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Base Erosion And Profit Shifting ("BEPS")- Emerging Trends in Tax Law, practice and Tax Administration

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Overview

- ❖ Introduction
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- ❖ Effects of BEPS
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 - OECD's 15 Point Action Plan
 - Convention on Mutual Administrative Assistance in Tax Matters
 - Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum)
 - Foreign Account Tax Compliant Act

Introduction

Globalisation has birthed an increased number of Multi National Enterprises(MNEs).This has facilitated the creation of offshore tax evasion whereby taxpayers fail to comply with tax obligations in their home jurisdictions. Offshore tax evasion has affected all countries, irrespective of their level of development. This has called for need for cooperation of various tax jurisdictions for purposes of sharing information to curb the vice. In Uganda, our taxpayers' portfolio comprises of 240 MNEs that contribute 75% of our revenue collections.

Emerging issues.

- Electronic commerce(e-commerce)
- Capital flight
- False invoicing
- Money Laundering

Emerging issues...

e-commerce and its effect on tax

The advent of e-commerce through the Internet and its continued growth has spawned many changes in the way business is being conducted. Like that of the industrial revolution, e-commerce promises to accelerate the rate of growth and development of the world economy.

Effect of e-commerce on Tax

effect of e-commerce on VAT

- Internet retail amounts to well over a hundred billion dollars annually in the United States and accounts for a growing share of overall retail commerce US Census Bureau 2011.
- The majority of Internet transactions occur across state lines, with striking tax consequences. While online sellers located in a particular state must collect sales tax/VAT on in-state sales, states currently cannot compel out-of-state sellers to collect tax on sales to state residents.

Effect of e-commerce...

- Resident consumers are obligated to pay an equivalent use tax, but enforcement is sufficiently lax that cross-state Internet sales generally go untaxed (**Sales Taxes and Internet Commerce By Liran Einav, Dan Knoepfle, Jonathan Levin, and Neel Sundaresan**).

Effect of e-commerce...

Effect of e-commerce on PE

- The approved changes to the commentary on Article 5 distinguish between web sites and servers for PE purposes so that web sites stored on a server should not constitute a PE. On the other hand, “the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location”

Capital flight

- The problem deprives states of tax revenue and from the perspective of countries' economic growth, disrupts the vital development of the private sector by distorting competition.
- Illegal capital flight is frequently channelled via tax havens. The scale of the problem is massive.
- according to conservative estimates, about €1,200 billion crosses state borders illicitly each year.
- The sum leaving developing countries is estimated to comprise over half of this, €680–800 billion. **(The Service Centre for Deveopment, Kepa:Illegal Capital Flight from Developing Countries).**

False invoicing and money laundering

- trade-based money laundering is defined as the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origin.
- This can be achieved through the misrepresentation of the price, quantity or quality of imports or exports

Money Laundering....

Basic techniques of trade-based money laundering include:

- over- and under-invoicing of goods and services;
- multiple invoicing of goods and services;
- over- and under-shipments of goods and services; and
- falsely described goods and services.
- All of these techniques are not necessarily in use in every country.

Effect of false invoicing

- By invoicing the good or service at a price below the “fair market” price, the exporter is able to transfer value to the importer, as the payment for the good or service will be lower than the value that the importer receives when it is sold on the open market.
- Alternatively, by invoicing the good or service at a price above the fair market price, the exporter is able to receive value from the importer, as the payment for the good or service is higher than the value that the importer will receive when it is sold on the open market.

BEPS

What is BEPS?

Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches 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 the taxes are low, resulting in little or no overall corporate tax being paid.

BEPS can be achieved through the use of transfer pricing, or, more correctly, "transfer mispricing".

BEPS.....

- Erosion” refers to the erosion of national tax bases. “Profit shifting” is one way this happens. Companies use a number of schemes to shift profits across borders to take advantage of tax rates that are lower than in the country where they made the profit.

BEPS.....

- Some multinationals end up paying as little as 5% in corporate taxes when smaller businesses are paying up to 30%. It's all perfectly legal, and exploits the fact that tax systems are still essentially nation-based and were designed for the “old” economy in which, for example, profits from intellectual property were relatively unimportant.

Transfer pricing.....

What is transfer pricing?

- **Transfer pricing** is the setting of the **price** for goods and services sold between controlled (or related) legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company, the cost of those goods is the **transfer price**.
- Section 90 of the ITA Cap.340 and the Income Tax Transfer Pricing Regulations of 2011 provide for transfer pricing in Uganda.

The line between tax avoidance and tax planning

- Though a handful of scholars use the terms interchangeably, “tax evasion” typically refers to illegally reducing tax payments, while “tax avoidance” generally refers to legally reducing tax payments.

The distinction is a legal one.

tax avoidance and tax evasion...

- “tax evasion” refers to conduct involving some level of “deception, concealment, or destruction of records,” whereas “tax avoidance” refers to “behaviour that the taxpayer hopes will serve to reduce his tax liability but that he is prepared to disclose fully to the revenue body.
- Tax avoidance practices seek to accomplish one of three things: payment of “less tax than might be required by a reasonable interpretation of a country’s law,” payment of a tax on “profits declared in a country other than where they were really earned,” or tax payment that occurs “somewhat later than the profits were earned.

Tax avoidance vs. tax evasion....

UK Prime Minister David Cameron in his speech to the World Economic Forum in Davos on 24th January 2013 said;

“..Of course there is a difference between tax evasion and tax avoidance. Evasion is illegal. It can and should be subject to the full force of the criminal law. But what about tax avoidance? Now of course there’s nothing wrong with sensible tax planning and there are some things that governments want people to do that reduce tax bills, such as investing in a pension, a start up business or giving money to a charity. But there are some forms of avoidance that have become so aggressive that I think it is right to say these raise ethical issues, and it is time to call for more responsibility and for governments to act accordingly...”

BEPS...

What causes BEPS?

Corporation tax is levied at a domestic level. When activities cross borders, the interaction of domestic tax systems means that an item of income can be taxed by more than one jurisdiction, thus resulting in double taxation. The interaction can also leave gaps, which result in income not being taxed anywhere. BEPS strategies take advantage of these gaps between tax systems in order to achieve double non-taxation.

Effects of BEPS

- It distorts competition: businesses that operate cross-border may profit from BEPS opportunities, giving them a competitive advantage over enterprises that operate at the domestic level.
- It may lead to inefficient allocation of resources by distorting investment decisions towards activities that have lower pre-tax rates of return, but higher after-tax returns.
- It is an issue of fairness: when taxpayers (including ordinary individuals) see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

Effects of BEPS....

- Double non-taxation also distorts investment decisions and reduces economic efficiency.
- Double non-taxation undermines integrity of the tax system.
- BEPS result in loss of revenue to governments thereby lessening their ability to provide public goods and services which eventually leads to widening the gap between the rich and poor causing social and political tensions.

Issues faced by Uganda in the context of BEPS

- Payment of excessively high interest on intra group loans.
- Treaty abuse – re routing a transaction through an entity in a treaty partner state.
- Stripping of functions to down grade business activities to “ preparatory and auxiliary activities “ thereby avoiding a PE status.

Issues faced.....

- Related buying agents buying back the commodity in the high seas for onward export to the intended customers at an exorbitant price.
- Creating a non value adding entity in the supply chain as “marketing agent.”

Issues faced....

- Transfer of locally developed intangibles to low tax jurisdictions without any compensation. A royalty is then charged for use by the Ugandan entity.
- Payment of head office expenses, management and technical fee with low or no services provided.
- Indirect transfer of assets by sale of shares of the overseas holding companies without payment of any tax.

Issues faced....

- Emergence of the digital economy where services are purchased and paid for online without traversing physical borders.
- Temptation to engage in tax competition in the region by offering a very generous incentive regime so as to attract FDIs.
- Low treaty network for exchanging information with other countries and jurisdictions as a tool in promoting tax transparency.

What has been done?

- The OECD developed a 15 Action Point Plan on BEPS to This Action Plan which calls for fundamental changes to the current mechanisms and the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting;
 1. Address the tax challenges of the digital economy.
 2. Neutralise the effects of hybrid mismatch arrangements.

15 Point Action Plan....

3. Develop recommendations regarding the design of controlled foreign company rules.(CFC Rules).
4. **Limit base erosion via interest deductions and other financial payments** – overpricing of intra-group loans and guarantees
5. **Countering harmful tax practices** . Interposing intermediaries in low tax jurisdictions with no capacity for value addition in the supply chain.

15 Point Action Plan....

6.Preventing Treaty Abuse. Management fees being invoiced through treaty partner states to benefit from reduced withholding taxes by entities in non treaty partners.

7.Preventing Artificial Avoidance of PE. Business restructuring being undertaken to limit activities in to preparatory and auxiliary or routine functions.

8. Intangibles. This involves undue weight of profits towards IP, relocation of IP

15 Point Action Plan....

9. Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital.

10. Other High Risk transactions. Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties.

15 Point Action Plan....

11. Establish methodologies to collect and analyse data on BEPS and the actions to address it.
12. Require taxpayers to disclose their aggressive tax planning Arrangements. Develop recommendations regarding the design of mandatory disclosure.
13. Re-examine transfer pricing documentation. Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.

15 Point Action Plan....

14. Make dispute resolution mechanisms more effective.
Develop solutions to this effect.
15. Develop a multilateral instruments.

Which of the 15 points are relevant to Uganda?

In the 2nd BEPS Technical Meeting held on 3rd and 4th March 2015 the following action points were adopted from the BEPS Action plan as most relevant from the continent's perspective:

- Limit base erosion via interest deductions and other financial payments (Action 4)
- The Artificial Avoidance of PE status (Action 7)
- Assure that transfer pricing outcomes are in line with value creation (Actions 8, 9 and 10)

Relevant action points.....

- Re-examine transfer pricing documentation rules (Action 13)
- Transfer pricing comparability data
- Indirect Transfers
- Tax incentives and Taxation of natural resources

Relevant action points....

- ATAF will actively participate in the upcoming OECD Global Forum on transfer pricing and public consultation meetings to take place in Paris and articulate the African position on the Action points of the BEPS action plan that are due for completion within the first half of the year.

What has been done.....

Global Forum

- Uganda became a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes(Global Forum) in October 2013.
- The Global forum is an international body that was established in a bid to improve transparency and exchange of Information to curb tax evasion.

What has been done....

- The Global forum currently has a membership of 107 countries. This membership comprises of all G20 countries, all OECD members, all key international financial centres and many developing countries.
- Uganda has undergone through the first Peer Review, where all our laws have been examined for compliance with the International Standard on Exchange of Information

What has been done....

- In June 2015, the second Peer Review will be undertaken to check the practical measures in place to actualise the exchange of information.
- Uganda is also a member of the African Tax Administration Forum. The (ATAF) is an international organisation which provides a platform for cooperation among African tax authorities.
- Through mutual cooperation between member states, ATAF works towards increasing the level of voluntary tax compliance whilst combating tax evasion and avoidance.

What has been done....

Convention on Mutual Administrative Assistance in Tax Matters

- The convention was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. The Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a top priority for all countries.
- Uganda has applied to be ratified as a member and is waiting for the signing ceremony.

What has been done....

- The Convention has a membership of 126 states which have benefited from free exchange of information for tax purposes.
- It facilitates international co-operation for a better operation of national tax laws, while respecting the fundamental rights of taxpayers.

What has been done.....

- The Convention provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This co-operation ranges from exchange of information, including automatic exchanges, to the recovery of foreign tax claims.

FATCA

- The Foreign Account Tax Compliance Act (FATCA) was passed into United States law in 2010 by the US Congress as part of the Hiring Incentives to Restore Employment Act.
- It is a US mechanism to ensure US taxpayers declare all income received outside of the US in an effort to curb non-compliance by US taxpayers using foreign accounts.

FATCA.....

Requires Foreign Financial Institutions(FFIs) to report to the Internal Revenue Service(IRS) of USA about;

- Financial accounts held by US taxpayers, or
- Foreign entities in which US taxpayers hold substantial ownership interest.

Operation of FACTA

- FFIs are required to sign a FFI disclosure agreement with the IRS.
- If an FFI refuses to sign the agreement, the FFI (and its customers) will be subject to a 30% WHT on all interest, dividends and sales proceeds from US securities and other income from the US, whether paid to a US person or not.
- FFI are required to make annual reports and disclosures in respect to identified US accounts, and upon request.

Obligations under FATCA

- Identification of US accounts
- Compliance with due diligence procedures required by the IRS
- Annual Reports on accounts
- Withhold on pass-through payments by 30% on recalcitrant account holders and Non Participating FFIs.
- Disclosure of further information upon request.

Obligations under FATCA....

- If the local legislation prevents the reporting of any information, the FFI must attempt to obtain a waiver from relevant account Holders in a reasonable period of time or exit the account.
- FFIs may not be able to comply due to domestic legal impediments eg data privacy law conflicts, issues relating to duplicative reporting and time required to develop the framework, people and standards, following legislation implementation.

IGAs under FATCA

- US has adopted IGAs(Inter-Governmental Agreements) between countries and the US where it is agreed that;
 - a) FATCA regulations will not apply to the financial entities in that country.
 - b) The local revenue bodies will report to IRS in respect to the taxpayer FFIs.
 - c) No requirement for FFIs to close client accounts or withhold the 30%

FATCA and Uganda

- Since 2011 the Global Industry has engaged extensively with the IRS for purposes of understanding the regulations and narrowing down the impact of FATCA on the Finance Industry and to highlight the effects required to achieve compliance.
- Unfortunately, Africa is not at the fore front of these engagements as yet.

Where can you get more information on BEPS?

- ❖ The BEPS Action Plan.
- ❖ The report Addressing Base Erosion and Profit Shifting.
- ❖ You can also visit the OECD website at www.oecd.org/tax/beps.htm

END