Recent developments of the BEPS Project and Japan's experience

9th IMF-Japan High-Level Tax Conference For Asian Countries in Tokyo

Recent Developments in International Corporate Taxation

April 10, 2018

Shuichi HOSODA, Director, International Tax Policy, Tax Bureau

Ministry of Finance, Japan

Overview of the BEPS Project

- ***Background***
  - ✓ Public anger against unfair tax burden for financing necessary fiscal spending to cope with the Global Financial Crisis

- ***Historical Value***
  - ✓ Inclusive participation
    - OECD member countries and non-OECD G20 countries on an equal footing
  - ✓ From "competition" to "cooperation" for the levelling the playing field
    - "Minimum standards" : agreed by participating countries to implement including through changing their domestic legislation
  - ✓ From "preventing double taxation" to "eliminating double non-taxation"
    - Better alignment of the location of taxable profits with the location of economic activities and value creation

Addressing the issues of international tax avoidance and evasion (BEPS and Tax Transparency)

In G7 Iseshima Summit, 26-27 May 2016, following the G7 Sendai Finance Minister meeting, G7 Leaders approved steady implementation of BEPS package and Exchange of Tax Information.

BEPS

In Kyoto, 30 June and 1 July2016,
OECD Committee on Fiscal Affairs
（Chaired by Masatsugu ASAKAWA)

・**established** "the Inclusive Framework" to kick off BEPS implementation

・**enlarged** its membership from 46 (G20/OECD members only) to 113 Jurisdictions (as of March 2018)

G20 members committed a timely, consistent and widespread implementation of the BEPS package.

Member jurisdictions are peer monitoring the status on BEPS implementation in "the Inclusive Framework"

Addressing aggressive tax planning

Tax Transparency / Exchange of Information

23 May 2016
Public announcement on agreement in principle on Tax Information Exchange Agreement with Panama

In Kyoto, 30 June and 1 July 2016
OECD Committee on Fiscal Affairs
（Chaired by Masatsugu ASAKAWA):
Discussed "objective criteria to identify non-cooperative jurisdictions in respect of tax transparency"

In Chengdu, 23-24 July 2016
G20 Finance Ministers Meeting:
In Hangzhou, 4-5 September 2016
G20 Leaders Summit:
Approved "objective criteria"

In Hamburg, 7-8 July 2017
G20 Leaders Summit:
Announced on non-cooperative jurisdictions

Will consider possible "defensive measures" against non-cooperative jurisdictions in case of no progress

In 2017-2018, over 100 jurisdictions will commence "automatic exchange of information of financial accounts" between tax authorities.

Tackling tax evasion using foreign accounts

10. We will continue our work for a globally fair and modern international tax system and welcome international cooperation and pro-growth tax policies. We remain committed to the implementation of the Base Erosion and Profit Shifting package and welcome progress to date. The impacts of the digitalisation of the economy on the international tax system remain key outstanding issues. We welcome the OECD interim report analysing the impact of the digitalisation of the economy on the international tax system. We are committed to work together to seek a consensus-based solution by 2020, with an update in 2019.

11. We have made substantial progress on tax transparency. Further steps to implement transparency standards and requirements for the exchange of information for tax purposes will take place this year. Jurisdictions scheduled to commence automatic exchange of financial account information for tax purposes in 2018 should ensure that all necessary steps are taken to meet this timeline. We call on all jurisdictions to sign and ratify the multilateral Convention on Mutual Administrative Assistance in Tax Matters. We look forward to the OECD's recommendations on how to further strengthen the criteria for assessing jurisdictions compliance with internationally agreed tax transparency standards. Defensive measures will be considered against listed jurisdictions. We continue to support assistance to developing countries to build their tax capacity. We welcome the first conference of the Platform for Collaboration on Tax and the efforts undertaken to help developing countries implement the new international tax standards. We also encourage countries to enhance tax certainty.

Recent developments on BEPS

◆ MLI (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS)
⇒signed by 78 jurisdictions, enter into force on July 1, 2018

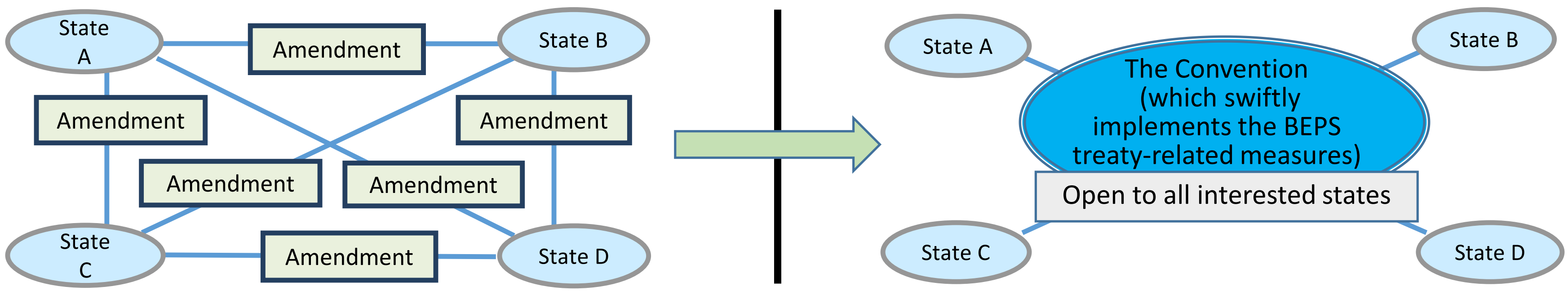
◆ Tax Transparency
⇒AEOI (Automatic Exchange of Information) started in 2017 and more countries will join by September 2018
⇒upgrade criteria on non-corporative jurisdictions and consider defensive measures

◆ Tax Certainty
⇒updated report by the IMF and the OECD

Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting (Action15)

Outline

- This Convention aims to introduce the BEPS treaty-related measures, which were developed under the BEPS project, into the existing tax treaties between the Parties of the Convention.
- The Convention enables the Parties thereof to implement the BEPS treaty-related measures across the network of their existing tax treaties simultaneously and efficiently.
- The BEPS treaty-related measures to be introduced through the application of the Convention consist of (1) measures concerning prevention of tax evasion through tax treaty abuse and (2) measures to eliminate the risks of uncertainty such as unintended double taxation.



Development

- November 24, 2016: The text of the MLI were adopted by the members of the ad hoc group.
- December 31, 2016: Opened for signature for all states and the specified territories.
- June 7, 2017: Signed by 67 states/jurisdictions including Japan at the signing ceremony in Paris.
- March 9, 2018: Japan submitted the text of the MLI to the ordinary session of the Diet in Japan
- As of March 2018: 76 states/jurisdictions have signed the Convention; five of them have deposited instruments of ratification and enter into force on July 1st 2018.

BEPS Implementation in Japan ①（Minimum Standards）

- Action 5 (Harmful Tax Practices)
  - Has no IP regimes.

- Action 6 (Treaty Abuse)
  - Has introduced recommendations in recent bilateral treaties.
  - Signed the MLI in June 2017 and the Diet is currently deliberating. (Action 15)

- Action 13 (TP Documentation and Country-by-Country Reporting)
  - FY2016: introduced a “CbC report” system concerning information on multinational companies. Information exchange will start in 2018.

- Action 14 (Dispute Resolution Mechanisms)
  - Compliant with the Minimum Standard in most of the DTAs and has been updating the rest of DTAs through the MLI and bilateral negotiations.

BEPS Implementation in Japan ②

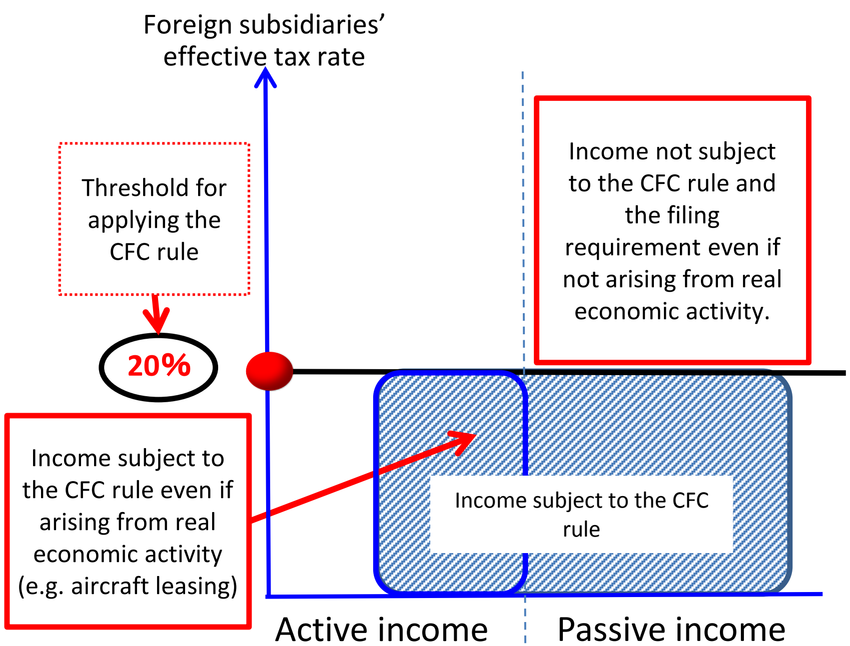
- Action 1 (Digital Economy)
  - FY2015 : reformed the consumption tax system on cross-boarder digital service transactions.
- Action 2 (Hybrid Mismatch)
  - FY2015: neutralized the effects of hybrid mismatch arrangements on dividends from foreign subsidiaries.
- Action 3 (Controlled Foreign Company(CFC) rules)
  - FY2017: reformed the CFC regime. Recognizing tax avoidance risk no longer relies on a pro-forma basis, i.e. effective tax rates of foreign subsidiaries, but instead is assessed on the basis of the specific activities and types of income of the relevant subsidiaries.
- Action 7 (PE)
  - FY2018: revised PE-related provisions.
- Action 15 (MLI)
  - Signed the MLI in June 2017. The Diet is currently deliberating.

Controlled Foreign Corporation Rules (Action3 FY2017 Tax Reform)

- Under the CFC rule, the income of a foreign subsidiary that meets certain criteria is deemed to be part of its Japanese parent corporation's income and is subject to taxation in Japan, in order to prevent tax avoidance using foreign subsidiaries.
- The current system is problematic in that **income not arising from real economic activity may be exempted from the CFC rule and the filing requirement** if the foreign subsidiary's effective tax rate is 20% or more ("threshold tax rate"), **while income arising from real economic activity may be subject to the CFC rule**.
- In the FY2017 tax reform, the CFC rule will be reformed as shown below in order **not to restrict Japanese corporations' overseas business activities while preventing tax avoidance more effectively** in consideration of the recommendation of the BEPS project Action 3 and the direction of the reform indicated in the ruling parties' FY2016 tax reform outline.

Before the revision

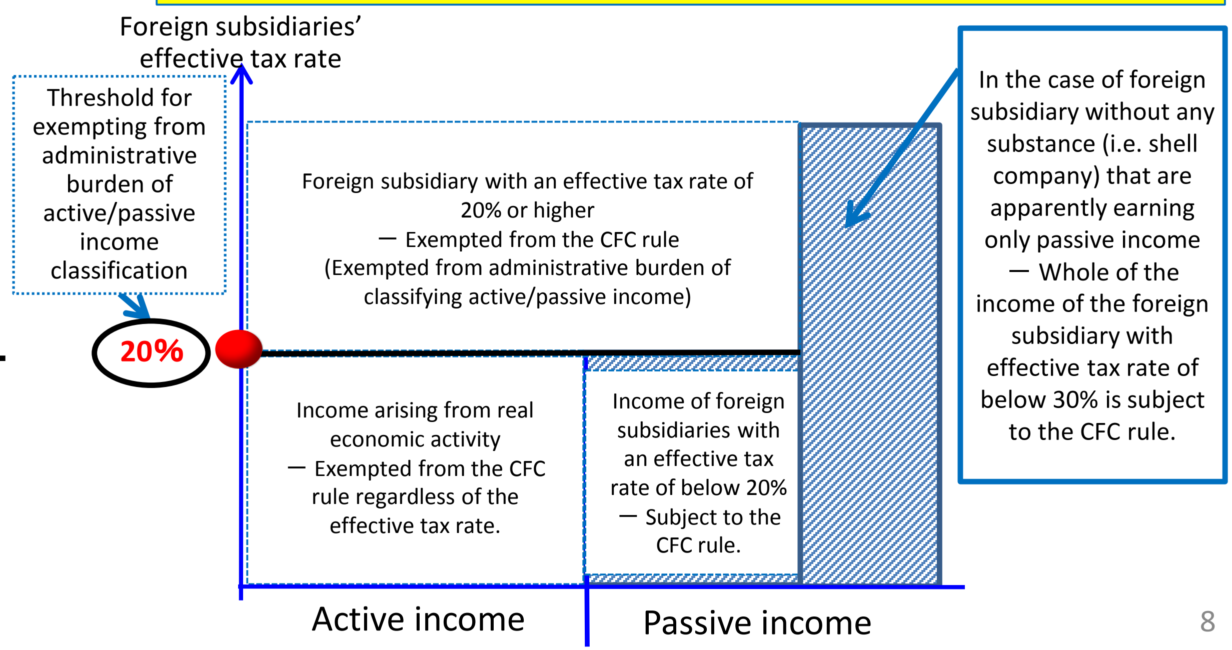
— Recognize the tax avoidance risk on the basis of a foreign subsidiary's pro forma characteristics(e.g. the subsidiary's effective tax rate (less than 20%) and the presence or absence of substance of the subsidiary as a whole).



After the revision

— Recognize the tax avoidance risk on the basis of the facts and circumstances of a foreign subsidiary's individual activities (e.g. type of income).

— Exempt a foreign subsidiary that is subject to a certain tax liability and not posing tax avoidance risk from the CFC rule with an aim of reducing administrative burden of classifying active/passive income.



Revising permanent establishments (PE)-related provisions
(Action7 FY2018 Tax Reform)

A "permanent establishment (PE)" is a place where a company conducts business (e.g. a branch). For example, when a foreign company conducts business in Japan, tax may not be levied on the company's business profit unless it has its PE in Japan ("No PE, no tax").

[International trends surrounding PEs]

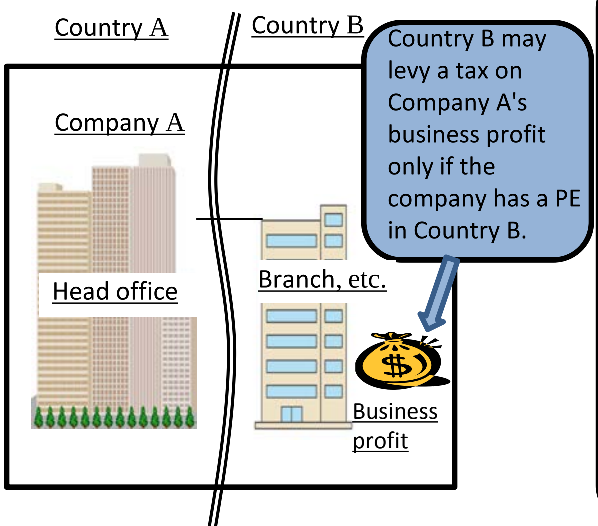
✔ The BEPS Report introduced measures to prevent the artificial avoidance of PE status through conducting exempted activities. (Note) The OECD Model Tax Convention was revised in November 2017 based on this report.

✔ The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) was agreed upon with the above-mentioned measures incorporated therein. Japan signed this convention in June 2017 and has adopted the PE definition of the MLI in its latest bilateral tax treaties.

[Amendments to the national tax law]

✔ The definition of "PE" under the national tax law will be revised in order for Japan to comply with the international standards (BEPS Report and the new OECD Model Tax Convention), including the measures to prevent the artificial avoidance of PE status.

* Other measures will be taken as well, such as clarifying the relationship between the provisions of tax treaties and those of the national tax law with regard to PEs.
* To be put into effect in January 2019



Revision of PE-related provisions

Current definition of "PE" (outline)	Major revisions
Branch PE Branch, office, plant, etc. * Excluding places dedicated to specific activities such as storage, exhibition and delivery.	・A place dedicated to specific activities will be recognized as a PE if the activities are equivalent to the execution of the business of a foreign person and if they are not of a preparatory or auxiliary nature.
Agency PE An agent for concluding contracts, etc. * Excluding an independent agent	・To address the artificial avoidance of PE status through limiting an agent's role. ・A person who exclusively or mainly acts on behalf of a parent company, etc. is excluded from the scope of "independent agent."
Construction PE A construction site where construction work is to continue for more than 12 months	・If a contract period is divided into multiple parts for the primary purpose of avoiding the PE status, the PE status is determined depending on the whole contract period.

15 BEPS Actions in Japan

Action 1	Digital Economy	FY2015：Revision of Consumption Tax (VAT) system on cross-border supplies of services
Action 2	Hybrid Mismatch	FY2015：Revision of foreign dividend exclusion system
Action 3	CFC Rules	FY2017：Revision of CFC (Controlled foreign company) rules
Action 4	Interest Deductions	Japan has the earnings stripping rule and the thin capitalization rule.
Action 5	Harmful Tax Practices	No IP (Intellectual Property) regimes exist.
Action 6	Treaty Abuse	Introducing recommendations, e.g. PPT (Principal Purpose Test), in MLI and bilateral treaties
Action 7	PE	FY2018：Revision of PE
Actions 8-10	TP	
Action 11	Measuring and Monitoring	OECD is working on this issue.
Action 12	Mandatory Disclosure Rules	
Action 13	CbC Reporting	FY2016：Introduction of a “CbC (Country-by-Country) report” system
Action 14	Dispute Resolution Mechanisms	Compliant with the Minimum Standard in most of the DTAs(Double Taxation Agreements) and has been updating the rest of DTAs through the MLI and bilateral negotiations.
Action 15	MLI	Signed the MLI in June 2017 The Diet is currently deliberating.

Taxation and Digitalization

Interim report of the Inclusive Framework on BEPS on the Tax Challenges arising from Digitalization (March 16, 2018)

- ◆ Work towards a consensus-based solution by 2020, with an update on progress in 2019
- ◆ The "Considerations" should be taken into account for the design of interim measures (i.e. excise tax on e-services).
- ◆ Explore opportunities and risks for tax policy and administration as a result of new technologies.

G20 Finance Ministers Meeting Communiqué (Buenos Aires, March 2018)

10. ･･･ We are committed to work together to seek a consensus-based solution by 2020, with an update in 2019.

Tax and Development

- Helping developing countries build capacity (BEPS, DRM (Domestic Resource Mobilization), MTRS (Medium-term Revenue Strategy))
  - Japan supports DRM and MTRS through IMF's trust fund.
- Coordinating IO's TA to maximize impact
  - Japan pledged financial contribution to the PCT secretariat and WB.

- Enhancing TA functions in Asia
  - Japan contributes to ADB Domestic Resource Mobilization Trust Fund.
- Technical assistance for tax administration
  - Japan provides technical assistance for tax administration by sending the experts.