2nd Workshop on Tax Base Protection for Developing Countries
Paris, France, 23 September 2014

QUESTIONS/ISSUES FOR DISCUSSION IN SMALL GROUPS

MORNING SESSION (11:45 AM-12:45 PM)

GROUP 1 - Preventing the Artificial Avoidance of PE Status

Example 1

Situation A:

- Non-resident Group of Companies entered into two different contracts re two different buildings ('construction work') with the same client for two different sites.
- Contracts are signed so that part of the work would be performed by the parent company (5 months per project), and another part of the work by two subsidiaries of the parent company (5 months per project each). The subsidiaries are parties to the contracts.

Note: Does it matter whether the parent/subsidiaries specialize in the work assigned? Would the outcome be different in case of contracts entered into for the provision of different services?

Situation B:

- Same as above, but the non-resident parent company opens a 'coordination office' in the capital of the source country (projects are located in other cities), which is there for more than six months.

Example 2

Situation A:

- A non-resident company (NR Co) (which is resident in low tax country R) has a subsidiary (S1) in source country S that sells products of NR Co in the local market in its own name but on behalf of NR Co (delivery takes places directly from NR Co to client, sales conditions are fixed by NR Co and S1 follows instructions of NR Co).
- S1 was a full-fledged distributor of the products before restructuring it into a limited risk distributor (remuneration based on cost-plus).

Situation B:

- Same as in Situation A, but in addition to distribution functions, S1 processes raw materials in source country S and stores them in a warehouse of an independent company; products are owned by NR Co (remuneration cost-plus).
- S1 helps in the process of transporting the products from the warehouse to the client.

Situation C:

- Same as in Situation B, but another subsidiary is used for distribution of the products.

Example 3

- A non-resident company (NR Co) (which is resident in low tax country R) operates a freezing vessel through a contract with a company (S Co) in source country S.
- All activities of NR Co (fishing, processing fish, freezing) take place in international waters, but its only client is located in country S.
- NR Co unloads fish always in the same port in country S (near client premises) and receives supplies from service providers there (to unload, repair ship etc.).
- One of the directors of NR Co lives in country S (same city of port), manages banks accounts of NR Co there and pays suppliers of services. He works from home since there are no premises of NR Co in country S.
- Another director of NR Co lives in country R. Contracts are signed there before fish enters country S waters. No other relevant activity.

Questions/Issues:

Please address the following questions with respect to any of the examples above:

1) Would you/your tax administration claim that there is a PE?
2) Is there a PE if Art. 5 UN/OECD MC applies?
3) If there is no PE, would your country consider that there is artificial avoidance of PE status?
4) Would your tax administration react?
5) Would you change the tax treaty policy/legislation of your country to capture the specific example? How?

Note: please consider whether there is only one or more PEs and how profits would be attributed to the PE(s) identified.

GROUP 2 - Neutralizing Effects of Hybrid Mismatch Arrangements

Example 1[1]

- Z Co, a company resident in Country A, issues perpetual, subordinated, profit sharing debentures to Y Co, a company resident in Country B. Country A characterises the return payable on the debentures as deductible interest. Country B characterises the return as dividends and grants a participation exemption (exemption for dividends paid between two companies) to Y Co with respect to receipt of the dividends.
- There is a mismatch between Country A and Country B as to the character of the return payable on the debentures (interest or dividends). This gives rise to a cross-border tax benefit (deduction in Country A) with no pick up in Country B (exemption granted). There are many variations on this style of mismatch. Some occur, as here, even though the two countries classify the investment in the same manner. Others occur because the two countries characterise the investment differently, e.g. debt or equity.

[1] This example is included as "Example 6" in the paper on "Neutralizing effects of hybrid mismatch arrangements".

Example 2[2]

- Z, a resident of Country A, owes money to Y, a resident of Country B. Z enters into an arrangement with its creditors whereby part of the debt owed to Y is written off. Under the Country B tax law Y can deduct the amount of the debt that is written off. Under the Country A tax law Z is not required to report any income.
- If the reduction in the debt is looked at in isolation, there is a mismatch that gives rise to a cross-border tax benefit (deduction in Country B) with no pick up in Country A (no income). In many cases, such a scenario is not abusive, presuming that Z has unrelieved (or cancelled) losses in Country A. However, the mismatch can result in untaxed funds if from a tax perspective Z has managed to set off all of the negative results that gave rise to the arrangement against income. This income might be in Country A or elsewhere, e.g. through carry back of losses or setting losses against income from other activities, including those of related parties.

Example 3[3]

- Z, a resident of Country A, borrows money from Y, a resident of Country B. The loan is for a term of three years and the agreement requires Z to pay interest in one lump sum at the end of the three year period. Country A permits Z to deduct the interest for tax purposes as it accrues, e.g. one third of the interest in each of the three years. Country B does not tax the interest as income to Y until it is received in year three.
- There is a mismatch between Country A and Country B as to the time at which the interest should be recognised for tax purposes. This gives rise to a cross-border tax benefit because most of the interest is deductible in Country A in tax years before it is included in income in Country B. Commonly, this timing benefit is not resolved if Country A taxes the interest at source (e.g. by withholding) because withholding is typically only at the point the interest is paid, i.e. when, on these facts, Country B also taxes.

Questions/Issues:

Please address the following questions with respect to any of the examples above:

1) Do you think tax is being avoided in this case?
2) Whose tax is being avoided? Explain why.
3) Do you think your country should respond - if it is Country A? or if it is Country B?
4) If so, how should your country respond and should your response depend on the actions or tax law of the other country?
5) Would you feel comfortable to enquire into the effects of the tax law of the other country? Does your administration have sufficient capacity to do so?
6) Can you provide a similar example dealing with a mismatch of the same income tax fundamental?
7) Can you provide an example where a similar mismatch with respect to a payment is caused by a disagreement as to earning activities, ownership of an asset or attributes of a person?

[2] This example is included as "Example 1" in the paper on "Neutralizing effects of hybrid mismatch arrangements".
[3] This example is included as "Example 5" in the paper on "Neutralizing effects of hybrid mismatch arrangements".

GROUP 3 - Limiting Interest Deductions

Questions/Issues:

1) Under your country's tax law, is there is a limitation on the deduction of interest paid by business taxpayers?
    - If the answer is yes, how does a taxpayer determine the maximum amount of interest that can be deducted?
    - Does the limitation apply to interest paid to lenders within the same country as the borrower? Or, does the limitation apply only to interest paid to a lender in another country?
2) Is all interest expense treated the same for purposes of determining whether the interest is tax deductible, or, is some interest (e.g., interest on a mortgage for business property) treated differently from other interest?
    - If some interest expense is treated differently from other interest, have tax administrators been able to audit these deductions effectively?
3) Are withholding taxes on interest an important source of tax revenue for your country?

AFTERNOON SESSION (3:30-4:30 PM)

GROUP 1 - Taxation of Capital Gains

Questions/Issues:

1) What are the most common objections that you have heard to the taxation of non-residents on capital gains realized on domestic assets? Which of these objections do you find most persuasive?
2) Has your country largely adopted provisions in Article 13 of the UN Model Convention? What are the important deviations, if any, from the UN Model in your country?
3) Are you familiar with, and do you think tax administrators in your country are familiar with, the typical legal structures for foreign investments in your country (whether FDI or portfolio investments)? Do these structures typically involve layers of offshore companies? Where are these companies typically located?
4) If your country taxes non-residents on capital gain, does the tax administration keep track of the total revenue from this source, and does it gather evidence of the level of compliance?

GROUP 2 - Preventing Tax Treaty Abuse

Questions/Issues:

1) *Significance*. Is there evidence / experience of residents of non-treaty countries trying to obtain benefits under your treaties? Is this practice regarded as a significant problem in terms of lost revenue? Are your domestic tax settings likely to encourage treaty abuse – i.e. big reductions in source country tax rates delivered by treaties, and/or big discrepancies between different treaties?
2) *Existing remedies*. Have you found that existing provisions in (i) domestic law and/or (ii) the terms of your current treaties, have been effective to counter abuse that has been discovered? Do you routinely seek to include a 'limitation on benefits' in your treaties? How does it operate and where does it differ from the proposed clause?

3) *Proposed LOB mechanisms*. Do you consider that the proposed structural LOB clause will assist your tax administration to counter treaty abuse? Is the design appropriate to your circumstances? Should the proposed article be amended (expanded or constrained) to address other structures / situations? Should the 'equivalent benefits' option be included?
4) *Proposed savings clause*. Can you see any potential problems arising from the proposed savings clause – i.e. that the benefits provided by treaties are (with the listed exceptions) just for the benefit of non-residents?
5) *Selecting treaty partners*. Are there other considerations that bear on the decision whether to have a treaty with another State? Are they important; how do they rank compared to the ones identified?

GROUP 3 - Transparency and Disclosure

Questions/Issues:

1) What is your most significant information-based challenge in taxing multinationals? (for example, inability to secure information from the local entity, difficulty in getting information in a useful format, effectively working with information that you have received, etc.)
2) An important aspect of OECD Action Item 13's effectiveness is getting information from the multinationals (which are preparing the files and templates) to the relevant jurisdictions. How would you like to see OECD Action Item 13 documentation delivered? If that route is not possible, what are the difficulties you would encounter with other delivery mechanisms?
3) Both OECD Action Item 13 and Automatic Exchange of Information require certain domestic law provisions be in place (including requirements imposed on taxpayers to prepare and report information, and rules and procedures to protect taxpayer privacy). Do these domestic law expectations (outlined by Action Item 13 and the Common Reporting Standard/Model Competent Authority Agreement) constrain your ability to benefit from the transparency and disclosure under the two regimes? Is there any capacity building or other assistance that would be of help to you in meeting those requirements? Are there requirements that you consider unduly burdensome?