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# *Navigating the Maze*

November 2015

# Impact of BEPS and Other International Tax Risks on the Jersey Funds Industry

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# *Current International Tax Environment*

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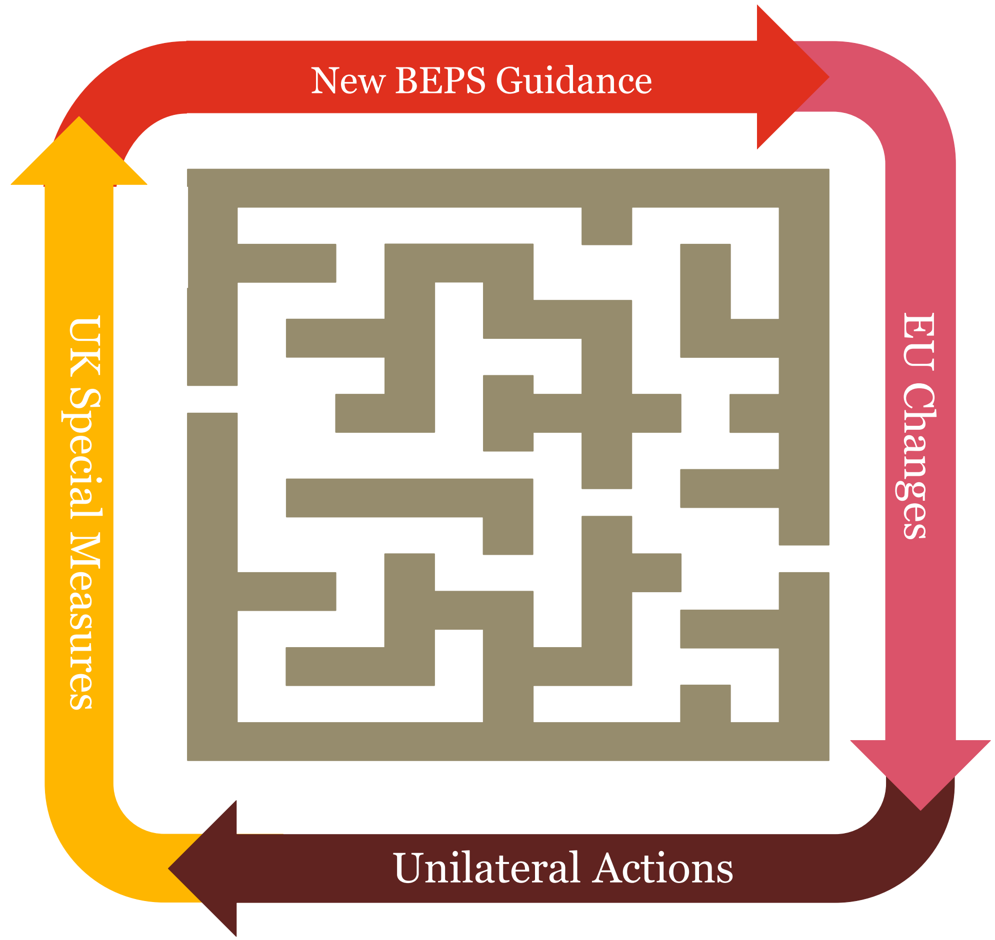
# The current environment

***The ability to achieve tax certainty is becoming increasingly difficult in light of the wider changes occurring in the international tax environment. These changes are having an impact both globally and in the UK, and have led to a substantial shift in tax authority behaviour.***

***These changes represent both a threat and opportunity to Jersey financial services businesses, and may require some small changes to structures / transactions to maintain benefits.***



# *Ongoing drivers*

**EU tax and transparency agenda**

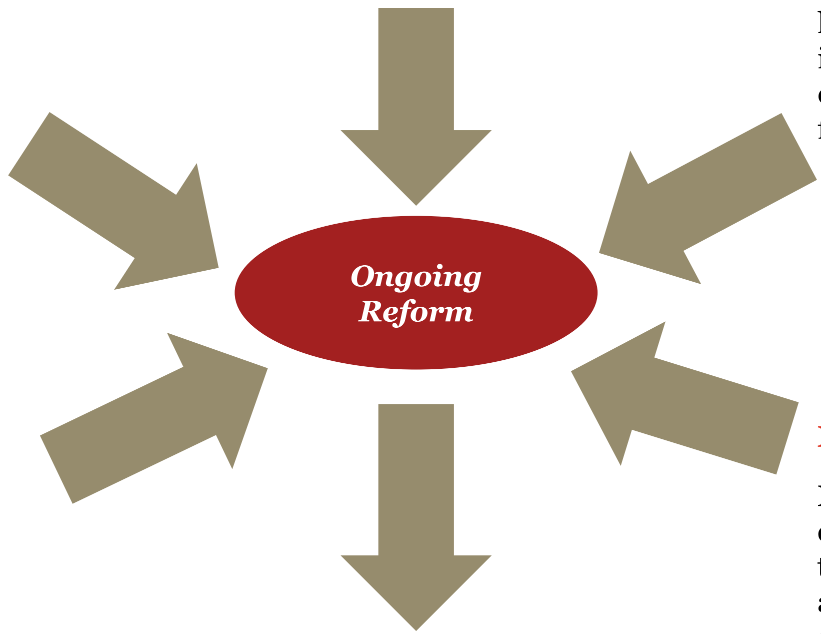
Despite lip service to the BEPS agenda, the EU is looking to take things further around disclosure and preventing perceived abuses

**Selective adoption of rules**

Countries are already diverging from suggested guidance from the OECD, which was meant to bring coherence and consistency

**Political pressure**

In various countries, politicians have committed to BEPS and implementing tax changes, and opposition parties will continue to focus on this area




**Country competition**

Despite aims of the OECD, countries will likely continue to take part in tax competition, though there will be greater stress on existing and future incentive regimes

**Media perception**

Mainstream media and NGOs will continue to focus on the morality of tax, blurring the line between avoidance and evasion in the view of the public

Short to medium term uncertainty, with potential increased level of disputes and double tax in the future

# *BEPS Impacts*

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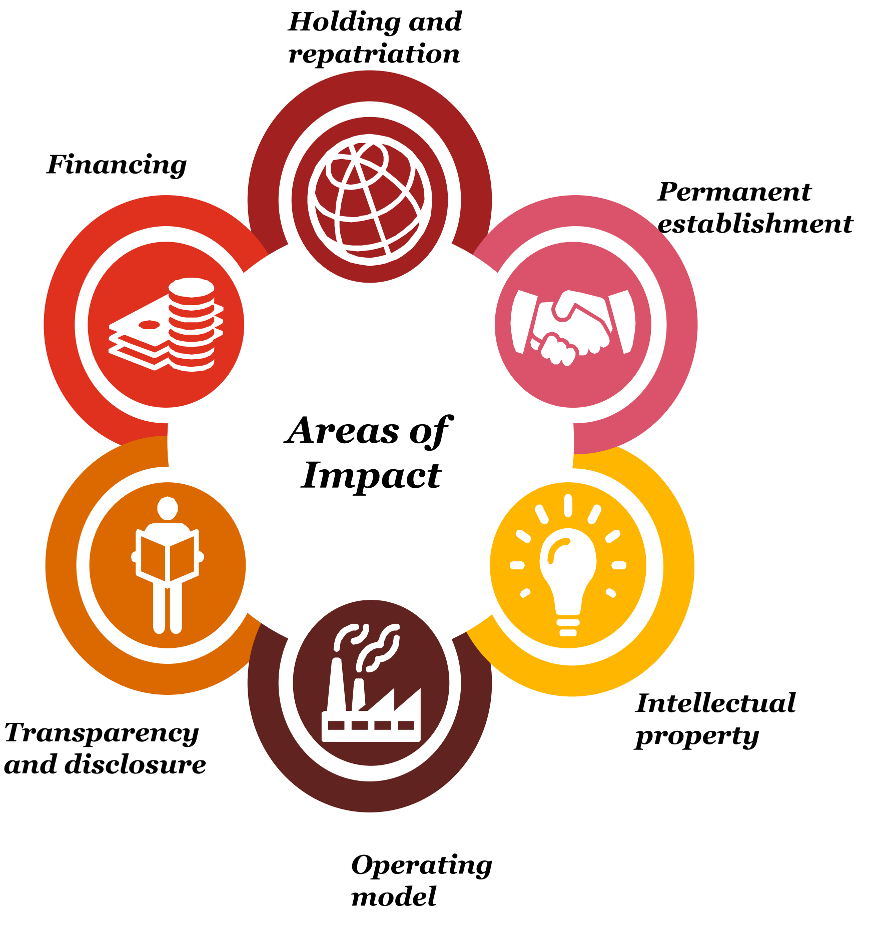
# *What is BEPS?*

- OECD action plan backed by G20 to address ***B***ase ***E***rosion and ***P***rofit ***S***hifting
- Areas of focus
  - Countering base erosion and arbitrage between territories
  - Jurisdiction to tax, with particular focus on the digital economy
  - Aligning taxable profits with the location of value creation
  - Transfer pricing, analysing issues related to the arm's length principle
- ***15*** actions with ***3*** key themes
  - Coherence – Improving interaction of corporate tax in different territories
  - Substance – Realignment of taxation and substance
  - Transparency – Greater availability of information to tax authorities



# *Timing of BEPS action plan workstreams*

| | September 2014 | September 2015 | December 2015 |
|---|---|---|---|
| 1. Address tax challenges of **digital economy –** (September 2014) | | | |
| 2. Neutralise **hybrid mismatch arrangement effects –** (September 2014) | | | |
| 3. **Strengthen CFC rules** – (September 2015) | | | |
| 4. Limit **base erosion via interest deductions/other financial payments** – (September/December 2015) | | | |
| 5. Counter harmful tax practices more effectively, taking into account **transparency and substance –** (Sept 2014/Sept 2015/December 2015) | | | |
| 6. Prevent **treaty abuse** – (September 2014) | | | |
| 7. Prevent the artificial **avoidance of PE status** – (September 2015) | | | |
| 8. **Transfer pricing: Intangibles** – (September 2014/September 2015) | | | |
| 9. **Transfer pricing: Risks/Capital** – (September 2015) | | | |
| 10. **Transfer pricing: Other high-risk transactions** – (September 2015) | | | |
| 11. **Collect and analyse data** on BEPS – (September 2015) | | | |
| 12. Disclose **aggressive tax planning** arrangements – (September 2015) | | | |
| 13. Re-examine **transfer pricing documentation** – (September 2014) | | | |
| 14. Make **dispute resolution** more effective – ( September 2015) | | | |
| 15. Develop a **multilateral instrument** (Sept. 2014/December 2015) | | | |

Output complete   Output 2015 A   Output 2015 B

# *Financing*

## Implications for Hybrids and Interest Deductions

### *Hybrids*

OECD has recommended domestic rules to neutralise the following results arising from hybrid mismatch arrangements:

- Deduction with no taxable inclusion (D/NI)
- Double deduction (DD)
- Indirect D/NI (imported mismatch)

Addresses hybrid mismatch arrangements arising from:

- Hybrid financial instruments and transfers
- Payments by hybrid payers
- Payments made to reverse hybrids
- Payments by dual residents
- Imported mismatches

Potential impact for funds structures:

- CPECs
- Check the box entities

### *Interest Deductions*

**Fixed Ratio Rule (Primary Rule):**

- Allow a deduction for interest up to a specified proportion of EBITDA.
- Range of acceptable ratios (10%-30%?).
- Principles to help countries set ratio.
- Applicable on country (rather than legal entity) basis?
- Currently used in a number of countries: Germany based on taxable EBTIDA, US based on adjusted taxable income. Perceived that ratios are too high.

**Group Ratio Rule (Secondary Rule):**

- Allow deduction for interest up to group ratio based on group's actual net third party interest expense.
- Optional carve-out from fixed ratio test where fixed ratio exceeded.
- Further work required during 2016.
- Similar proposal in the Obama Administration's annual budget.
- Similar rules operate in Australia, Germany and New Zealand as a carve-out from a 'fixed ratio' test.

### Relevance to Jersey

Need to monitor local implementation

Potential need to reconsider existing fund structures, if using hybrids

Possible impact of use of interest deductions, especially in UK

Use opportunity to negotiate interest treatment in UK treaty

# Holding and repatriation

## Could treaty relief be a thing of the past?

*Limitations of Benefits*

- Potential issues if follow US model, especially if not publicly owned/traded, intermediate holding companies, no active trade or business
- Objective tests, but complex to follow
- Difficulty in applying to competent authority relief

*Principal Purpose Test*

- Subjective test
- Could create greater uncertainty, but allows interpretation and self assessment
- Likely to be more favoured outside US treaties

*Other Issues*

- Change in purpose of tax treaties
- Guidance on where to negotiate tax treaties
- Carve-out for certain types of funds
- Left considerations for private equity and hedge funds to 2016

*Tax authorities refocussing on treaty access, even under existing rules (e.g. beneficial ownership)*

### Relevance to Jersey

Consider expansion of treaty network, where possible

Risk of on-shoring or moving substance to platform location

Important that final wording and carve-out is appropriate for alternatives

Still time for industry to lobby and find compromise solution

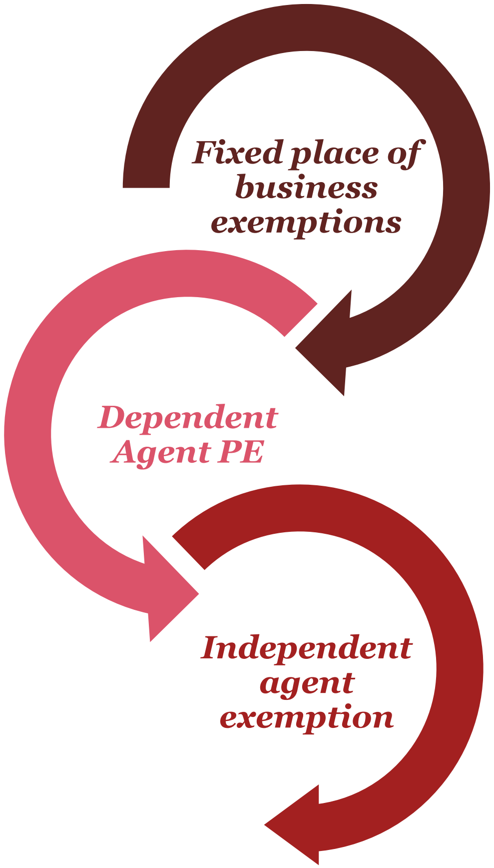
# Permanent establishment

## Changing rules and a renewed focus

- *Intention is to narrow PE exemptions for warehouses etc. – With particular focus on facilities for delivering goods and 'purchasing offices'*
- *Subject all specific activity exemptions to an overriding preparatory or auxiliary test*
- *Rule to prevent exemptions applying where business activities have been fragmented (by one enterprise or between related enterprises)*

- *Changes aimed at commissionaire and similar arrangements*
- *But likely to impact a broad range of taxpayer structures*
- *Key change from 'concluding contracts' to playing a 'principal role' in leading to the conclusion of contracts*

- *Higher threshold to be considered independent*
- *Change of 'exclusively' test and greater focus on legal and operational independence*
- *Loss of test used for supporting ordinary course of business exemption*




## Relevance to Jersey

Potentially limited impact on funds where IME (or similar) exemption exists

Significant risk for mobile marketing activities or use of related agents

Pre-emptive action by certain countries (e.g. UK and Australia) and potential treaty changes

Considerations for significant functions in Jersey to mitigate risks

# *Operating model impacts*

## Focus on 'substance'


Knowledge and experience to effectively make key strategic decisions in relation to important functions, assets risks of the business

Actual performance or control of important functions:
- Development
- Enhancement
- Monitoring
- Protection
- Exploitation

Financial capacity to adequately fund investments and bear key risks without support from group

### Relevance to Jersey

Ongoing (and increased) scrutiny of offshore residency will require more work by administrators

Importance of maintaining quality standards of Board and NEDs

Greater focus on transfer pricing arrangements in relation to transactions with Jersey entities

Having sufficient substance in Jersey will be key to maintaining current benefits

# Transparency and disclosure

## OECD's Three Tier Approach

### *Master file*

- Contains 'common standardised information **relevant for all MNE group members'.**
- Prepared either for **'the MNE group as a whole or by line of business'.**
- Purpose is to 'elicit a reasonably complete picture of the global business'.

### *Local file*

- Provide information that **supplements the master file** and aims to ensure **compliance in a specific jurisdiction.**
- Focuses on 'information relevant to the transfer pricing analysis related to the transactions taking place between a local country affiliate and associated enterprises in different countries'.
- Information to include detailed financials relevant to the specific transactions.

***Three tier TP Documentation***

### *Country-by-country reporting*

- CbCR for fiscal years beginning on or after **1 January 2016** if annual consolidated group revenue in preceding fiscal year of ≥ **EUR 750 million**
- CbCR contains a breakdown of:
  - Revenue between third party and related party
  - PBT
  - Income tax (paid and accrued)
  - Capital
  - Earnings
  - No. of employees; and
  - Tangible assets (excl. cash)
- Does **not** contain any disclosure of **royalties, interest or services/WHT,** although this will be kept under review until 2020

## Relevance to Jersey

Greater level of disclosure required for Jersey businesses that meet criteria

Potential consideration of whether Jersey will implement documentation rules?

# EU Changes

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# EU State Aid Investigations and Parliament Recommendations

## *State Aid Investigations*

- Focus on transfer pricing arrangements and rulings given.
- Concern that tax authorities did not do sufficient analysis.
- Focus on technical aspects, as well as length and rationale (was there selective treatment?).
- Potential to go back up to 10 years of arrangements.

## *EU Parliament Recommendations*

**Convergence**

- Anti-BEPS EU directive
- Common definition of tax haven
- Counter measures for use of tax havens
- GAAR clause in all directives

**Coordination**

- Two step CCCTB
- Code of Conduct Group
- Patent Box = new nexus approach
- CFC regulation
- Coordination on tax audits

**Transparency**

- Public CBCR
- Mandatory notification of new tax measures
- Mandatory AEOI on tax rulings

## Relevance to Jersey

Potential need to continue efforts to clarify benefits of Jersey to EU

Possible risk from reduction in ability to obtain and sustain rulings outside of Jersey

Public reporting could raise questions from media and NGOs

Benefits of being outside the EU and having transparent tax system

# *Unilateral Actions*

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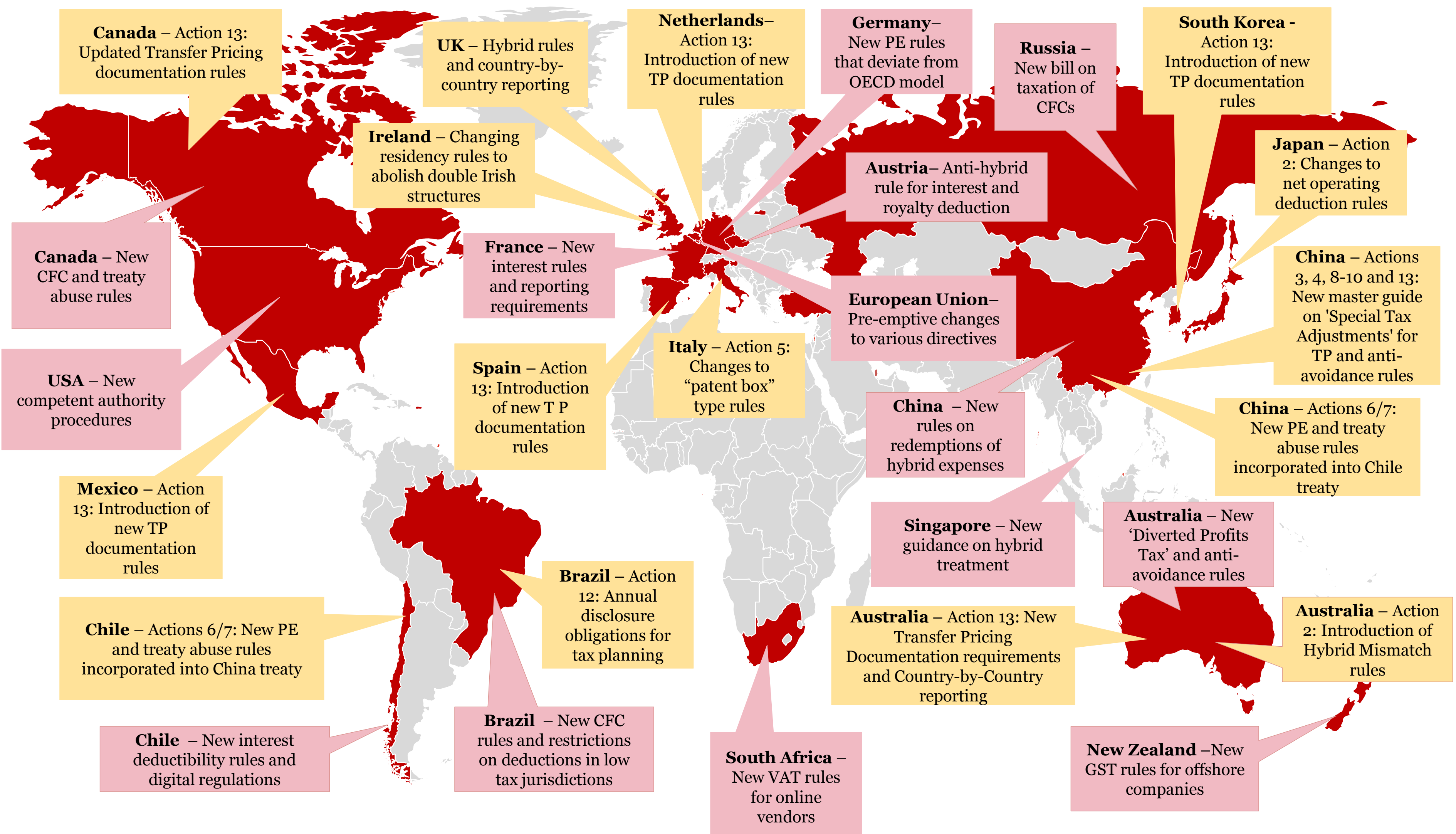
# *Unilateral actions already taking place*



# UK Tackling Offshore Tax Evasion

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# *Current HMRC consultations*

- Strengthening civil deterrents for offshore evaders.
- Civil sanctions for enablers of offshore evasion.
- A new corporate criminal offence of failure to prevent the facilitation of evasion.
- A new criminal offence for offshore evaders.

### *Civil Sanctions for Enablers*

An enabler is "any person (whether legal or natural) who, whether knowingly or unknowingly, provides services which assist a UK taxpayer to evade UK tax", which can include:

- Acting as a middleman
- Providing planning and bespoke advice
- Delivery of infrastructure
- Maintenance of infrastructure
- Financial assistance
- Non-reporting

### *Corporate Criminal Offence*

Three aspects of potential law:

1.) Requirement that there has been evasion;

2.) Requirement that business or its agents were involved in aiding or abetting the evasion; and

3.) Due diligence defence if reasonable steps to put in place adequate compliance procedures.

Not intended to criminalise corporations that take reasonable steps to prevent the facilitation of tax evasion by their agents

### Relevance to Jersey

HMRC view is that it should not be onerous to comply and businesses can build on existing AML training

Consider whether regulations should be amended to further encourage good behaviour

# *Jersey in a Post-BEPS World*

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# *It's not all doom and gloom, but we need to act now*

### *Strengths – Tax Neutrality is Still Relevant*

- Jersey generally tax neutral, with no withholding taxes.
- Respect of key aspects of EU law without being tied up in all EU regulations and rules (e.g. State Aid).
- Legal and political stability.
- Close relationship with the UK strengthened by Capital Economics report.
- Easy access to regulators and greater flexibility.

### *Weaknesses – Perception is Key*

- Lack of large tax treaty network.
- Perception of Jersey, especially outside the UK.
- Perceived difficulties in moving key employees to Jersey.
- Jersey is not a full member of the OECD, but can still participate in discussion on potential compromises.

### *Opportunities – Island of Substance*

- Knowledgeable and experienced local non-executives and service providers.
- Preferable geographic location (flight connections).
- Sufficient new office space.
- Island 'open for business'.
- Current UK rules provide opportunities to work within hybrid mismatch guidelines.
- Substance in Jersey can still offer overall tax benefits to a group.

### *Threats – Onshore competition*

- Potential changes in UK tax rules could undermine beneficial relationship.
- Domestic adoption of some BEPS rules in jurisdictions where Jersey does not have a DTA will have immediate impact.
- Action 6 (Treaty Abuse) could be used as support for on-shoring of funds.
- Aggressive behaviour by tax authorities could lead to increasing number of disputes.

# *Questions?*

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# *Thank You!*