

Are You In Control? BEPS Readiness Status Report

High-Tech Company

16 April 2014

For illustrative purposes only

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Executive summary

Today tax executives are feeling the heat due to enduring pressure to improve efficiency, grow revenue and ensure control. Increasing tax regulatory requirements are making their “being in control” even more challenging. In July 2013, OECD – the global guiding institute on tax and transfer pricing issues, released an Action Plan on Base Erosion and Profit Shifting (BEPS). The BEPS action plan sets forth 15 actions aimed to address tax planning strategies that exploit gaps and mismatches in tax rules or shift profits to locations where there is little or no activity. The BEPS action plan contains 15 separate action points or work streams aimed to address tax planning strategies that exploit gaps and mismatches in tax rules or shift profits to locations where there is little or no activity.

In the near future BEPS actions will result in fundamental changes to the international tax standards

Purpose of the report

The purpose of the BEPS Readiness Test is to identify the **readiness of a High-Tech Company to comply with new international tax standards** that are encouraged by OECD Action Plan on BEPS. BEPS proof assessment:

- Gives a **broader recognition and understanding** of the key High-Tech Company compliance risks
- Assists in prioritizing High-Tech Company **improvement initiatives**
- Assists in developing **actionable tax/ transfer pricing risk management tactics**

Methodology

BEPS Readiness Test captures insights across the organization using structured interviews facilitated by TPA Global professionals. Interviews are based on a 15 BEPS action points approach. These 15 action points comprise:

1. The digital economy
2. Hybrid mismatch arrangements
3. Controlled foreign companies (CFC) regimes
4. Financial payments
5. Harmful tax practices
6. Treaty abuse
7. Permanent establishment (PE) status
8. Transfer pricing and intangibles
9. Transfer pricing and risk/ capital
10. Transfer pricing and other high risk transactions
11. Data and methodologies
12. Disclosure of aggressive tax planning
13. Transfer pricing documentation

- 14. Dispute resolution mechanisms
- 15. A multilateral instrument

The significance of the risks is evaluated in terms of the following perspectives: *Management board perception of High-Tech Company exposure to compliance risk* and *TPA assessment of High-Tech Company exposure to compliance risk (including TPA technical and political assessment)*.

Participants

BEPS Readiness Test approach included performing a series of one hour BEPS interviews with finance and business management representatives. A total of 8 BEPS proof interviews were conducted to populate insights of High-Tech Company risk profile. Interviews were performed with the following representatives:

Role in organization	Name
1. CFO	XXX
2. Head of Tax	XXX
3. Head of TP	XXX
4. Internal audit	XXX
5. [Type] business unit leader	XXX
6. [Type] business unit leader	XXX
7. Management board	XXX
8. Management board	XXX

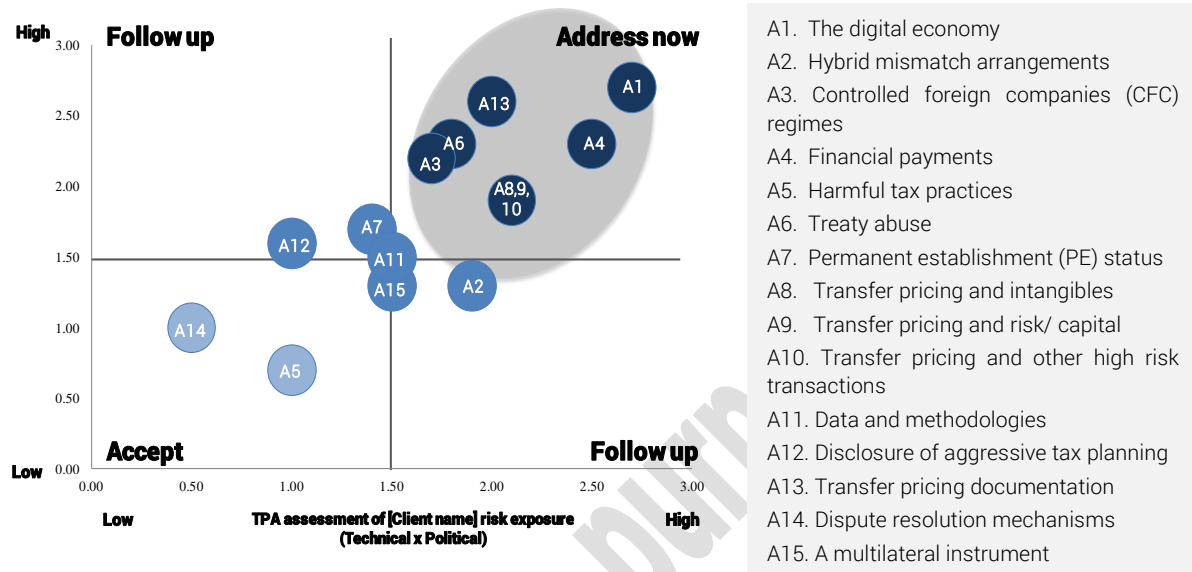
Assessment results at a glance

High-Tech Company's risk assessment revealed that High-Tech Company is facing high compliance risk in a combination with low level of compliance efforts/ control activities. The following table summarizes major High-Tech Company's risk areas and set priorities for improvement activities.

Major risk areas	Objectives	Recommended response and timeframe	BEPS action points	BEPS time targets
R1. High exposure to digital economy	O1. Reduce vulnerability to risk rising from high exposure to digital economy	Full scope audit in the coming 3 months	A1. The digital economy	September 2014
R2. High volume income subject to CFC regimes	O2. Take control over income subject to CFC regimes	Full scope audit in the coming 9 months	A3. CFC regimes	September 2015
R3. High use of hybrid financial instruments/ entities	O3. Minimize high use of hybrid financial instruments/ entities	Full scope audit in the coming 3 months	A4. Hybrid mismatch arrangements	September 2014
R4. Leverage on treaty abuse	O4. Address tax techniques leveraging on tax treaties	Full scope audit in the coming 3 months	A6. Treaty abuse	September 2014
R5. TP outcomes deviate from value creation of intangibles	O5. Assure that TP outcomes are in line with value creation of intangibles	Full scope audit in the coming 6 months	A8/9/10. Transfer pricing and intangibles/ risk and capital/ other high risk transactions	September 2014
R6.No tax/TP risk management framework	O6. Re-design tax/ TP risk management framework	Full scope audit in the coming 6 months	A13. Transfer pricing documentation	September 2014

Assessment results

BEPS proof interviews revealed that High-Tech Company is facing **moderate** or **high risk** with almost all BEPS action points. In many cases High-Tech Company's scores align with TPA's assessment indicating that High-Tech Company should address or at least follow up on BEPS areas with high/moderate risk levels.



- A1. The digital economy
- A2. Hybrid mismatch arrangements
- A3. Controlled foreign companies (CFC) regimes
- A4. Financial payments
- A5. Harmful tax practices
- A6. Treaty abuse
- A7. Permanent establishment (PE) status
- A8. Transfer pricing and intangibles
- A9. Transfer pricing and risk/ capital
- A10. Transfer pricing and other high risk transactions
- A11. Data and methodologies
- A12. Disclosure of aggressive tax planning
- A13. Transfer pricing documentation
- A14. Dispute resolution mechanisms
- A15. A multilateral instrument

Key insights

1. High-Tech Company is **vulnerable** to the risk of its high dependence on **digital products/ royalties from IP**
2. **Tax techniques** as Double Irish Dutch Sandwich are used on a highly basis to save tax leakages
3. High-Tech Company applies **certain financial instruments/ entities** that are qualified as hybrid
4. **A great portion of the firm's income is subject to CFC regulations**
5. **The firm is** highly dependent on inter-company transactions
6. **High-Tech Company's has no** tax/ TP risk management framework
7. High-Tech Company has **no TP software solution** in place/ data requirements for TP purposes are designed locally on an ad-hoc

Focus areas

- A1. The digital economy**
- A3. CFC regimes**
- A4. Financial payments**
- A6. Treaty abuse**
- A8/9/10. Transfer pricing and intangibles/ risk and capital/ other high risk transactions**
- A13. Transfer pricing documentation**

The following table further describes High-Tech Company perceived risks and TPA assessment results in terms of each BEPS action point.

BEPS Actions	High-Tech C		TPA assessment		Description	Recommended response
	Management board perception	Technical	Political	Overall		
A1. The digital economy	High	High	High	High	<ul style="list-style-type: none"> Significant portion of High-Tech Company profits is derived from royalties from IP or digital products High-Tech Company R&D and IP management functions are geographically dispersed, but <i>de facto</i> major part of employees in this function are concentrated in one location 	Address now
A2. Hybrid mismatch arrangements	Moderate	Moderate	High	High	<ul style="list-style-type: none"> Financial instruments that can be qualified as hybrid are used on a high-volume transactions Some subsidiaries are disregarded for US tax purposes 	Follow up
A3. Controlled foreign companies (CFC) regimes	High	High	High	High	<ul style="list-style-type: none"> A great portion of income is subject to CFC regulations for tax purposes 	Address now

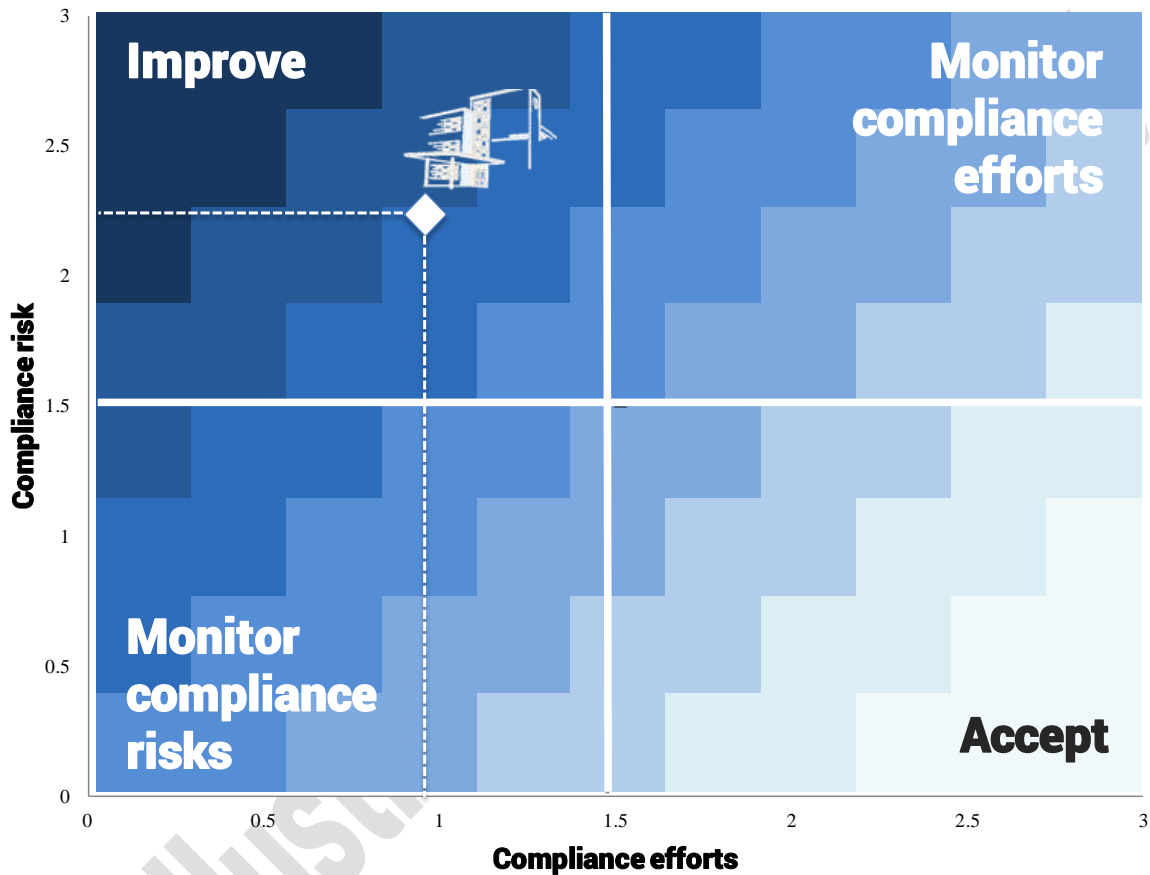
BEPS Actions	High-Tech C	TPA assessment			Description	Recommended response
	Management board perception	Technical	Political	Overall		
A4. Financial payments	Moderate	High	High	High	<ul style="list-style-type: none"> High volume loans are constantly received from third parties and/or other group entities, where the lender is located in a low tax country 	Address now
A5. Harmful tax practices	Low	Low	Low	Low		Do nothing
A6. Treaty abuse	High	High	High	High	<ul style="list-style-type: none"> A tax technique known as “Double Irish with Dutch Sandwich” is used to save tax leakages Advantages are extracted through tax treaty between Ireland and The Netherlands 	Address now
A7. Permanent establishment (PE) status	Moderate	Moderate	Moderate	Moderate	<ul style="list-style-type: none"> Sometimes local operations perform more functions than has been agreed upon in the intercompany agreement 	Follow up

BEPS Actions	High-Tech C		TPA assessment			Description	Recommended response
	Management board perception	Technical	Political	Overall			
A8/9/10. Transfer pricing and intangibles, risk/capital, other high value transactions	High	High	High	High	<ul style="list-style-type: none"> • Turnover from related party transactions significantly exceeds turnover towards 3rd parties • Business is highly dependent on intangible assets • Some group entities responsible for managing significant financial/ business risks lack adequate level of professionals to de facto manage such risks 	Address now	
A11. Data and methodologies	Moderate	Moderate	High	High	<ul style="list-style-type: none"> • Foreign direct investments (FDI) are designed through special countries and/or vehicles to optimize the return on such FDI investment 	Follow up	
A12. Disclosure of aggressive tax planning	Moderate	Low	Moderate	Moderate	<ul style="list-style-type: none"> • Information on tax and transfer pricing is disclosed by filing tax returns, SEC filings, annual reports 	Follow up	
A13. Transfer pricing documentation	High	High	High	High	<ul style="list-style-type: none"> • High-Tech Company has no approved Tax/ TP risk management framework • There is no management information produced on the 	Address now	

BEPS Actions	High-Tech C	TPA assessment			Description	Recommended response
	Management board perception	Technical	Political	Overall		
					performance of Tax/TP <ul style="list-style-type: none"> No software solutions tailored to meet TP needs are applied/ data requirements for TP purposes are designed locally on an ad-hoc basis 	
A14. Dispute resolution mechanisms	Low	Low	Low	Low		Do nothing
A15. A multilateral instrument	Moderate	Moderate	Moderate	Moderate	<ul style="list-style-type: none"> There is a basic understanding of BEPS measures across the organization, but no formal responsibilities exist to take control over possible risk shifts due to upcoming BEPS activities 	Follow up

Risk response strategy

BEPS Readiness Test captured both the overall High-Tech Company's exposure to compliance risk and the level of management compliance efforts/ control activities. The following risk matrix defines possible management response strategy to assure a proper tax/ transfer pricing risk management.



Improve

High-Tech Company has a **high inherent exposure to compliance risk**. However, its **compliance efforts/ control activities are low**. This forms priorities for improvement activities.

High-Tech Company's improvement activities should be focused on:

1. Reducing vulnerability to the risk rising from high exposure to digital economy
2. Minimizing high use of hybrid financial instruments/ entities
3. Assuring further control over income subject to CFC regimes
4. Aligning TP outcomes with value creation of intangibles
5. Avoiding treaty abuse
6. Designing and implementing tax/ TP risk management framework

Improvement plan

High-Tech Company's risk assessment revealed that High-Tech Company is facing high compliance risk in a combination with low level of compliance efforts/ control activities. The following improvement plan sets priorities for High-Tech Company's improvement activities in the coming one year period.

Major improvement areas	Improvement sub-areas	Plan - Quarter 1		Plan - Quarter 2		Plan - Quarter 3	
		Future action	Time	Future action	Time	Future action	Time
Compliance risk	1. High exposure to digital economy	Full scope audit	4 weeks				
	2. High use of hybrid financial instruments/ entities	Full scope audit	4 weeks				
	3. High volume income subject to CFC regimes					Full scope audit	4 weeks
	4. TP outcomes deviate from value creation of intangibles			Full scope audit	4 weeks		
Compliance efforts	5. Treaty abuse	Full scope audit	4 weeks				
	6. No tax/TP risk management framework	Full scope audit	4 weeks				

TPA Global

TPA Global provides international businesses with integrated and value-added solutions in improving financial performance, operational efficiency, strategic development and talent coaching through a cross-border and cross-discipline team of professionals which identifies the right solutions for customers and targets; efficient and streamlined advisory and implementation processes which cut through operational complexities across functions and borders; and superior customer service and support which proactively anticipate the evolving needs of the clients.

Appendices

Appendix 1: High-Tech Company risk profile in the eyes of different management representatives

BEPS action points	CFO	Head of Tax	Head of TP	Internal audit	Business unit leaders	Management board	Overall
A1. The digital economy	High	High	Moderate	High	High	Moderate	High
A2. Hybrid mismatch arrangements	Moderate	Moderate	High	High	Moderate	Moderate	High
A3. CFC regimes	High	High	Moderate	High	Moderate	High	High
A4. Financial payments	Moderate	Moderate	Moderate	High	Moderate	Moderate	Moderate
A5. Harmful tax practices	High	High	Moderate	High	Moderate	High	High
A6. Treaty abuse	Moderate	Moderate	High	Moderate	Moderate	High	High
A7. PE status	Moderate	Moderate	Moderate	Moderate	Moderate	Moderate	Low
A8/9/10. Transfer pricing	Moderate	Moderate	High	Moderate	Moderate	Moderate	Moderate
A11. Data and methodologies	Moderate	Moderate	High	High	Moderate	Moderate	High
A12. Disclosure of aggressive tax planning	Moderate	Moderate	Moderate	Moderate	High	Moderate	Moderate
A13. Transfer pricing documentation	Moderate	Moderate	Moderate	Moderate	Moderate	High	Moderate
A14. Dispute resolution mechanisms	Moderate	Moderate	Moderate	Moderate	High	High	High
A15. A multilateral instrument	Moderate	Moderate	Moderate	High	Moderate	Moderate	High

Appendix 2: High-Tech Company Form A - Overview of allocation of income, taxes and business activities on country-by-country bases

Country	Constituent Entities Organised in the Country	Place of Effective Management	Important business activity code(s)	Revenues	Earnings Before Income Tax	Income Tax Paid (on Cash Basis)		Total Withholding Tax Paid	Stated capital and accumulated earnings	Number of Employees	Total Employee Expense	Tangible Assets other than Cash and Cash Equivalents	Royalties Paid to Constituent Entities	Royalties Received from Constituent Entities	Interest Paid to Constituent Entities	Interest Received from Constituent Entities	Service Fees Paid to Constituent Entities	Service Fees Received from Constituent Entities
						(a) To Country of Organisation	(b) To All Other Countries											
	1.																	
	2.																	
	3.																	
	4.																	
	Total:																	
	1.																	
	2.																	
	3.																	
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	Total:																	
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	4.																	
	Total:																	

Appendix 3. Description of BEPS action points, expected output and time targets

Action	Description	Expected output	Deadline
1 – Address the tax challenges of the digital economy	Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterization of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.	Report identifying issues raised by the digital economy and possible actions to address them	September 2014
2 – Neutralize the effects of hybrid mismatch arrangements	Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic	Changes to the Model Tax Convention Recommendations regarding the design of domestic rules	September 2014 September 2014

Action	Description	Expected output	Deadline
	<p>law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on coordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.</p>		
<p>3 – Strengthen CFC rules</p>	<p>Develop recommendations regarding the design of controlled foreign company rules. This work will be coordinated with other work as necessary.</p>	<p>Recommendations regarding the design of domestic rules</p>	<p>September 2015</p>
<p>4 – Limit base erosion via interest deductions and other financial payments</p>	<p>Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other</p>	<p>Recommendations regarding the design of domestic rules</p> <p>Changes to the Transfer Pricing Guidelines</p>	<p>September 2015</p> <p>December 2015</p>

Action	Description	Expected output	Deadline
	insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules.		
5 – Counter harmful tax practices more effectively, taking into account transparency and substance	Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.	Finalize review of member country regimes Strategy to expand participation to non-OECD members Revision of existing criteria	September 2014 September 2015 December 2015
6 – Prevent treaty abuse	Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.	Changes to the Model Tax Convention Recommendations regarding the design of domestic rules	September 2014 September 2014
7 – Prevent the artificial avoidance of PE status	Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.	Changes to the Model Tax Convention	September 2015

Action	Description	Expected output	Deadline
8 – Assure that transfer pricing outcomes are in line with value creation: intangibles	Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2014 September 2015
9 – Assure that transfer pricing outcomes are in line with value creation: risks and capital	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. The rules to be developed will also require alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments.	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention	September 2015
10 – Assure that transfer pricing outcomes are in line with value creation: 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. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be re-characterized; (ii) clarify the application of transfer pricing methods, in particular profit	Changes to the Transfer Pricing Guidelines and possibly to the Model Tax	September 2015

Action	Description	Expected output	Deadline
	splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.	Convention	
11 – Establish methodologies to collect and analyze data on BEPS and the actions to address it	<p>Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.</p>	<p>Recommendations regarding data to be collected and methodologies to analyze them</p>	<p>September 2015</p>
12 – Require taxpayers to disclose their aggressive tax planning arrangements	<p>Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions. The work will be</p>	<p>Recommendations regarding the design of domestic rules</p>	<p>September 2015</p>

Action	Description	Expected output	Deadline
	<p>coordinated with the work on co operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.</p>		
13 – Re-examine transfer pricing documentation	<p>Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.</p>	<p>Changes to Transfer Pricing Guidelines and Recommendations regarding the design of domestic rules</p>	<p>September 2014</p>
14 – Make dispute resolution Mechanisms more effective	<p>Develop solutions to address obstacles that prevent countries from solving treaty related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.</p>	<p>Changes to the Model Tax Convention</p>	<p>September 2015</p>
15 – Develop a multilateral instrument	<p>Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.</p>	<p>Report identifying relevant public international law and tax issues</p> <p>Develop a multilateral instrument</p>	<p>September 2014</p> <p>December 2015</p>