

Prevailing & Emerging Tax Issues

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November 8, 2016



Corporate Tax – A New World Order ?

- *BEPS ... The Big Trends*
- *Capital Gains .. A New Legitimacy*
- *Tax Incentives ... A New “Villain” in the block*
- *Headline Tax Rate vs. ETR*
- *Territoriality versus World Wide Taxation*

BEPS – The Big Trends ..

- BEPS project started to prevent double non-taxation
- 15 action plans around transfer pricing, PE, digital economy, etc.
- Debate graduated to source vs. residence taxation

- Generating income no longer requires proximity to customers... countries demanding tax on access to market
- Capital, IP, people (economic factors) are mobile... factors can be migrated to countries offering attractive tax environment
- Dilution of return to legal owner / funder

Race to tax income at source... is indeed income “accruing” at source?

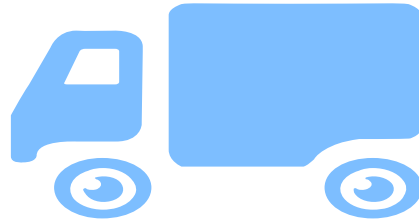
Funding vs. Value Creation



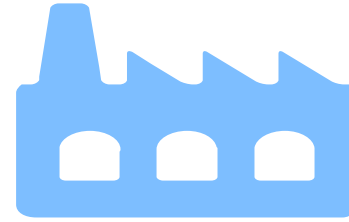
**Strategic
decision**



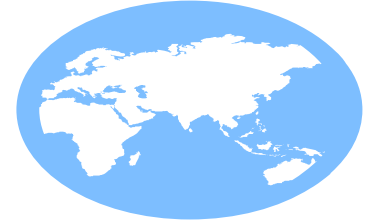
R&D



Sourcing



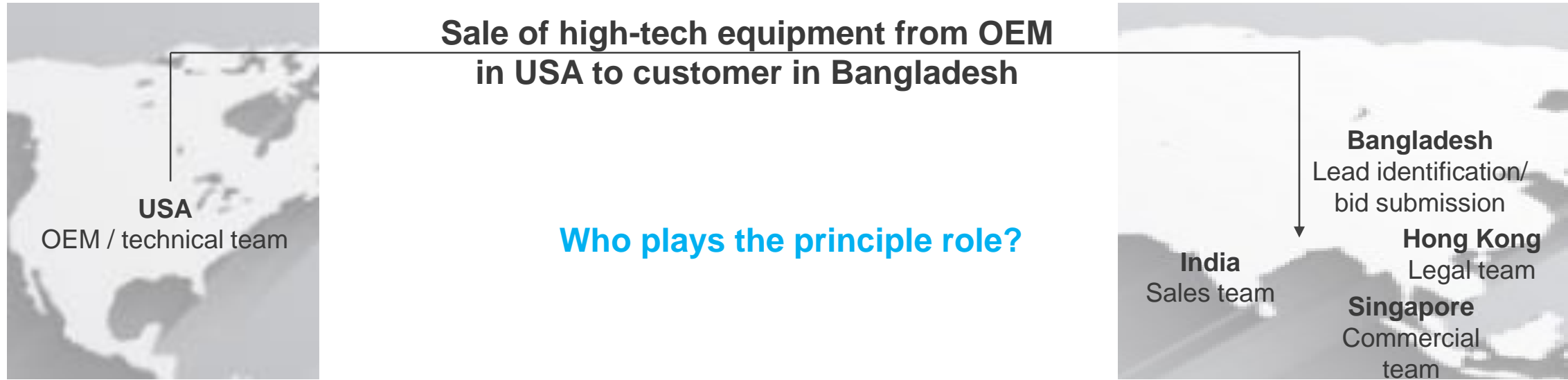
Production



Market

- Where/what is the role of Capital?
- Who gets the pie?
- Immobility of market

PEs... Lowering the Bar



Hypothetical example

- PE threshold lowered significantly:
 - **Playing the principle role** leading to conclusion of contract
 - Convincing a customer to enter into **standard contract (without negotiation authority)**
- New threshold will result in a vast number of PEs with no (or little) profit attribution ... Need for balancing compliance burden (e.g. multiple tax returns) with expected tax to be collected
- Many countries do not follow authorized OECD approach for profit attribution... Follow formulary apportionment

Questions on the threshold remain outstanding... ambiguity around attribution continues...

Software Taxation ... OECD Vs UN Outlook

Royalty definition under OECD/ UN Model:

Payments of any kind received as consideration for use of, or the right to use, any copyright of literary, artistic or scientific work ... any design or model, plan, secret formula or process ...

OECD Approach – Article 12

- Taxation rights restricted to Residence state
- Payments to use:
 - Software copy (copyrighted article) – not Royalty
 - Copyright (eg, copy/reproduce software) – Royalty

UN Approach - Article 12

- Taxation rights extended to Residence as well as Source state
- UN model commentary replicates OECD's guidance on software taxation
- UN tax committee recommendation:
 - All software payments taxed as Royalty

Will Royalty tax on software be counteractive for India?

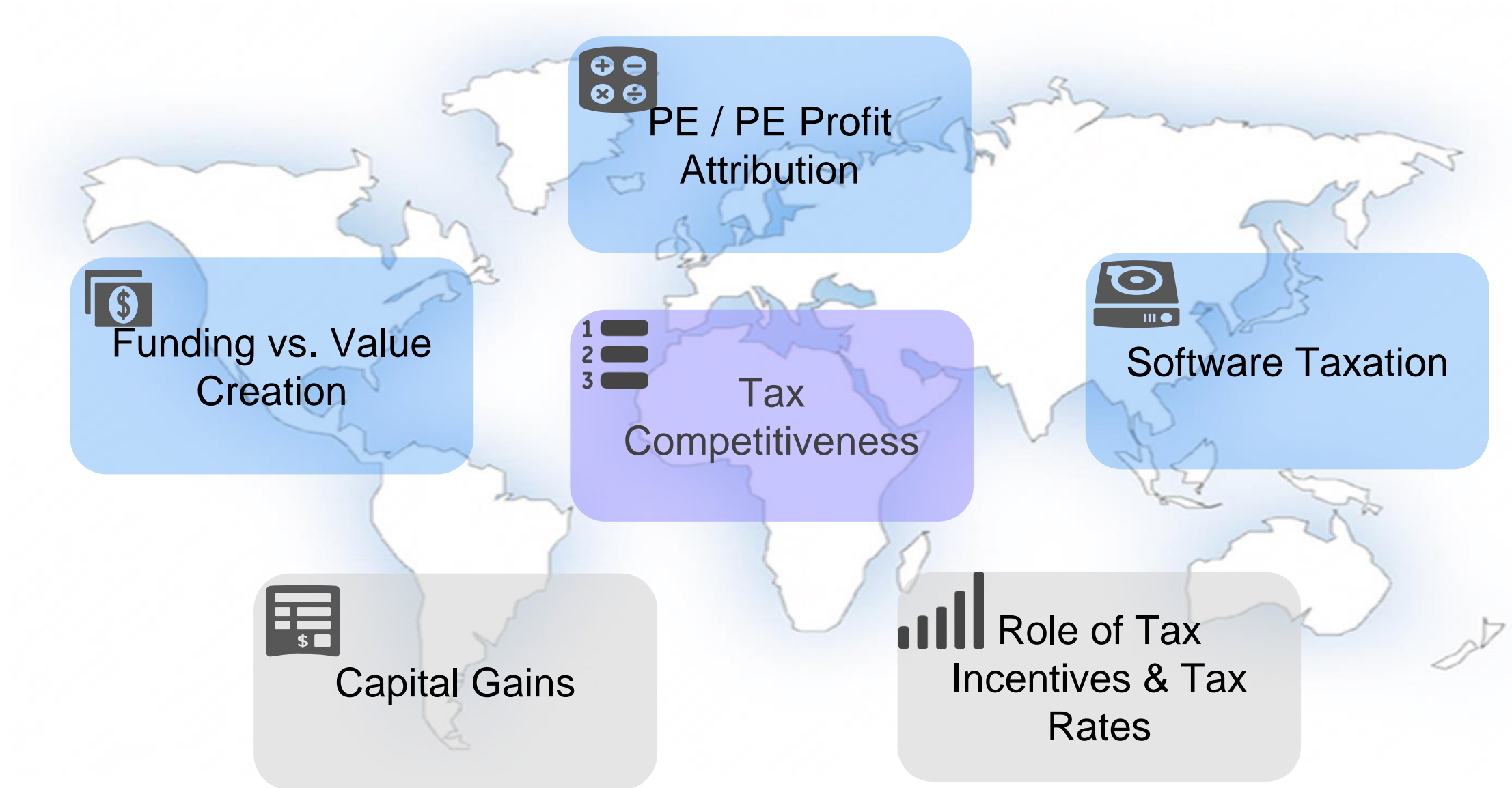
Capital Gains Tax... A Puzzle

- Capital gains on firms leads to multiple layers of taxation
- Capital gains can distort investment decisions
- No capital gains tax where capital re-deployed into productive assets ... Full tax where re-deployed into passive assets?

Tax Competitiveness... Role of Tax Incentives & Tax Rates

- Competition to attract FDI... Lower tax rates vs. tax incentives
- OECD study indicates 3.7% decrease in FDI for every 1% increase in tax rates ... Exact impact depends upon host country conditions
- Tax Incentives/rate one of the factors impacting FDI ... Cannot compensate for weak fundamentals
- Lower rate with a broader base could be key to make India a favorable destination for Manufacturing & Regional HQs

Tax Competitiveness ... Still a Key Investment Criteria



Exacerbated by Territoriality in Capital Exporting countries