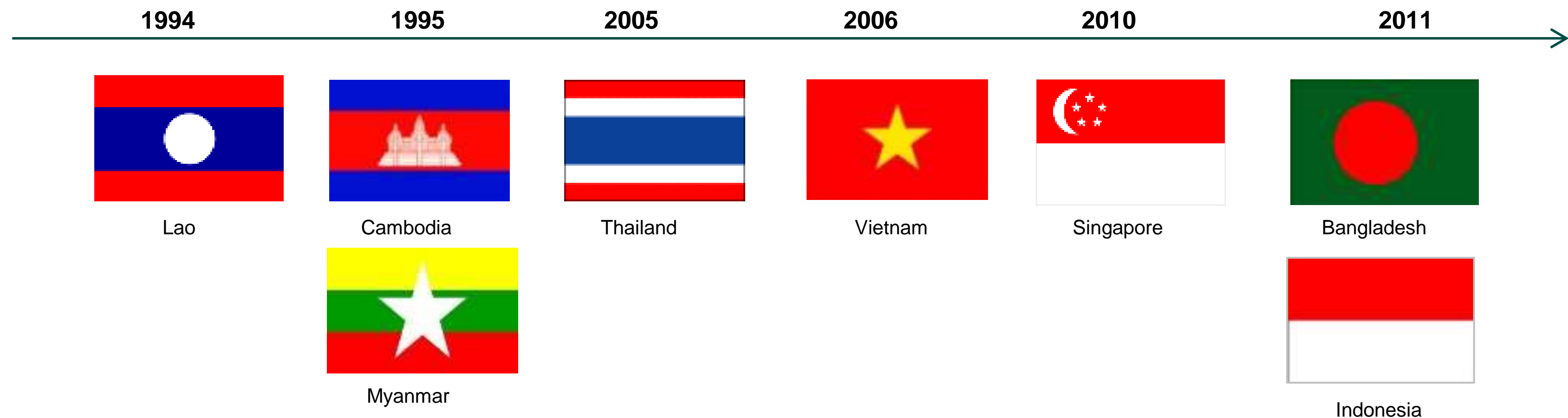

Our Strategy

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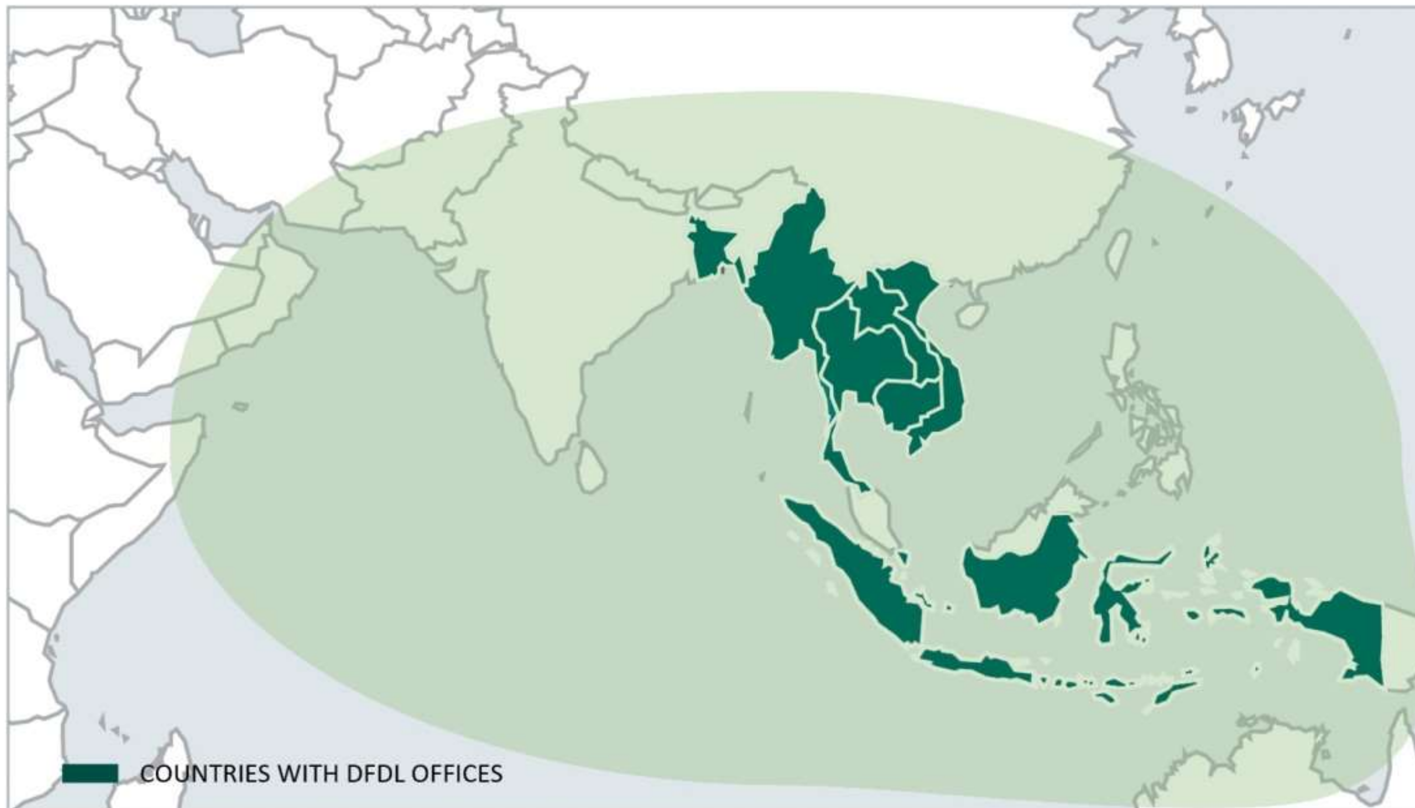
From Southeast Asia to the Middle East



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  Singapore

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Outline of the Talk

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1. Anti-Avoidance Rules
2. The changing landscape of international tax
3. The BEPS initiative
4. The Vietnam front
5. What now?

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Why all the fuss?

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"We do need a debate in this country, not only what is against the law — that's tax evasion, that is against the law, that's illegal and if you do that the Inland Revenue will come down on you like a ton of bricks — but what is unacceptable in terms of really aggressive tax avoidance.

Because some people say to me, 'Well, it's all within the law; you're obeying the law, it's okay'. Well, actually there are lots of things that are within the law [that] we don't do because actually we have some moral scruples about them and I think we need this debate about tax too.

– **David Cameron, Prime Minister, UK.**

"Practices that reduce tax liability through "strictly legal arrangements" but at the same time contradict the "intent of the law"

– **EU Commission Action Plan on aggressive tax planning**

Defining GAAR – General Anti Avoidance Rules

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- Anti-avoidance rules are generally divided into two categories: "general" and "specific"
- A GAAR is a set of rules within a country's tax law to counteract the avoidance of tax. A GAAR provides tax authorities with a mechanism to deny tax benefits
- GAAR will target transactions or arrangements that lack commercial substance or purpose
- GAAR, SAAR, TAAR
- Different countries have varying approaches to combat tax avoidance

General Characteristics of GAAR

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- Tax benefit – e.g. tax relief, deduction, rebate, refund, tax treaty relief, deferral of income
- Purpose Test: "commercial sense". USA economic substance doctrine, Australia "dominant purpose test"
- Is burden of proof on taxpayer or tax authorities?

Answer: It depends:

USA	Taxpayer
Japan	Tax Authorities
Singapore	Tax Payer
China	Taxpayer
Vietnam	???

GAAR Country Highlights

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USA

- No GAAR, however, TAAR and disclosure rules
- Economic substance doctrine (sham transaction doctrine, business purpose doctrine)
- Large volume of precedent court decisions
- Limitation of benefit ("LOB") clauses in tax treaties

China

- In January 2009 introduced "substance over form" and "reasonable commercial purpose" into the tax regime.
- In 2011, China initiated 248 GAAR cases and concluded 207 cases worth USD 3.81 Billion

Singapore

- Section 33 of the Singapore tax code provides that the tax authority may disregard or vary the arrangement and make such adjustments as he considers appropriate including the computation or recomputation of gains or profits, or the imposition of liability to tax, so as to counteract any tax advantage obtained or obtainable by that person from or under that arrangement.
- Limitation of benefit (“LOB”) clauses in many tax treaties

GAAR Country Highlights

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UK

- General Anti "Abuse" Rule
- "Arrangements that have a main purpose of obtaining a tax advantage, and which are abusive"

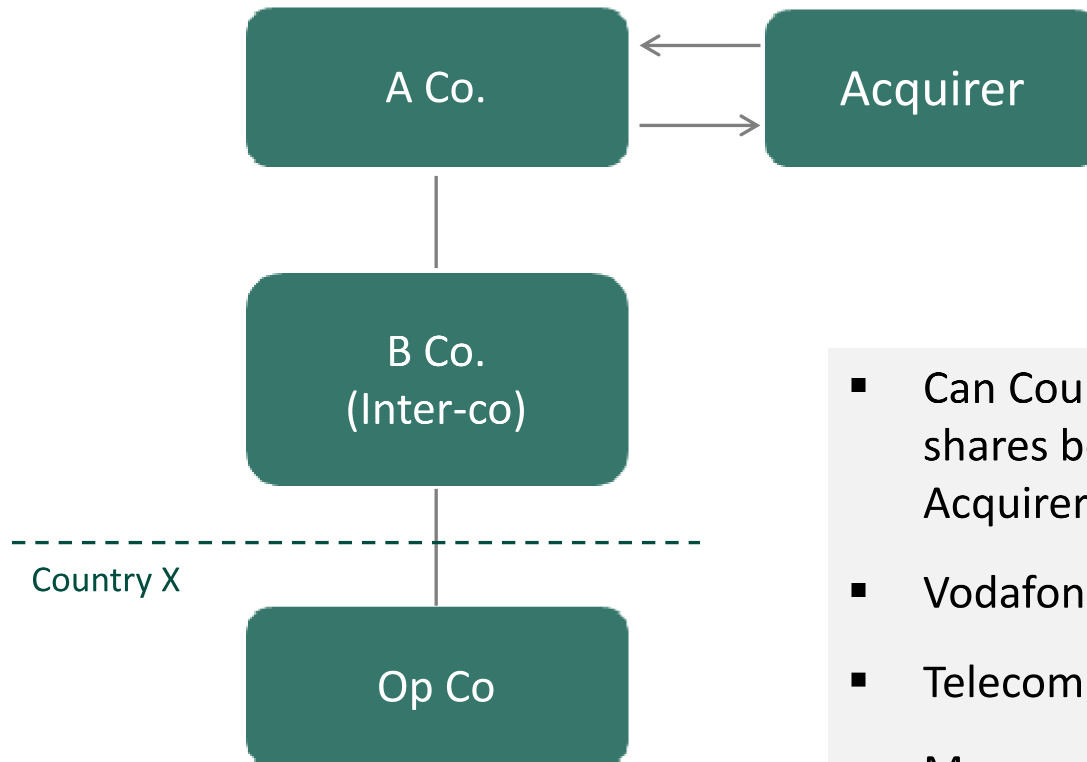
India

- "Substance over form approach" adopted by tax authorities
- GAAR implementation expected April 2016

Indonesia

- In 2010, Indonesia introduced a FORM – DGT 1. The form requires information from the taxpayer seeking relief:
- The form requires information from the taxpayer seeking relief:
  - The creation of the entity and/or transaction structure is not motivated by reasons to take benefit of a tax treaty;
  - The company has its own management to conduct business and such management has an independent discretion;
  - The company employs sufficient qualified personnel;
  - The company engages in active trade or business;
  - The income earned is subject to tax;
  - No more than 50 per cent of the company's income is used to satisfy claims by other persons (i.e. interest, royalties, other fees).

Indirect transfers of assets (SAAR)



- Can Country X tax a transfer of shares between A Co and Acquirer?
- Vodafone Case in India
- Telecom Case in Laos
- Myanmar, China (Circular 698), Indonesia
- Vietnam?

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4 The Vietnam front

5 What now?

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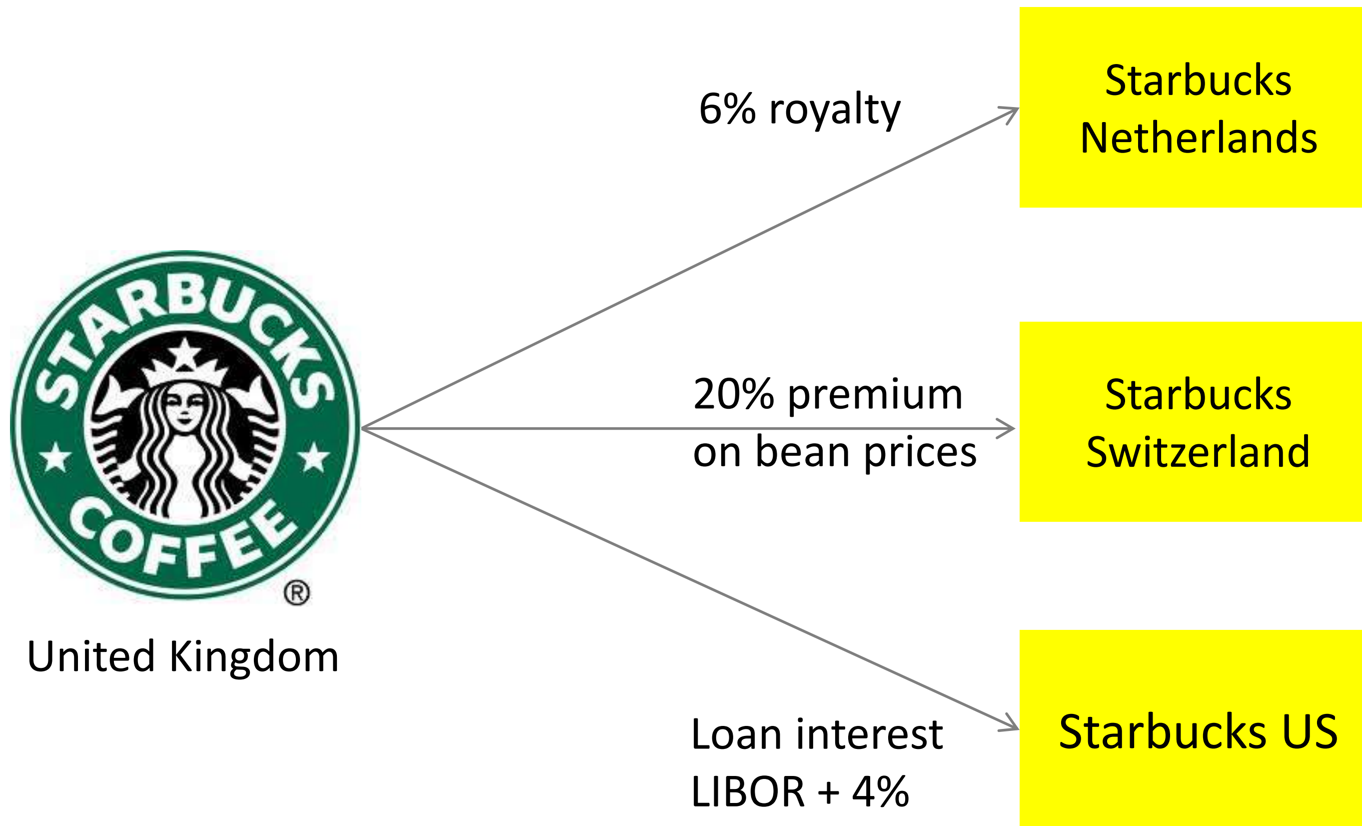

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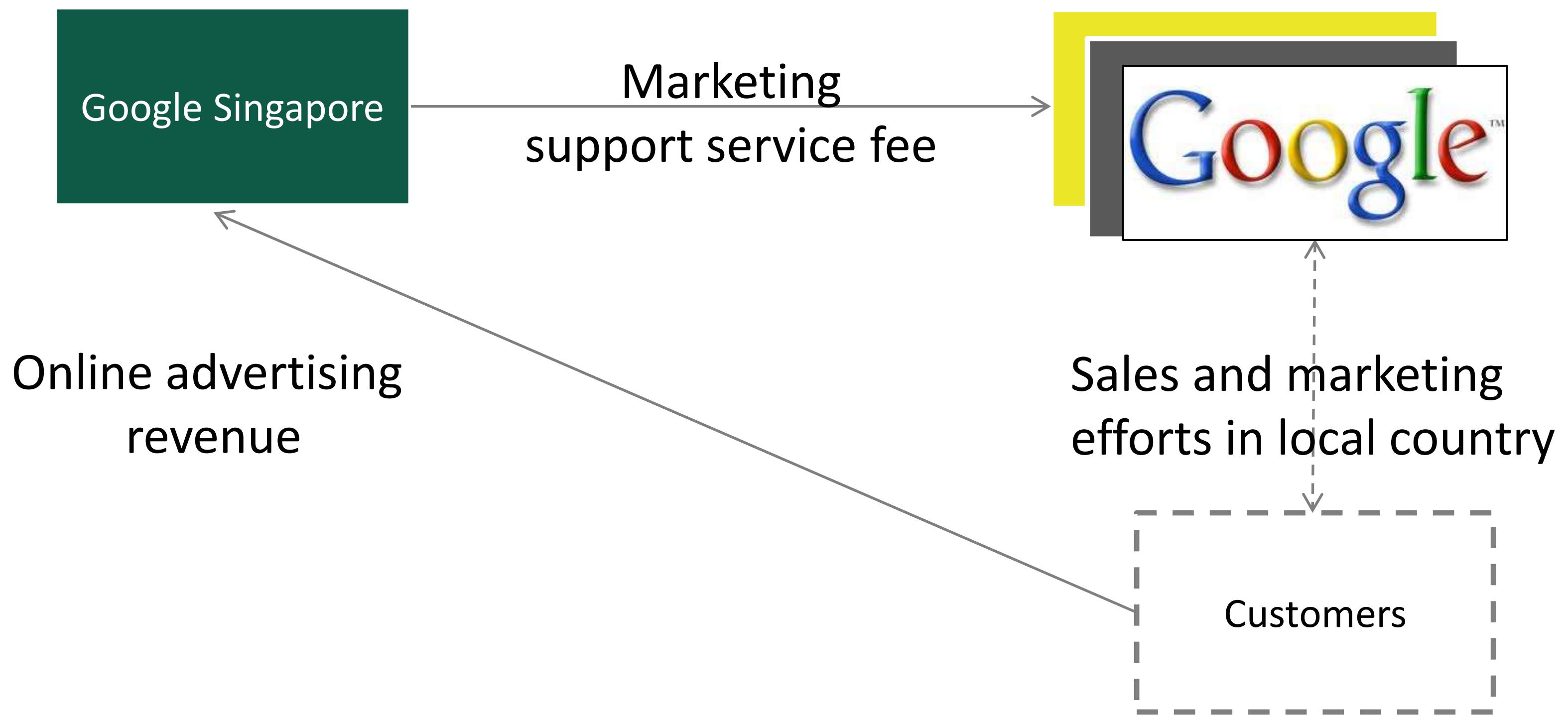

Tax avoidance is the legal usage of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. The legal reduction of taxes through tax planning by taking advantage of allowable deductions, exemptions and other tax reliefs.

Tax evasion is the illegal non-payment of tax due.

Public opinion: "The difference between tax avoidance and tax evasion is the thickness of a prison wall." *- Denis Healey, former UK Chancellor of Exchequer*

The global tax landscape in 2014

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- Continuing campaign by nations to demand their “fair share” in taxes (BEPS – recommendations on approaches on the digital economy; international standards of transparency; changes on treaty interpretation, TP guidelines, recommendations on local legislation, etc.)
- A renewed focus on substance, GAARs and SAARs, etc. Schemes and structures that were perfectly acceptable before may now be questioned
- Developing countries will try to make themselves more attractive to investors (lower CIT rate, more incentives), but will focus on stricter tax enforcement
- Public opinion and public perception will play a role
- Demand for Exchange of Information among tax authorities gearing towards multi-lateral and perhaps even automated exchange

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What is BEPS?

Base erosion and profit shifting ("BEPS") refers to tax planning strategies that exploit loopholes 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 where they are lightly taxed, resulting in little or no overall corporate tax being paid.

- Growing concern has been expressed regarding BEPS by MNEs
- Increased attention of civil society to corporate tax affairs
- Spreading perception that MNEs dodge taxes all around the world and in particular in developing countries

G20 meetings of June and November 2012 focused on BEPS issue and requested OECD action. OECD came up with its BEPS diagnosis in February 2013; an Action Plan on July 2013; first batch of prescriptions by Sept 2014; completion by Dec 2015.

International tax response: OECD initiative on BEPS

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- BEPS Action Plan published in July 2013 prescribed actions organized around three main pillars:
  - ✓ The coherence of corporate tax at the international level
  - ✓ A realignment of taxation and substance
  - ✓ Transparency, coupled with certainty and predictability
- The OECD observes that most BEPS planning is legal – if governments are unhappy with results, the rules should be changed
- No single country acting unilaterally can effectively address the issue. Thus, the need for a multilaterally agreed solution

International tax response: OECD initiative on BEPS

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- BEPS report expected on September 2014 will focus on:
  - The digital economy – analysis of business models and identification of special features of digital economy players (such as mobility, reliance on data, network effects, multi-sides business models)
  - Treaty abuse – anti-treaty abuse provisions in treaty and domestic law and clarify that tax treaties not intended to generate double non-taxation
  - Hybrid mismatch arrangements – arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries

International tax response: OECD initiative on BEPS

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- BEPS report expected on September 2014 will focus on:
  - Transfer pricing on intangibles
  - Harmful Tax Practices regimes – with a priority on transparency, including compulsory exchange of information on rulings, and on requiring substantial activity for preferential regimes.
  - TP Documentation - tax administrations need for 'big picture' information on the global value chain
  - Multilateral instruments - multilateral instruments to implement BEPS measures and amend bilateral tax treaties

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The Vietnamese GAAR

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- The GDT issued a circular introducing rules against abusive arrangements to obtain tax treaty relief or exemption *(Circular 205/2013/TT-BTC dated 24 December 2013)*
  - Agreements or contracts are deemed to be abusive if their main purpose is solely or mainly to obtain treaty benefits
  - Treaty relief or exemption will be denied if the recipient of the income is deemed **NOT** to be a "resident" of the treaty territory and the recipient is **NOT** the "beneficial owner" of the income

Resident and Beneficial Owner (B/O)

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Example:

- Vietnam FCT on Royalties is 10% income tax
- VN-SG DTA:
  - The tax shall not exceed 5% of the gross amount of the royalties
  - In respect of payments of any kind received as a consideration for the use of, or the right to use, any patent, etc.
  - If the beneficial owner of the royalties is a resident of (Singapore)

Who is a resident?

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- A resident under the DTA is a “resident” as defined under domestic law of the contracting state.
- Place of incorporation test? Place of effective management test?
- Example, flow-through entities, partnerships, branches of corporations of a third state may be deemed as not being “resident”

Who is a beneficial owner? (OECD)

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- NOT a mere agent, nominee, conduit company acting as a fiduciary or administrator
- A B/O is someone with:
  - full right to use and enjoy (the income)
  - unconstrained by a contractual or legal obligation
  - to pass the payment received to another person

NOTE: This type of obligation must be related to the payment received; excludes other unrelated obligations

2004 examples in Vietnam

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- Circular 133: B/O of interest:
  - A Vietnamese company pays an interest to Thai Bank C. At the request of this bank, this interest is remitted to French bank P headquartered in Paris
    - FCT - 5%
    - Thai-Vietnam DTA - 10 – 15%
    - France-Vietnam DTA - Exempt
  - In this case, the beneficial owner of the interest is Thai bank C, not French bank P. So, bank P is not entitled to request the application of the provisions of the Vietnam-France Agreement to this interest.

Vietnam's GAAR circular

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- Vietnam's proposed test on who is NOT a beneficial owner:
  - Use of "substance over form" test for the identification of abusive transactions
- Seven tests:

As to substance of transaction

1. The applicant is due to distribute its profit to a third country within 12 months of receipt of the income.
2. The applicant has a back to back loan, royalty or technical service agreement with a third party.

Vietnam's GAAR circular *cont'd*

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3. The applicant does not carry out any particular business operations except for right to income from assets.

4. The applicant's assets, size of business and/or a number of employees do not correspond to an amount of income received, even though the applicant may have some business operations.

5. The applicant does not have any control, power or (has) a low risk over the assets, income and/or rights to future income

6. The applicant is a resident of a low or no tax jurisdiction.

7. The applicant is formed as a special purpose vehicle solely for treaty shopping purposes.

Issues that we will encounter

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Will the seven tests be seen as mere badges of treaty abuse or will these be deemed direct evidence of abuse?

Who bears the burden of proof? The taxpayer or the tax authority?

Aside from denying treaty relief, will the tax authority also deny deductibility of the expense?

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Next Steps

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Taxpayers should:

- Review the commercial substance in their transactions
- Ensure a *bona fide* business reason
- Establish substance in offshore entities and consider requirements of both jurisdictions
- Transaction must be arm's length
- Expect to address moral question (?)

Thank you!

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