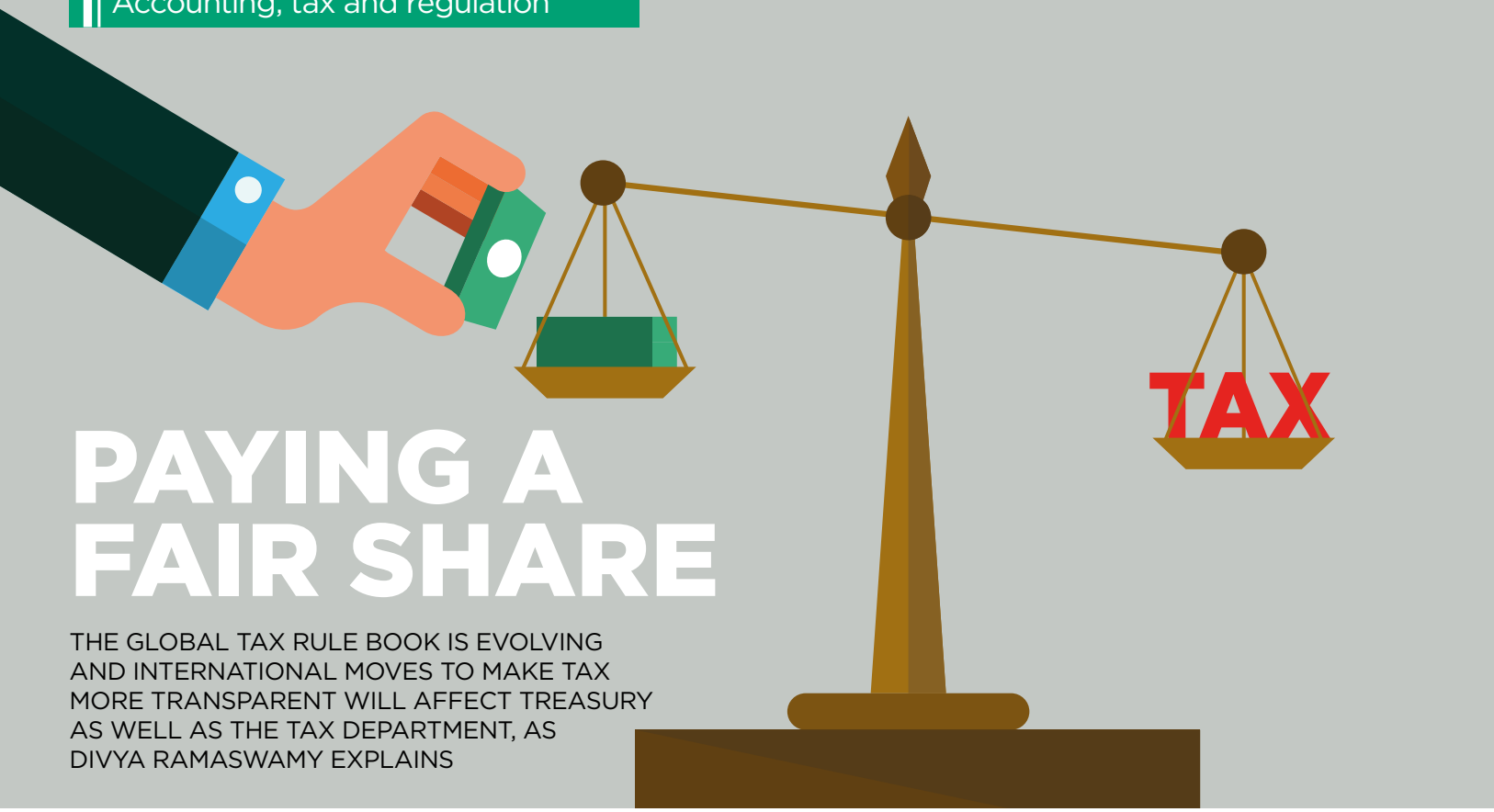

PAYING A FAIR SHARE

THE GLOBAL TAX RULE BOOK IS EVOLVING AND INTERNATIONAL MOVES TO MAKE TAX MORE TRANSPARENT WILL AFFECT TREASURY AS WELL AS THE TAX DEPARTMENT, AS DIVYA RAMASWAMY EXPLAINS

SHUTTERSTOCK

As the economic slowdown that followed the global financial crisis reduced taxable earnings around the world, governments took a variety of actions to increase tax take and extend the scope of their domestic tax legislation. A reduction in tax receipts has also meant that tax has become a matter of public debate, increasing pressure on governments to ensure that multinationals pay their fair share.

According to Peter Mason, group tax director at IMI, "Seldom does a day pass when a tax story is not in the press. It's the newspapers that are starting to be a major force in changing the tax landscape, and that's because in times of austerity, the public needs to know whether big business is paying its fair share."

The tax shield

From a treasury or funding perspective, legislation has progressively limited tax relief for interest on corporate debt. The amount of relief and what qualifies for relief have become increasingly restricted:

- Whether funding is characterised as debt or equity is often quite complicated to determine, but fundamental for tax purposes. Also, there is a risk of using just one interpretation for larger debt bundles.
- Intercompany lending is an essential tool for all treasurers to pool cash and move money quickly between countries and companies, but most countries have now introduced rules legislating arm's-length tax treatment for transactions. Thin capitalisation rules and transfer pricing are commonly applied by tax authorities to restrict tax relief for intercompany interest charges.
- The purpose of the transaction is paramount, and if the transaction is done for tax purposes, it is unlikely to qualify for tax relief.
- Earnings stripping is quite a common practice. Rules are being introduced globally to limit interest deductibility paid to related parties where interest is disproportionate to income.
- Withholding taxes are also a common way for governments to recoup taxes early and an instant way to impact tax cash flows, but the rules surrounding this are becoming increasingly stringent.
- For FX there are typically complex tax rules in most countries, for example, to assess whether financial instruments should be marked-to-market or taxed on a cash realisation basis.

The BEPS initiative

The BEPS initiative is the latest development in the tax arena and is set to change the tax landscape for many years to come.

International tax rules are generally efficient in ensuring that companies are not subject to double taxation. However, in an increasingly interconnected world, where tax laws have not always kept pace with global corporations, and the fluid movement of capital, there are gaps where tax-planning strategies can be used to artificially move profits to low- or no-tax locations. This undermines the fairness and integrity of tax systems.

The BEPS initiative aims to ensure that businesses that operate internationally align the tax paid with their economic activities and value creation. The initiative has the backing of the G20, and a set of 15 Actions has been produced by the Organisation for Economic Co-operation and Development (OECD). Each OECD country is expected to adopt some form of those Actions and it is anticipated that countries around the world will follow suit.

For the treasurer, three of those Actions are key:

- **Action 2** – Neutralise the effects of hybrid mismatch arrangements.

- **Action 4** – Interest deductions and other financial payments.
- **Action 13** – Guidance on transfer pricing and country-by-country reporting.

The BEPS initiative's overall impact on treasury functions is that it will restrict a group's ability to deduct interest expenses, potentially increasing the group's effective tax rate. But perhaps its greatest impact will be an increased focus on risk management rather than tax efficiency.

James Lockyer, development director at the ACT, regards the BEPS initiative as significantly increasing risk. "For those of us who put something in place, something that's reasonably efficient without being too aggressive, there are now risks attached to that," he says. "Even though you're currently complying, that environment is likely to change substantially over the next year or so."

Implementation

Another challenge lies in implementation. For a treasurer, additional analysis and reporting may be required. For example:

- Potential for additional reporting for the enactment of linking rules to match the tax treatment in two countries.
- Additional analysis for group-wide or fixed-ratio interest limitation rules; and
- Greater scrutiny on transfer pricing, with a focus on substance and prescriptive documentation.

Another significant concern is the potential for inconsistent application of OECD guidance. Mason says: "The OECD has made these recommendations, which have to be brought into national laws and enacted by countries around the world. And the key questions are: When are they going to do this? Are they going to be doing it consistently? And what impact does it have on their competitive position in global trading? The jury is out at the moment as to when all these rules will be implemented."

We are already seeing some actions assigned timescales, like country-by-country reporting, which is required by the end of 2017. But BEPS adoption is likely to take several years and local nuances will need to be managed.

The risk of an increase in double taxation is a significant concern for multinational companies, one that many corporates have voiced. However, the OECD understands the complexity of this and has made the shoring up of mutual agreement procedures an action point for BEPS.

What else you need to know

The BEPS initiative will lead to a better understanding of supply chains, as corporates focus on where profits are made and where they are taxed. Where are your remittances, your royalties, your dividends, and what does your cash management structure look like at the moment?

Project evaluation will also be affected, as sensitivities will need to include the changing tax treatment of cash flows. Any acquisition or investment will require extreme care.

Some treasuries may need to consider changing their operational structures to align better under BEPS. And, of course, the changing tax landscape is not confined to BEPS. Corporates will still need to devote resources to manage the impact of the Foreign Account Tax Compliance Act, Financial Transaction Tax, Diverted Profits Tax and an increasing number of General Anti-Abuse Rules.

Actions for the treasurer

The changes to tax are designed to increase transparency, scrutiny and information sharing on a global scale, but it may require changes to treasury functions at a practical level, including:

- A significant amount of information gathering, as tax teams will require more granularity of information than before. Interactions with tax departments will most probably require multiple iterations of discussions.
- Increased time pressure for the gathering and production of required information.

This is an area where tax technology can really help, assisting tax to align with all stakeholders and information providers, including treasury, which is highly likely to be crucial as tax becomes more complicated and the global tax authorities move to an 'on-demand model' for requests for information, including, but not limited to, the new country-by-country rules due in 2017. Tax and treasury departments will certainly need to work more closely to react to ongoing tax changes.

At the highest level there are three recommended actions for the treasurer:

- Treasurers will need to have a granular understanding of their funding transactions. Treasury teams will need to have better control on their data.
- Changes in tax legislation will result in financial uncertainty and the treasury will need to put in place a pragmatic and practical process to manage these risks.
- Suitable technology should be identified to help ensure compliance and increase efficiency.

For many large corporates, this may be the first time that there is such a level of scrutiny on funding transactions, and will result in increased insight, not only for the treasury department, but for the company as a whole, enabling more informed strategic decisions.

Start your planning now

While there are still many unknowns surrounding BEPS, what is clear is that it will be implemented around the world and that corporates must comply. The end result will be an increase in reporting and analysis, and an increase in risk. If a corporate is to successfully limit its administrative burden and manage financial risk, it must start planning now; after all, BEPS doesn't just impact the tax department.

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- For more information, view the ACT webinar, 'The impact of tax and regulatory changes on the treasury function', sponsored by Thomson Reuters, at www.treasurers.org/events/webinars
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