



# Global tax environment

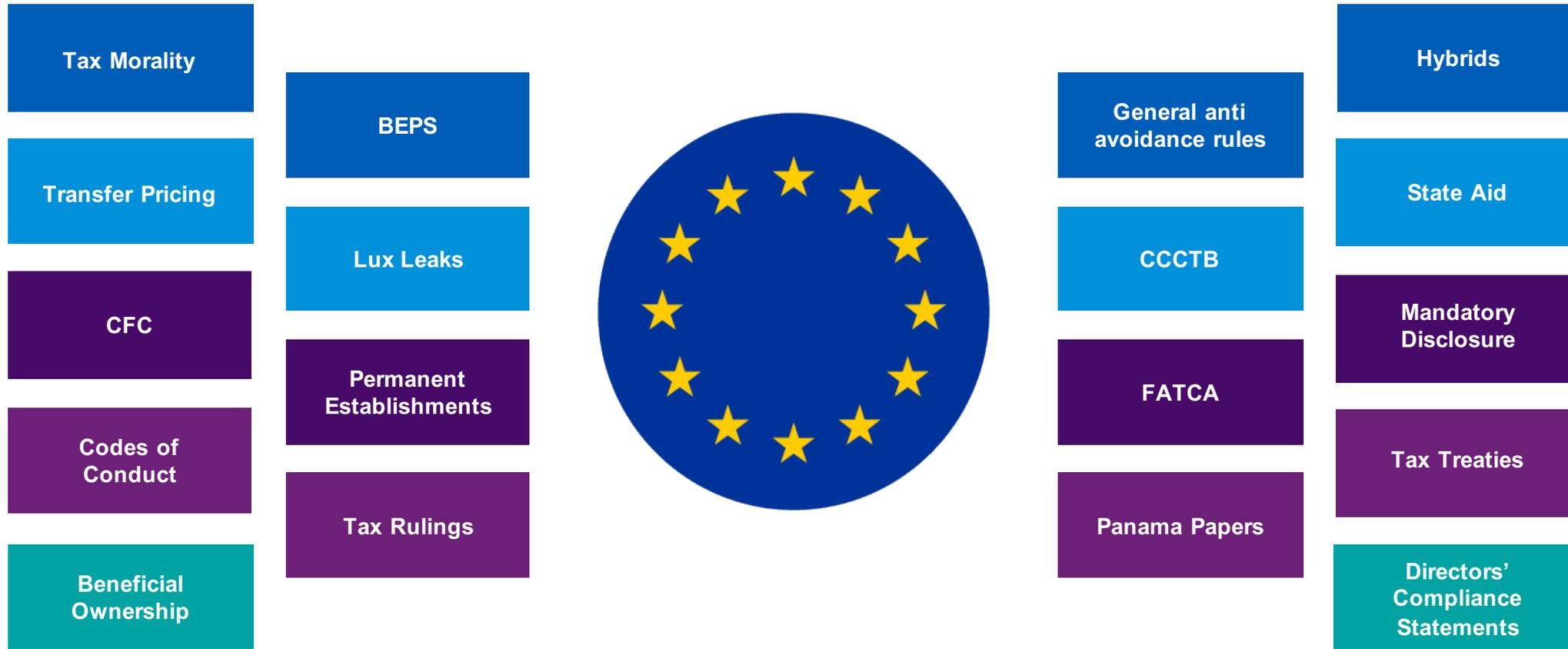


AE Leasing School

2 November 2016

HK

# The Changing Tax Landscape



# The impetus for change



Governments under fiscal pressure as a consequence of the global economic crisis



Austerity measures prompted a 'fairness' and 'tax morality' debate: "Is everyone paying their fair share in society?"



Increased public and media focus on tax practices of multinationals



Policy concern that international tax rules are outdated and do not adequately address modern business models in the digital age



G20 reinforced political concerns and endorsed collaborative efforts to modernise international rules and standards

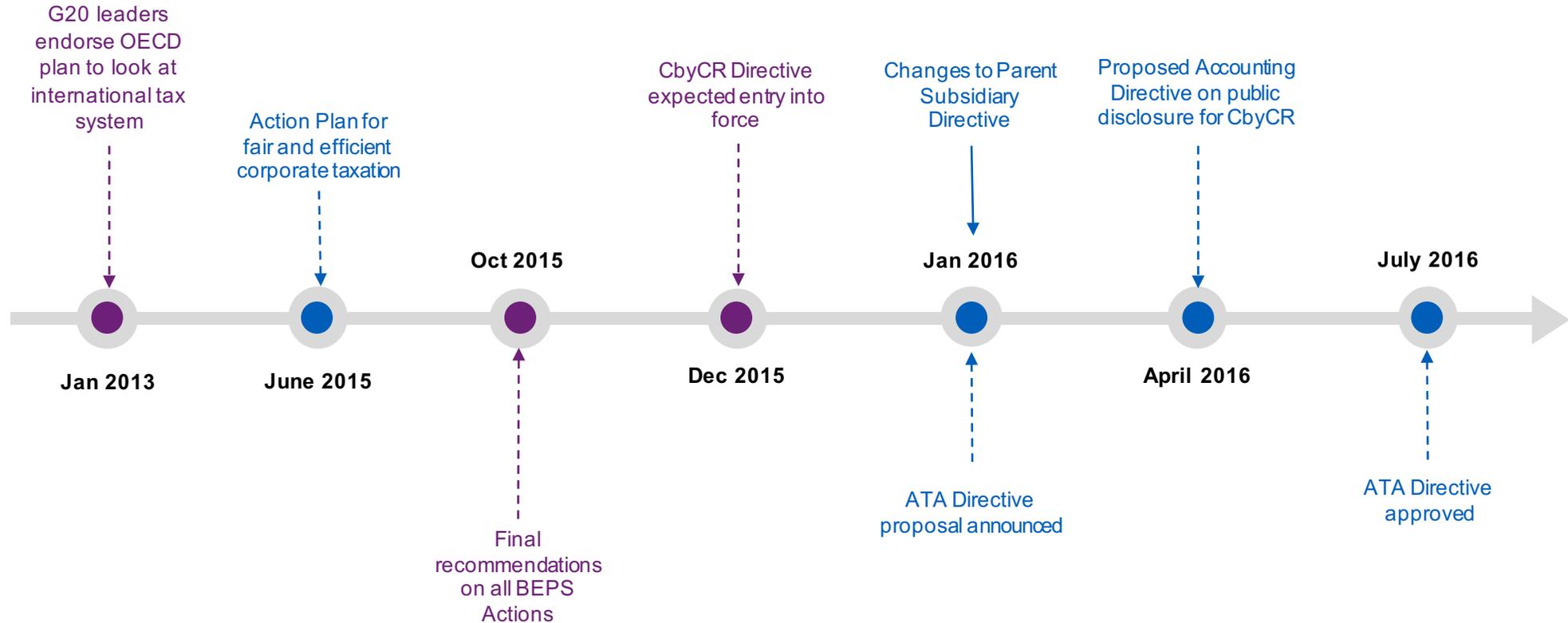


Lux leaks, Panama papers, etc.



State aid concerns

# Developments – BEPS & EU





# Base Erosion and Profit Shifting ("BEPS")



# BEPS – where are we?

- Action 1 – Digital Economy
- Action 2 – Hybrid Mismatches
- Action 3 – CFC Rules
- Action 4 – Interest Deductions
- Action 5 – Harmful Tax Practices
- Action 6 – Tax Treaties
- Action 7 – Permanent Establishment
- Action 8-10 Transfer Pricing
- Action 11 – BEPS Data
- Action 12 – Mandatory Disclosure
- Action 13 – Country-by-Country Reporting
- Action 14 – Dispute Resolution
- Action 15 – Multilateral Instruments

# Key Action Plans affecting leasing industry



**Action 2 – Hybrid Mismatches**



**Action 4 – Interest Deductions**



**Action 6 – Tax Treaties**



**Action 7 – Permanent Establishment**



**Action 13 – Country by Country Reporting (“CbyC”)**

# Action 2 – Hybrid Mismatches

- Focuses on the use of hybrid instruments or entities to create mismatches in treatment.
- Two main types:
  - Instruments which create a deduction in one jurisdiction with no corresponding taxable income in the other jurisdiction.
  - Instruments which create a double deduction for a payment.
- Indirect mismatches may also exist, e.g. hybrids used further up in chain of transactions.
- Seeks to align tax treatment of instrument or entity with tax outcome in counterparty jurisdiction:
  - Deny tax deduction if payment not subject to tax in recipient country
  - Deny one deduction for double deduction outcomes
- Financing structures relying on hybrid mismatches to reduce foreign taxes likely to see benefits eroding in future.
- Treaty measures relating to dual residents, hybrid entities and branches

# Action 4 – Interest Deductions

- Prevent base erosion through funding structures by limiting tax deduction for interest.
- Recommends limiting a deduction for an entity's net interest expense to a percentage of EBITDA
  - Fixed ratio corridor of 10%-30% of EBITDA.
  - Group ratio for highly-leveraged groups – allow a 10% uplift on group's net third party interest expense.
- Targeted anti-avoidance
- De minimus threshold
- Carry forward/back unused interest
- Member States have differing views on this Action.

# Action 6 – Tax Treaties

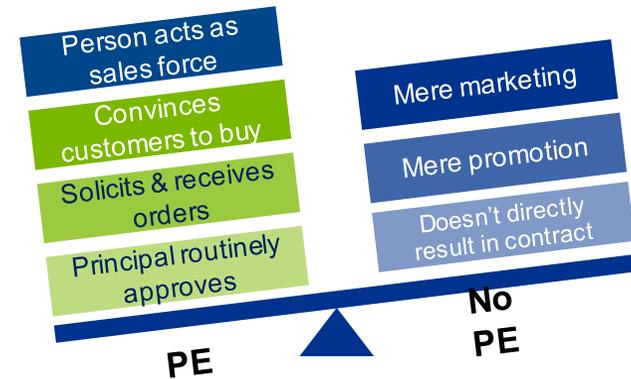
- Focuses on new approach to address tax treaty shopping arrangements.
  - **Limitation on benefits clause** (“LOB”) which focuses on ownership, base erosion and complexity. Often criticised for its complexity.
  - **Principal purposes test** (“PPT”) which focuses on whether one of the main purposes is accessing tax treaty. Often criticised for its uncertainty.
- Proposed measures include:
  - Clear statement not to avoid tax
  - Simplified LOB with PPT
  - Detailed LOB with anti-conduit measures
  - PPT
- Suggested specific anti-abuse rules for certain transactions
- Work ongoing to finalise wording of LOB clause (to be aligned with now finalised US model treaty).
- Implementation through country choices and Multilateral Instrument.

# Action 6 – Tax Treaties

- Tax treaty access is critically important for aircraft lessors:
  - Direct leases
  - LILOs
  - Orphan structures
  - Securitisations
- Emphasis on commercial purpose – focus on structure and substance.
- Complexity as every country will interpret rules in their own way.
- ‘EU compliant’ recommended PPT preserves treaty benefits if the transaction “*reflects a genuine economic activity*”.
  - Improvement on the OECD draft but still highly subjective.
  - Unclear what will happen if non-EU counterparty to a tax treaty chooses LOB or LOB/PPT combination under the Multilateral Instrument.

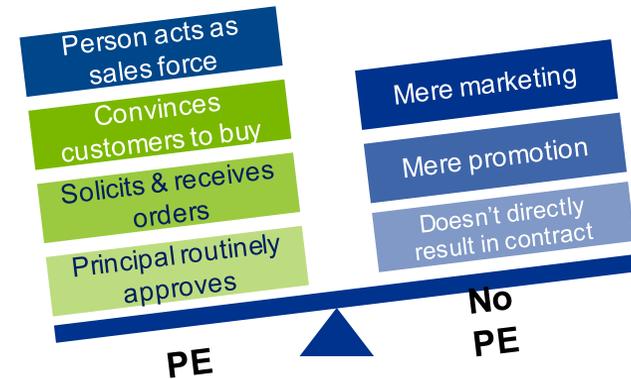
# Action 7 – Permanent Establishment (“PE”)

- Focuses on activities which will create a PE in a foreign jurisdiction.
- Three issues specifically addressed:
  - Dependent Agent Standard
  - Preparatory and Auxiliary Activities
  - Splitting Contracts
- Dependent Agent Standard
  - Replaces “conclusion of contracts” and “in the name of” with broader standards.
  - Independent agent exception cannot apply where agent acts exclusively for connected persons
  - Broadens “conclusion of contracts” to include “habitually play principal role in leading to conclusion of contracts without material modification”.



# Action 7 – Permanent Establishment (“PE”)

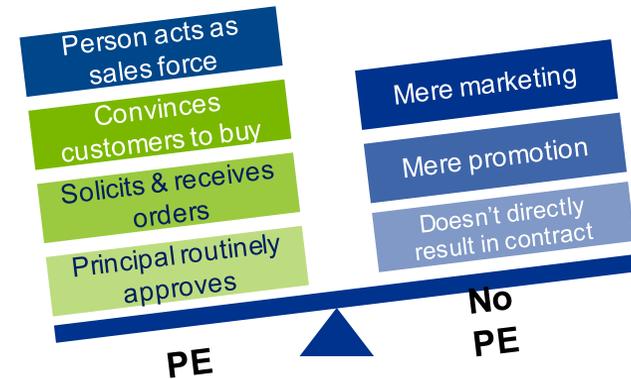
- Preparatory and Auxiliary Activities – addresses concern over abuse of specific activity exemptions by:
  - Subjecting all specific activity exemptions to an overall “preparatory and auxiliary” condition; or
  - Retaining existing exemptions so long as the “anti-fragmentation rule” is adopted (grouping of connected enterprises).
- Splitting Contracts
  - Addresses installation, construction and service PEs.
  - No specific rule in Article 5 of the model treaty; instead relies on proposed principal purposes test
  - Unlikely to be relevant to the leasing sector.



# Action 7 – Permanent Establishment (“PE”)

- Impact on leasing sector

- Potentially very significant for leasing groups which have people travelling internationally and involved in buying, selling and leasing aircraft.
- The changes are targeted at commissionaire structures and on the ground teams which negotiate the terms of contracts but which do not formally conclude contracts for the non-resident.
- Key issue for leasing sector given the fact that senior executives/ marketing personnel regularly visit local customers to discuss contract terms. It will therefore be important to carefully review evidence of ‘head office’ decision making on final contracts – head office needs to do more than merely ‘rubber stamp’ the final contract terms.
- Review local market sales support and marketing activity as these may ‘lead to the conclusion of contracts’.



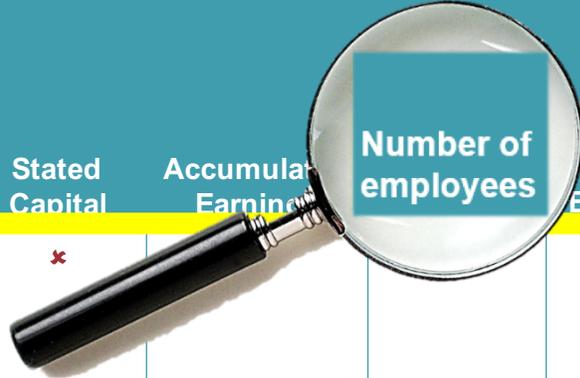
# Action 13 – CbyC Reporting

- Reporting of global allocation of sales, profits, employees, taxes and other metrics
- Applies to:
  - Groups with turnover of €750m+
  - Accounting periods commencing after 1 January 2016
- Reports must be filed with Tax Authorities within 12 months of year end.
- Automatic sharing of report between Tax Authorities in countries that group operates (where exchange agreement in place).
- EU Member States introducing legislation to accommodate data sharing. Some, including Ireland already adopted CbyC measures.
- Implications on transfer pricing policies & global tax allocation
- Data collection challenges

# Final CbyC Template (Numerical Disclosures)

CbyC Template – Page 1

Tax Jurisdiction	Revenue			Profit (loss) before income tax	Income tax paid (on a cash basis)	Income tax accrued – current year	Stated Capital	Accumulated Earnings	Number of employees	Tangible assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							
Country A	x	x	x	x	x	x	x	x	x	x
Country B	x	x	x	x	x	x	x	x	x	x
Not resident in any tax jurisdiction	x	x	x	x	x	x	x	x	x	x

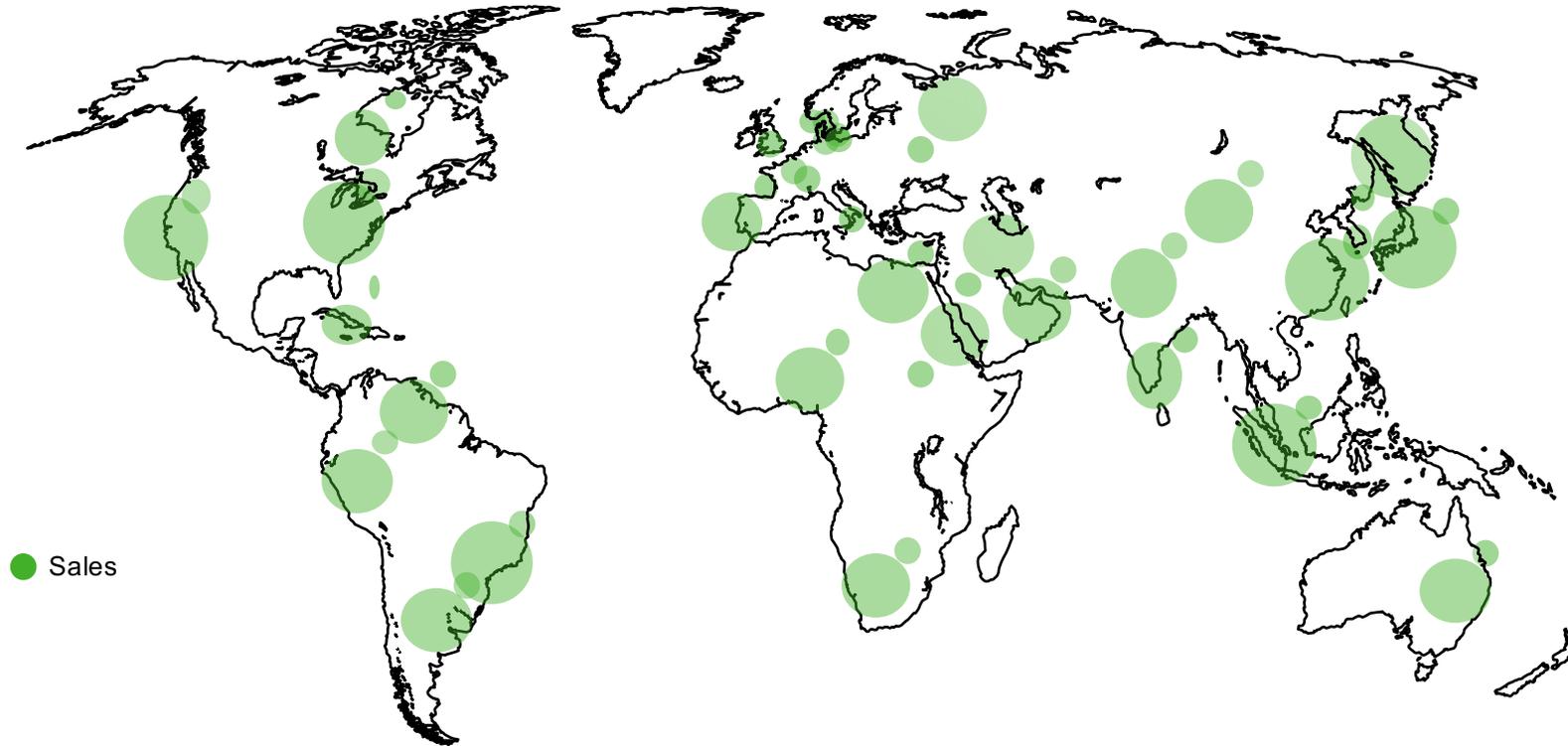


# Final CbyC Template (Business Activity Disclosures)

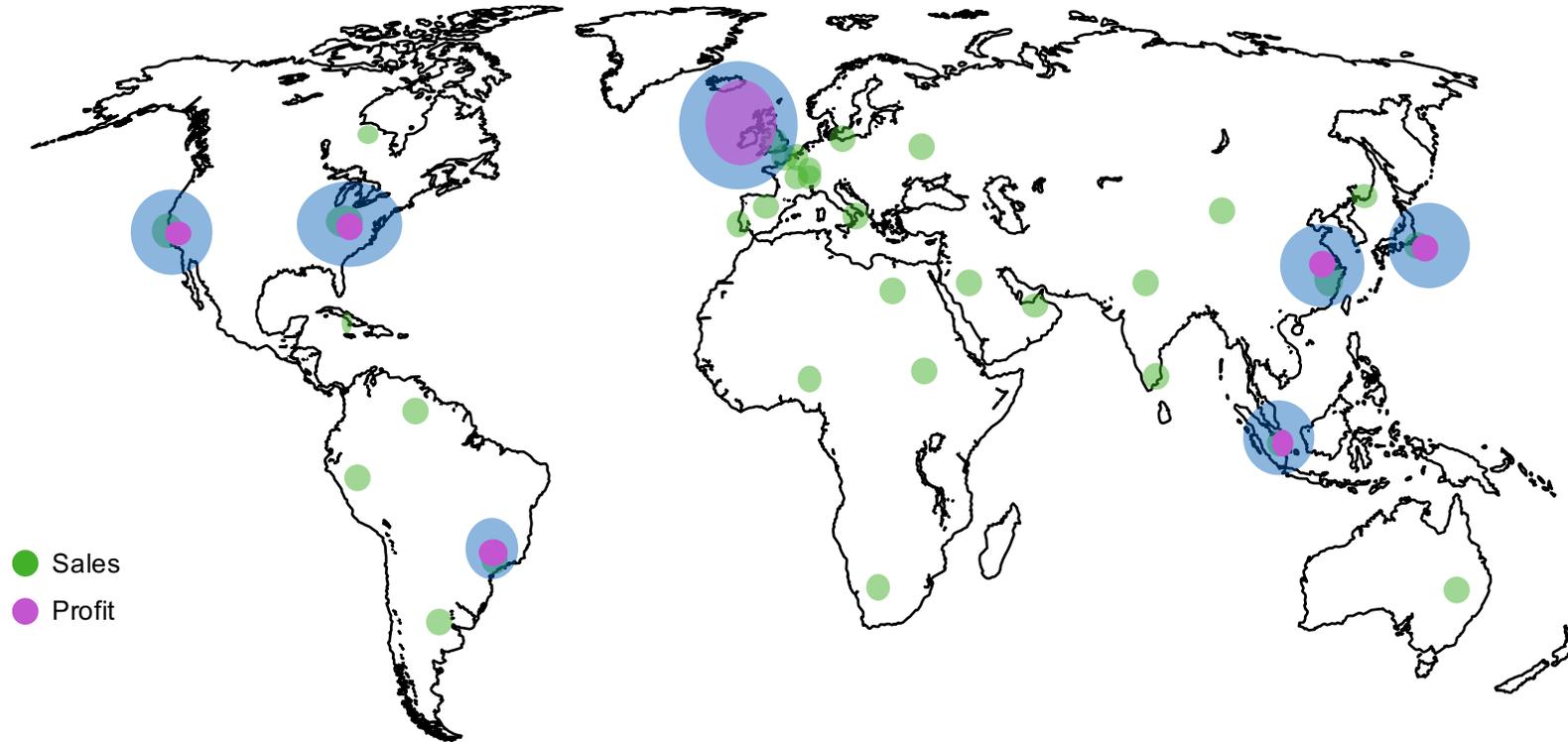
## CbyC Template – Page 2

Tax Jurisdiction	Constituent entities resident in the tax jurisdiction	Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence	Example Activities					
			Sales, marketing or distribution	Purchasing or procurement	Technical	Support services	Internal group finance	Other
Country A	Service Co A		✓		✓	✓	✓	
	Lease Co A	Country B		✓				✓
Country B	Service Co B		✓		✓			
Country C	Service Co C		✓		✓	✓		
Country D	Finance Co D						✓	

# Action 13 – CbyC Reporting



# Action 13 – CbyC Reporting



# Action 13 – CbyC Reporting



# Action 15 – Multilateral Instrument (“MLI”)

- Developing a Multilateral Instrument (“MLI”) to modify bilateral tax treaties.
- MLI seeks to implement agreed treaty measures in a reasonably short time frame while preserving the bilateral nature of tax treaties.
- Aim of finalising the MLI and to open it for signature by 31 December 2016.
- Participation in the development of the MLI is voluntary and does not entail any commitments to sign up to the instrument, but the OECD treaty measures are Minimum Standard, signalling strong political commitment.
- Will be the driver for changes recommended under Treaty and PE actions.
- Not clear yet what exact form the MLI will take and what level of optionality will be available to those countries which sign up.
- EU recommendation in January 2016 package of measures, endorsed by the EC in May that EU Member States make harmonised choices under MLI of ‘EU compliant’ PPT (treaty anti-abuse measure) together with common anti-abuse measures for branches and common PE standard.



# EU Anti-Tax Avoidance Directive



# ATA Directive – what is it?

- The EU has approved an Anti-Tax Avoidance Directive that will apply across all EU Member States:
  - Proposal first announced by EU Commission on 28 January 2016
  - Formal approval on 12 July 2016
  - Implementation scheduled to commence from 2019
  - Deferral of some measures to 2020 and 2024.
- The Directive is a separate and distinct initiative from the OECD's BEPS plans BUT is designed to further build on the proposals announced as part of the BEPS initiative.
- The EC's ambition is to harmonise to the greatest extent the adoption of anti BEPS measures into local laws across EU Member States.
- Given the complexity and range of measures, it is understood that the **Department of Finance plans to hold a consultation on Ireland's implementation of the Directive** measures – no details as yet as to structure or timing of the consultation.

# OECD BEPS vs EU Response

BEPS Actions	EU Response
Action 1 - Digital Economy	Focus not on BEPS but on removing barriers to growth and on VAT. European strategy on Digital Economy – 16 target initiatives by end of 2016 to exploit growth opportunities (May 2015)
Action 2 - Hybrid Mismatches	Included in Article 9 of ATA Directive. Measures also included in changes to Parent Subsidiary Directive
Action 3 - CFC Rules	Included in Article 7 & 8 of ATA Directive
Action 4 - Interest Deductions	Included in Article 4 of ATA Directive. Possible to defer implementation to 2024
Action 5 – Harmful Tax regimes	ECOFIN adopted an amended DAC (DAC 3) for automatic exchange of EU rulings to be implemented by MS by December 2016
Action 6 – Tax treaty abuse	Included in package of measures announced in January 2016
Action 7 – PE's	Included in package of measures announced in January 2016
Action 8-10 – Transfer Pricing	EU Transfer Pricing forum working on EU approach
Action 11 – BEPS Data	EU Tax policy recommendations require MS to conduct cost/benefit analysis. EU study underway on impact of some aggressive tax planning
Action 12 – Mandatory Disclosure	May 2016 announcement that EC to develop proposals for EU Mandatory Disclosure
Action 13 – TP Documentation & CbyC	EU CbyC reporting in DAC 4 – to take effect for accounting periods beginning on or after 1 January 2016
Action 14 – Dispute Resolution	EU Arbitration Convention Consultation launched Feb - May 2016. EU presidency indicates development of EU proposals by November 2016
Action 15 – Multilateral Instrument	EU Compliant measures agreed
	Exit Taxation
	EU GAAR

# Key Concepts



Interest  
Restriction



Hybrid  
Mismatches



Exit  
Charge



Controlled Foreign  
Company Rule  
(CFC)



General  
Anti-Abuse Rule  
(GAAR)

- **Implementation with effect from 1 January 2019 (with some exceptions)**
- **Minimum Standard**

# Interest Restriction

- Deduction for net borrowing costs capped at 30% of EBITDA
- Borrowing costs: Interest and economic equivalent to interest as defined under national law
- Applies to “Net” borrowing costs
- Tax measure of EBITDA



# Interest Restriction

## Permitted Exclusions



Net Interest  
≤€3 million



Standalone  
Entities

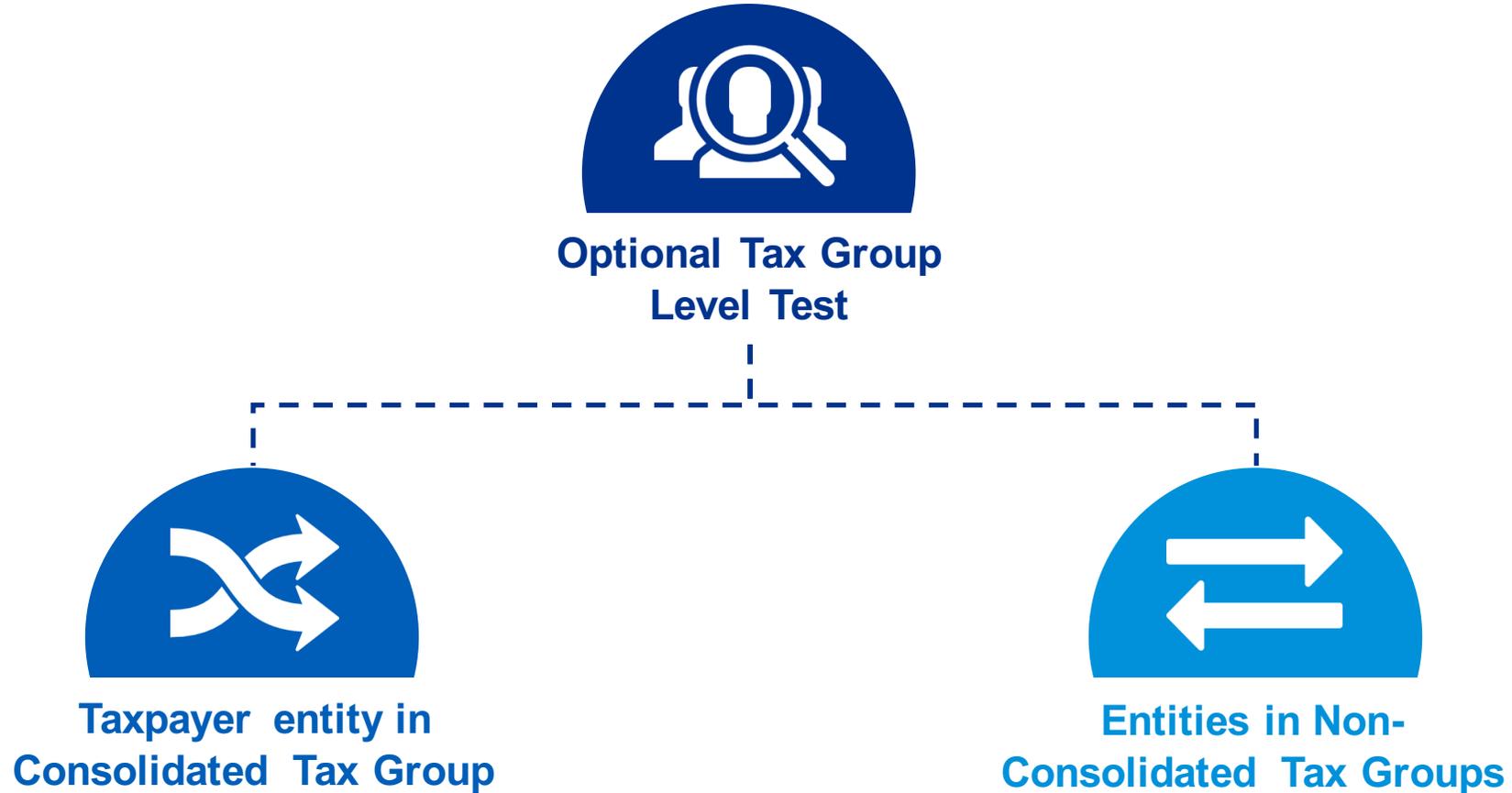


Pre 17 June  
2016 Loans



Long-term Public  
Infrastructure

# Interest Restriction



# Interest Restriction

## Group Ratio Rule

Raise cap to same ratio as group's interest on third-party borrowing to EBITDA

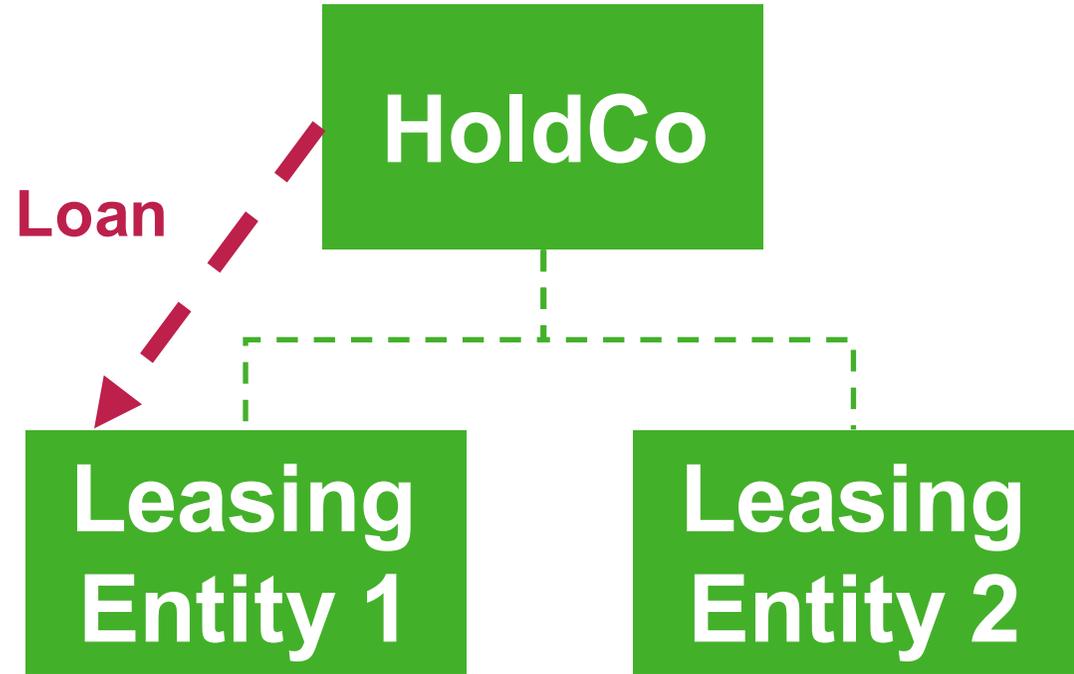
Borrower's equity-to-assets ratio  $\geq$  group ratio

2% leeway

Financial statements valuation methodology

# Interest Restriction

Example 1



**EBITDA:** €5,000,000

**Interest:** €2,000,000

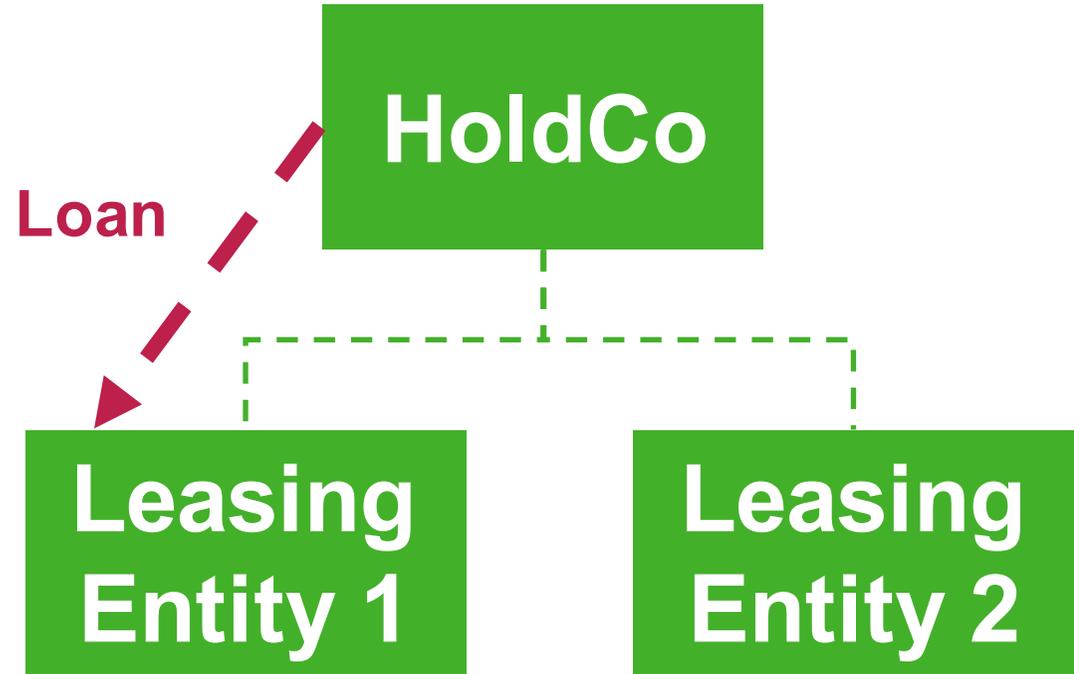
**Ratio:** 40%

**BUT...** Total Interest < €3,000,000

**Result:** No Restriction

# Interest Restriction

## Example 2



**EBITDA:** €50,000,000

**Interest:** €20,000,000

**Ratio:** 40%

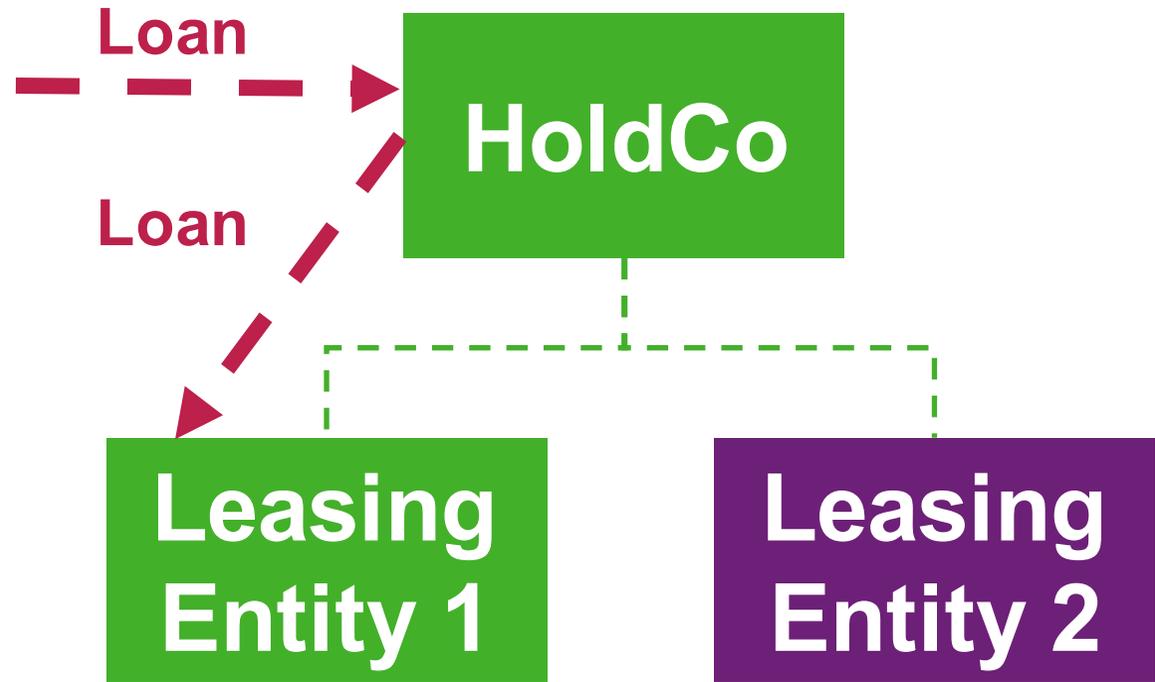
**BUT...** Leasing Entity 2 EBITDA = €25,000,000  
Total EBITDA = €75,000,000

**Tax Group Ratio:** 27%

**Result:** No Restriction

# Interest Restriction

Example 3



EBITDA: €50,000,000  
 Interest: €20,000,000  
 Ratio: 40%

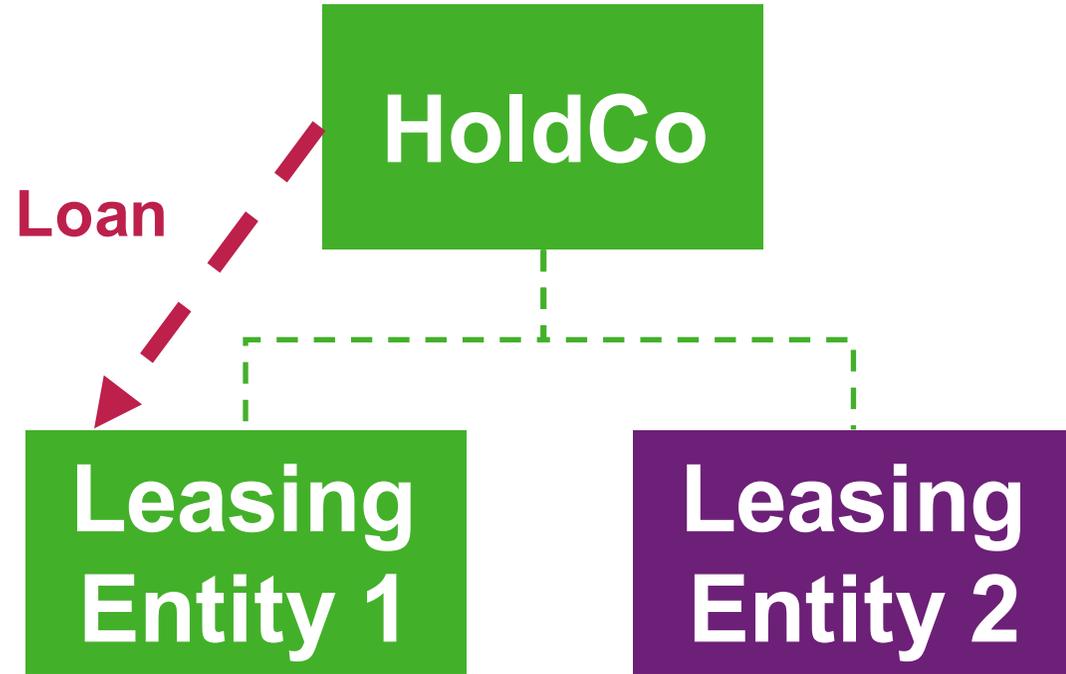
**BUT...**  
 Leasing Entity 2 EBITDA: €25,000,000  
 Group Consolidated Accounting EBITDA: €75,000,000  
 Group 3<sup>rd</sup> Party Interest: €27,000,000

Consolidated Group Accounting Ratio: 36%

**Result:** Deductible interest capped at 36% of local taxable EBITDA = €18,000,000

# Interest Restriction

## Example 4



**EBITDA:** €50,000,000

**Interest:** €20,000,000

**Ratio:** 40%

**BUT...** Leasing Entity 1 Equity-to-Assets: 1:3

Group Consolidated Accounting Equity-to-Assets: 1:4

**Result:** No Restriction

# Interest Restriction

## Member State option to allow

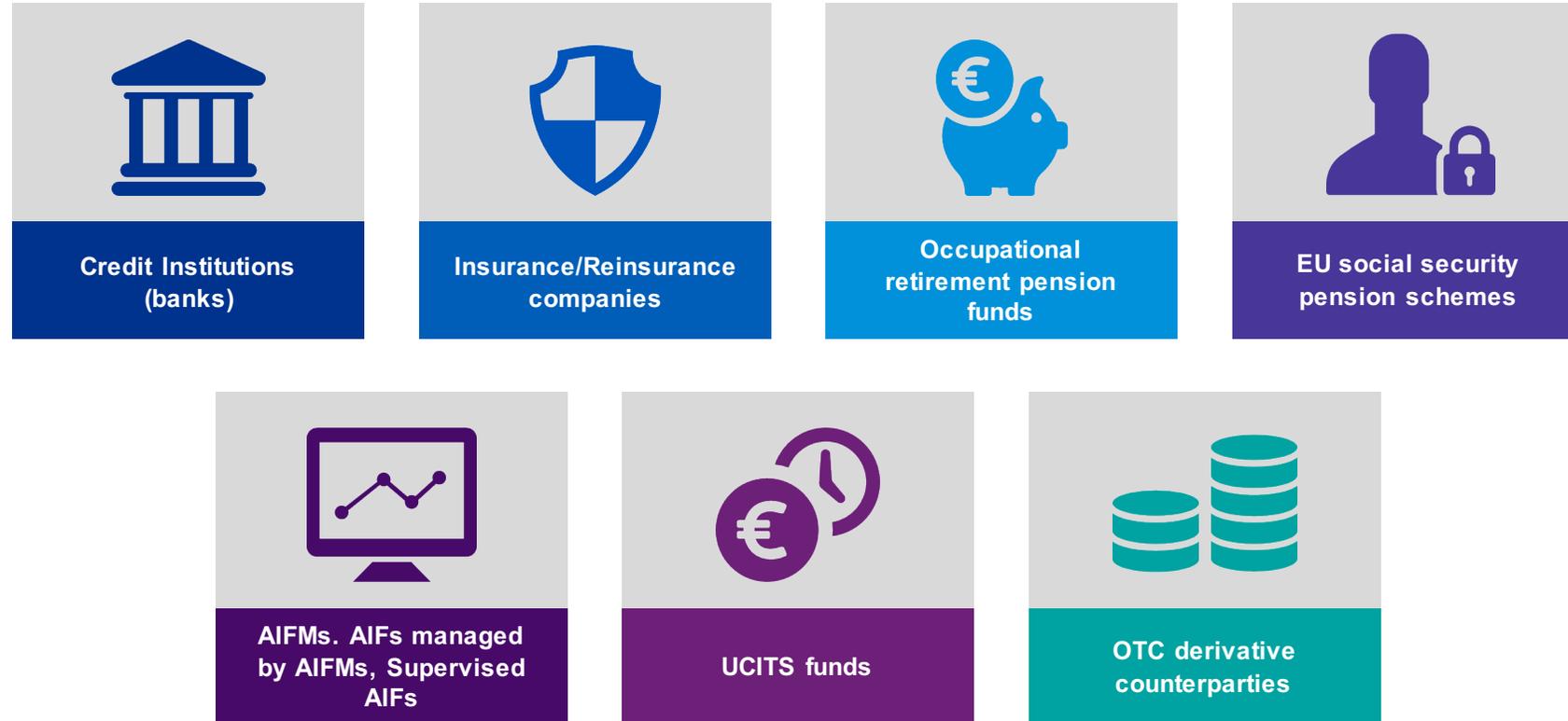
Carry forward  
(indefinitely) unused  
deductions

Carry forward  
(indefinitely) unused  
deductions or back  
(3 years)

Carry forward  
(indefinitely) unused  
deductions and  
unused interest  
capacity  
(5 years)

# Interest Restriction

## Optional exemption for financial undertakings



# Interest Restriction

**Effective  
1 January 2019**



**Possible Deferral to  
1 January 2024**

# Hybrid Mismatches



# Exit Charge

Deemed disposal at market value where Member State loses taxing rights as a result of:

Exclusion for <12 month transfer for:

- Financing of securities
- Collateral
- Prudential capital requirements
- Liquidity management

Transfer of assets from Head Office to foreign PE

Transfer of assets from PE to Foreign Head Office or Foreign PE

Transfer of residence

Transfer of business from local PE

# Exit Charge

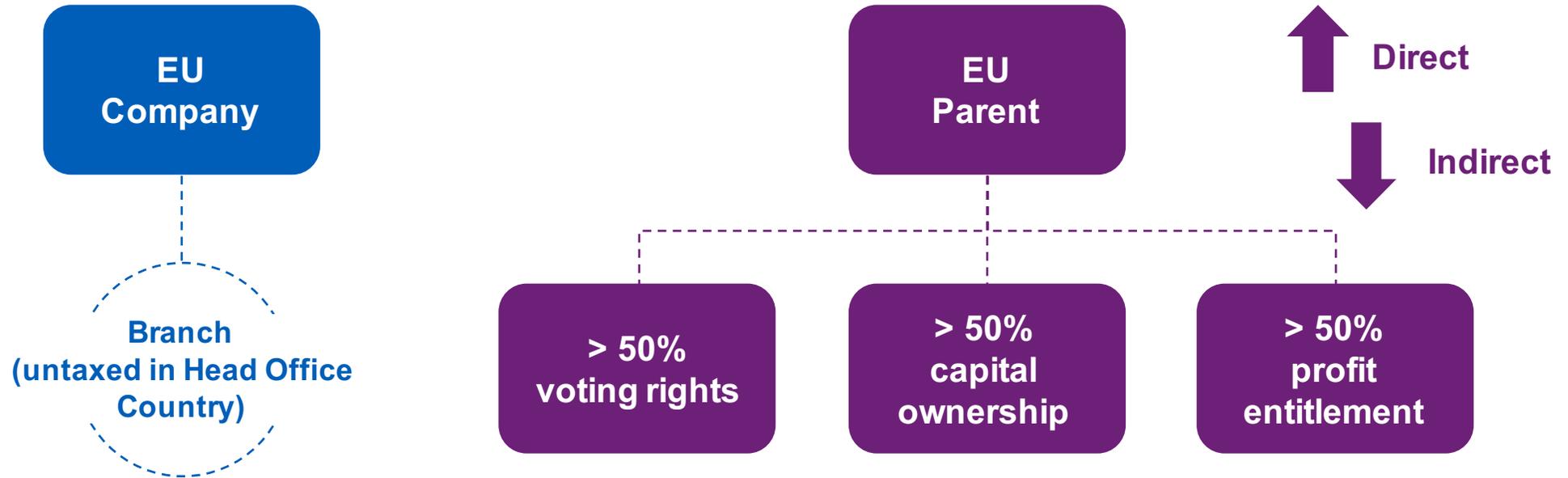
**Re-basing of Assets in Acquirer's Member State**

**EU / EEA  
5 Year Instalment Plan**

**Option to Defer Implementation until 2020**

# Controlled Foreign Company (CFC) Rule

Parent / Head-Office Pays Tax on Undistributed Income & Gains of Branch / Subsidiary



# Controlled Foreign Company (CFC) Rule

CFC  
Tax

<50%

Parent /  
Head Office  
Tax

***Black, White, & Grey Lists?***

# Controlled Foreign Company (CFC) Rule

What Income & Gains are caught?



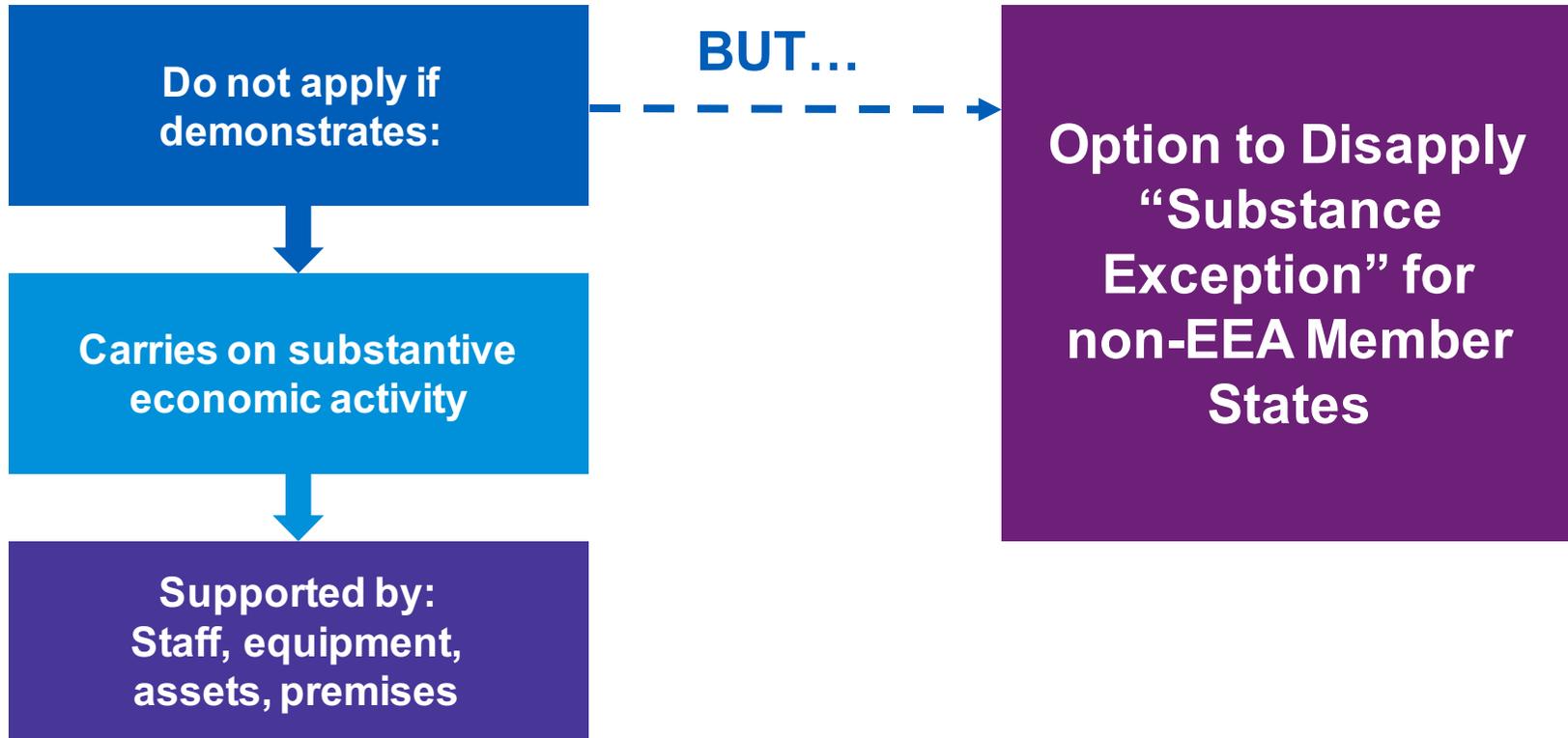
# Controlled Foreign Company (CFC) Rule

Category Approach – **NON DISTRIBUTED**

			
Interest & income from financial assets	Royalties & IP Income	Dividends	Gains on shares
			
Finance lease income	Insurance, banking and financial activity profits	Limited-risk distribution / commissionaire profits	

# Controlled Foreign Company (CFC) Rule

Category Approach



# Controlled Foreign Company (CFC) Rule

## Optional Exclusions (Category Approach)



≤1/3 total income is from specified categories



**Financial Undertakings\***  
≤1/3 income in specified categories from Head Office or 25%+ associates

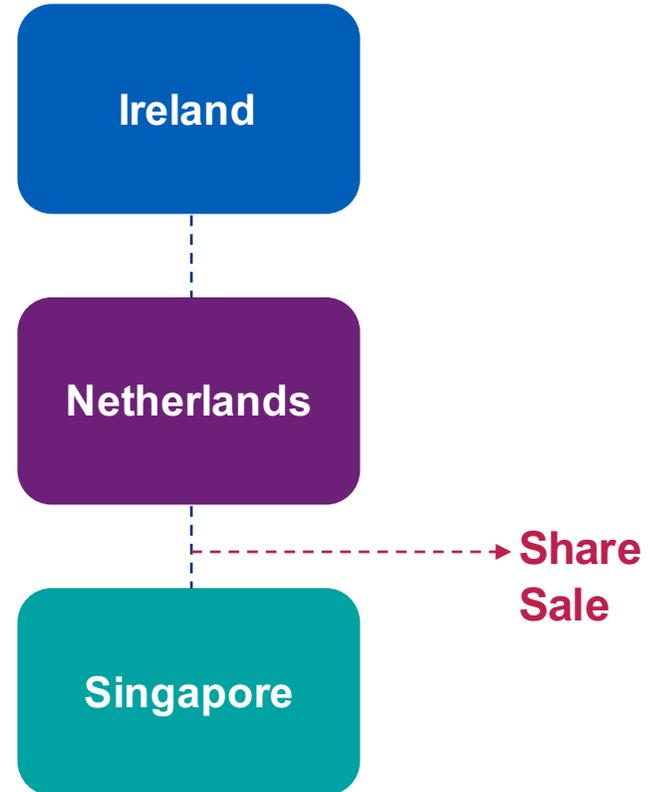
**\*Credit institutions | Insurance / reinsurance companies | Occupational retirement pension funds | EU social security pension schemes | AIFMs | AIFs | UCITS funds | OTC derivative counterparties**

# Controlled Foreign Company (CFC) Rule

Example 1

- ▶ Netherlands sells Singapore
- ▶ Netherlands exempts gain
- ▶ Netherlands does not distribute
- ▶ Share sale would be taxable in Ireland
- ▶ **Result: Irish CFC Charge on Gain**

**Unless: Exception  
Applies (e.g. substantial  
economic activity)**

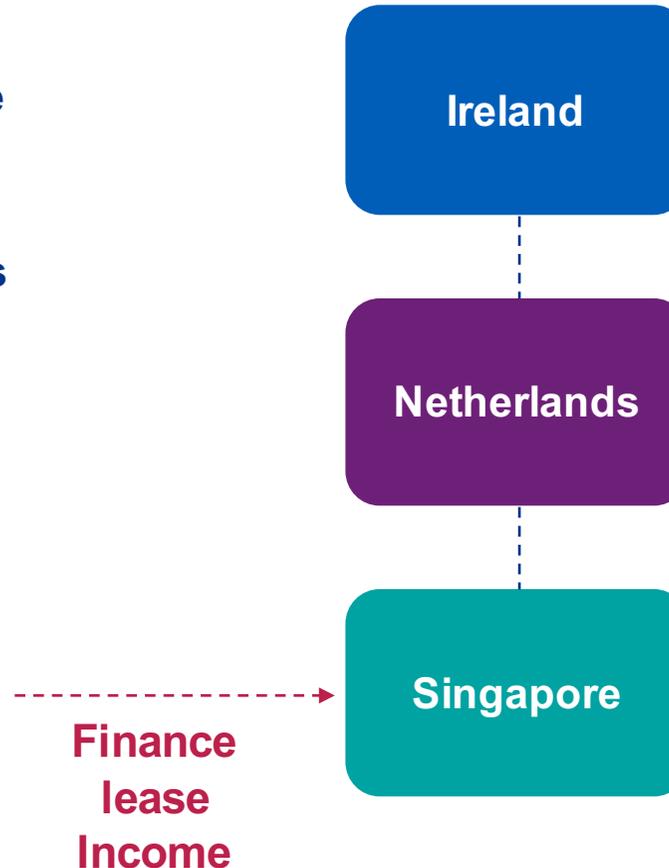


# Controlled Foreign Company (CFC) Rule

## Example 2

- ▶ Singapore earns finance lease income
- ▶ Singapore does not distribute
- ▶ Income would be taxed in Netherlands
- ▶ **Result: CFC Charge in Netherlands**
- ▶ **AND Income would be taxed in Ireland**
- ▶ **Result: CFC Charge in Ireland**

**Unless: Exception Applies (e.g. substantial economic activity test is applied to non-EEA)**



# Controlled Foreign Company (CFC) Rule

## Transactional Approach

- Non-distributed income from transactions
- Not “genuine” arrangements
- Essential purpose of obtaining a tax advantage



- Not own assets / undertaken risks
- Controlled by a company
- Significant people functions
  - Relevant to assets / risks
  - Instrumental in generating the CFC's income

# Controlled Foreign Company (CFC) Rule

## Optional Exclusions (Transactional Approach)



Accounting profits  $\leq$  €750K and  
non-trading income  $\leq$  €75K



Accounting profits  $\leq$  10% operating  
costs. Operating costs exclude:

- ▶ costs of goods sold outside CFC's  
country of residence
- ▶ payments to 25%+ associates

# Controlled Foreign Company (CFC) Rule

## Parent / Head-Office country tax rules

Proportional  
allocation of  
profits / gains

No deduction  
for CFC losses  
(carried  
forward)

Credit for taxes paid by CFC

Deduction  
against  
subsequently  
distributed  
income

Deduction  
against sales  
proceeds on  
disposal of CFC

# General Anti-Abuse Rule (GAAR)

## Ignore Arrangement

**Main  
Purpose: Tax  
Advantage**

**Defeats Object  
/ Purpose of  
Law**

**Not  
Genuine**

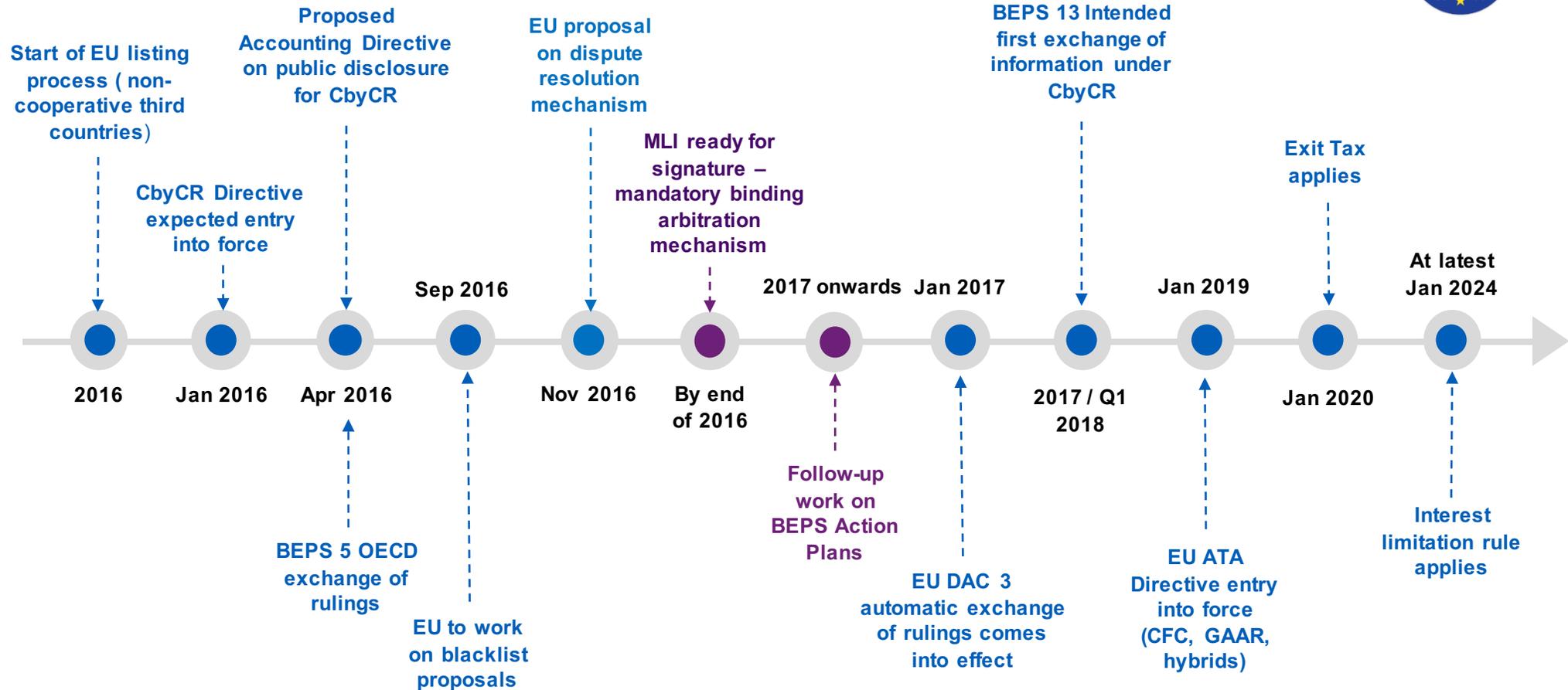
# Business Impact

	Interest Limitation	Hybrids	Exit taxation	GAAR	CFC
Leasing industry	●	●	●	●	●
	<ul style="list-style-type: none"> <li>Financial undertakings e.g. banks and insurance companies excluded BUT treatment of unregulated entities within a regulated group impacted</li> <li>Asset finance sectors will be impacted</li> <li>Orphans and securitisation vehicles will be impacted</li> <li>Could increase effective tax rate</li> </ul>	<ul style="list-style-type: none"> <li>Ireland has legislation addressing hybrid instruments</li> <li>No branch exemption in Ireland - reduces scope for foreign branch mismatches</li> <li>Limited impact for now - only covers intra EU hybrid structures</li> <li>Proposals for non-EU transactions issued in October 2016. Treatment of entities "checked open" for US purposes will be important</li> <li>Important that there is consistency in measures between OECD and EU</li> </ul>	<ul style="list-style-type: none"> <li>Ireland's current exit tax regime does not apply to companies <i>ultimately</i> 90% controlled by EU or tax treaty resident persons.</li> <li>A tightening of Ireland's exit tax regime may make it less attractive as a location.</li> <li>BUT, market value step up in tax basis for intra EU transfers not currently available in Ireland – may make it easier to move to Ireland.</li> </ul>	<ul style="list-style-type: none"> <li>Potentially limited impact given rule already closely aligned to Irish GAAR.</li> <li>Likely to be reluctance to introduce ATA Directive GAAR in Member States where local GAAR already in use and considered to meet minimum standard in Directive</li> </ul>	<ul style="list-style-type: none"> <li>Potential to reduce attraction of establishing regional HQ here (although might increase attraction compared to other EU countries)</li> <li>Applies to each EU parent - shareholdings may need to be changed. Impact on tax grouping</li> <li>CFC low tax test based on parent country income measure – differences in timing and availability of deductions could trigger low tax result</li> </ul>

# More to come?

EU	Other proposed measures including cross-border transparency on beneficial ownership, improving oversight of tax advisors and protection of whistle blowers.
OECD	Execution of Multilateral Instrument expected during 2017 to give effect to a number of the OECD BEPS recommendations. Discussion drafts issued on allocation of profits to PEs and other transfer pricing related matters.
EU	EU coordination on development of a “black-list” of non-EU jurisdictions in an effort to tackle perceived non-cooperative tax jurisdictions.
EU	Implementation of Directive on Administrative Cooperation (DAC3) – Automatic exchange of tax rulings to commence from 1 January 2017
EU	Introduction and implementation of Directive on Administrative Cooperation (DAC4) – Country-by-Country Reporting (closely aligned with OECD Action 13 Country-by-Country Reports)
EU	Introduction of Directive on Administrative Cooperation (DAC5) – providing tax authorities with access to national money-laundering information including beneficial ownership information for companies and trusts.
UK	Ongoing implementation of UK Diverted Profits Tax (DPT), expansion of scope of withholding tax and meaning of royalties, domestic anti-conduit treaty provisions, enactment of anti-hybrid mismatch measures, limitation on interest measures and proposals around publication of tax strategy for large businesses.

# Timeline: What to expect?





# International Development Assessing



# International Tax Developments in the Leasing Industry

- **Argentina**
  - Lessors required to provide “Anexo 2228” confirming that lessor does not have PE in Argentina.
- **Australia**
  - Abolition of New South Wales mortgage duty and South Australia stamp duty.
  - Changes to GST Act – to come into effect on 1 October 2016.
  - Australian MAAL– applies to ‘significant global entities’.
  - Changes to Australian thin cap rules.
- **Brazil**
  - Updated ‘blacklist’ which now includes Ireland.
  - ‘Rental agreement’ exemption from withholding tax no longer available on lease payments to Irish lessors - 25% Brazilian withholding tax applies.
  - May still be possible to claim ‘leasing agreement’ exemption where the relevant conditions are satisfied.

# International Tax Developments in the Leasing Industry

- **Korea**
  - Increased focus on beneficial ownership in applying treaty benefits.
- **Russia**
  - Changes to beneficial ownership rules – strict approach taken by Russian tax authorities.
- **Ukraine**
  - Ukrainian government considering implementing BEPS-style initiatives Ukraine from 1 January 2017.
  - Increased focus on beneficial ownership.
  - Initiatives include two additional tests for deciding on whether tax treaty relief should be applied – in particular, a “business purpose test” and a “substance test”.
  - Create issues in sub-leasing to Ukrainian carriers.

# International Tax Developments in the Leasing Industry

- **UK**

- Introduction of anti-hybrid mismatch rules.
- Potential impact for UK leasing intermediary structures where there is ultimate “hybrid” financing in the group.

- **US Model Treaty**

- New US Model Treaty has been released.
- Several new provisions to deal with treaty abuse.
- Ireland / US treaty being renegotiated.

# Apple case

- **EU Commission decision on State aid**
  - EU Commission issue decision that Ireland provided State aid to Apple.
  - Ireland instructed by EU Commission to recover up to €13bn (plus interest and penalties).
  - EU Commission explicitly stated that “this decision does not call into question Ireland’s general tax system or its corporate tax rate”.
  - No other companies are subject to this decision – particular to the facts of the case.
  - Ireland’s position – full amount of tax was paid in this case and no State aid was provided.
  - Decision will be appealed by both Apple and Irish government.

# Irish Tax Treaties

- **New treaties agreed**
  - Botswana (in effect 1 January 2017); Ethiopia (in effect January 2017); Pakistan (subject to ratification); Thailand; Ukraine; Zambia.
- **New protocols to existing treaties**
  - Belgium (subject to ratification); Germany; Luxembourg
- **Treaties being negotiated**
  - Azerbaijan; Ghana; Kazakhstan; Netherlands; Oman; Turkmenistan
- **Protocols being negotiated**
  - Mexico; South Africa



# Thank you



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