At the start of 2015, many groups will be planning any reorganisations they need to put in place over the next year. As ever, both tax and non-tax factors (commercial, regulatory, etc) will drive these reorganisations. On the tax front, I expect that five main factors are likely to prompt changes to group structures over the next few years.

1. PUBLICITY AND CBCR

Corporate tax has scarcely been out of the news for several years, and significant public pressure has been applied to the corporate tax practices of big business. For example, ActionAid published research in 2011 and 2013, listing the number of subsidiaries that FTSE 100 companies had in ‘tax havens’ (including, oddly, Delaware subsidiaries which were subject to US tax well above UK rates). In response, several groups have been dissolving entities in these territories, and avoiding the formation of new entities there if at all possible, so they can report a declining number of problematic subsidiaries when ActionAid updates its report.

Country by country reporting (CBCR), recommended by BEPS Action 13, has largely been seen by business as an administrative or compliance issue. Tax campaigners, in contrast, see it as a major shift in governments’ favour, which will make it easier to identify cases in which profits are generated by entities with limited substance and/or a low effective tax rate. Businesses should, unsurprisingly, be looking to respond either by shutting down these operations – or, conversely, by increasing their staff and activities undertaken there, so that existing profit allocations become easier to justify.

What’s the timing? CBCR will be included in a 2015 Finance Bill, enabling detailed CBCR regulations to be introduced, likely in late 2015 or early 2016. Given the additional reporting burden (extraordinarily, estimated by the Government to cost only £142.86 a year for each affected group), businesses should be preparing for CBCR in the early part of 2015 – both in administrative terms and by assessing how to deal with any problematic entities.

2. TOUGHER TAX TREATIES

In these pages, Jonathan Schwarz has recently analysed the BEPS treaty proposals in detail (‘BEPS treaty abuse-related actions’, Tax Journal, 12 December 2014). In short, these include: (i) applying both a US-style limitation on benefits article and a purpose test exclusion to treaties; (ii) extending the PE concept to cover commissionaires, warehouses and purchasing offices; and (iii) providing that dual-resident companies will not, subject to competent authority agreement, be entitled to treaty benefits.

If these changes are introduced in full-blooded form, many groups will need to adjust their international structures significantly. For example, IP-owning and finance companies in a different country from their ultimate parent may no longer be protected from withholding taxes, and companies which rely on a ‘place of effective management’ tie-breaker to deal with dual-residence issues could find themselves stripped of treaty protection.
What’s the timing? As recent BEPS publications have noted, there is still much to do in narrowing down the options for treaty change. For example, there are currently four different options for dealing with commissionaire structures. When (and if?) the BEPS project reaches a unanimous position on treaty changes, these will also need to be incorporated into countries’ existing tax treaties, which will take many years to do bilaterally. The proposal for a multilateral treaty implementing the BEPS changes is an ingenious attempt to accelerate this, but it will operate only between those countries which want to implement all of the BEPS treaty changes. Given the wide range of views here, it seems likely that many “hold outs” will still require bilateral treaty changes.

In short, this should be an area where tax directors can remain as interested spectators – for now.

3 ANTI-HYBRID RULES

Many UK groups have funded their US operations through ‘tower’ structures, which are treated as equity in the UK and as debt in the US. These have typically been protected from the UK’s arbitrage rules (TIOPA 2010 Part 6) on the grounds that the UK purpose test is not failed, as the right comparator should be vanilla equity funding. Less commonly, inbound funding to the UK has been provided in hybrid form, on the argument that the right comparator should be debt, such that the funding is again on the right side of the UK purpose test.

The anti-hybrid rules proposed in BEPS Action 2 – now endorsed by the UK government – will remove this purpose test from the arbitrage rules, ending the benefit from existing hybrid funding structures (except, broadly, for hybrid regulatory capital issued by financial services groups to third parties).

In light of this, many UK groups are now creating partially exempt finance companies, under Chapter 9 of the CFC rules, to provide debt funding to overseas affiliates at an effective tax rate of 5.25%. Following a restriction to these rules in FA 2014, they can generally be used only to provide new funding, rather than holding loans assigned in from the UK. (Whether this restriction complies with EU law is another matter.) There is, moreover, some tension between the partially exempt finance company rules and parts of the BEPS project. Businesses with this structure in place will be watching for any attack in the September 2015 BEPS deliverables.

What’s the timing? The UK will not implement the BEPS anti-hybrid rules until 1 January 2017, allowing two years in which to decide how to restructure any existing hybrid funding. Where groups want to establish a partially exempt finance company, it would be sensible to start providing funding through it as soon as possible, as the purpose test in TIOPA 2010 section 371H(9A) makes it difficult to move existing funding out of the UK (for HMRC’s view, see www.bit.ly/IySuvV).

4 DIVERTED PROFITS TAX

The rules on diverted profits tax (DPT) were discussed in the last edition of this journal (‘Diverted profits tax: give BEPS a chance’ (Heather Self) Tax Journal, 19 December 2014). How should groups which are worrying about DPT address it – other than by ordering a large stack of cold towels and struggling mightily to make sense of the legislation?

DPT issues obviously cannot be solved merely by moving corporate boxes around the group (unless, of course, you move those boxes to a higher tax jurisdiction). There are, however, four practical steps which can be taken at this stage.
The first step is to identify low-tax operations, as DPT applies only where there is an ‘effective tax mismatch outcome’. (‘Low-tax’ here means 80% of equivalent UK taxes, not the 75% threshold familiar from CFC legislation.) For the ‘economic substance’ charge, this assessment can be confined to affiliates transacting with the UK company in question; for the ‘avoided PE’ charge, the assessment should cover both the non-UK company selling into the UK, and any affiliates which transact with it.

Second, assess the transfer pricing position for the UK companies involved. The primary DPT remedy applies to the amount which should have been recognised, at arm’s length, as the profits of the avoided PE or the UK company involved. So, if the UK group members are already being properly rewarded for their contribution, there should be nothing to tax (subject to HMRC’s power, discussed below, to tax on a different basis in some cases). And, if the UK is being fully rewarded, it also seems difficult to say that the structure was designed to avoid a UK PE or to reduce UK corporation tax costs.

Third, review whether it could be ‘reasonable to assume’ that a different provision would have existed but for the tax mismatch. For example, would assets have been held in the UK, so that all of the profits from those assets could be apportioned to the UK? In this situation, the DPT rules allow HMRC to depart from the arm’s length standard, and to tax a hypothetical transaction which it is ‘just and reasonable’ to assume would have existed but for the tax mismatch. This is perhaps the most difficult part of the exercise, given the shortage of guidance so far on when it will be just and reasonable to assume a different transaction into existence – but it is better to start thinking about this now, rather than scrambling to react if and when HMRC raises it.

Finally, assess the level of substance in any relevant low-tax operations. Is there enough to offer protection under the ‘insufficient economic substance’ condition – or can sufficient substance be moved into the relevant operations?

**What’s the timing?** DPT will apply from 1 April 2015, so businesses which may be affected will want to assess their position, and begin any restructuring, over the next few weeks.

5 **STATE AID CHALLENGES**

The European Commission has recently made several high-profile challenges to tax rulings – specifically, to advance pricing agreements (APAs). The Commission argues that these departed from the arm’s length standard, and therefore conferred a ‘selective advantage’ which must be clawed back by the EU state concerned. (Paradoxically, this outcome would put significant additional profits into the ‘wrong’ jurisdiction in DPT terms. So the Apple case, say, would put more taxable profit in the Irish trading hub, rather than in the countries where Apple actually makes sales to customers.)

It is worth spending some time assessing any APAs or other rulings from EU states. Save for the most rickety rulings, however, it should be premature to jettison or restructure them. This autumn’s state aid challenges from the European Commission have a long way to run, and we understand that the countries involved will be defending their positions robustly. In particular, it seems far from clear that state aid rules empower the European Commission to act as an effective final court of appeal on transfer pricing for EU companies, not least as the judgment which the Commission prays in aid – *Belgium and Forum 187 v Commission* (C-182/03 and C-217/03) – involved a regime which ignored the arm’s length standard almost entirely. In cases merely of disagreement over the finer points of applying the OECD transfer pricing guidelines, it looks more difficult to identify the ‘selectivity’ prohibited by state aid rules.
**What’s the timing?** It should take several years to resolve these state aid challenges, so this is another area in which tax departments should be able to maintain a watching brief for now.

**CONCLUSION**

The continuing political and public spotlight on corporate tax means that group tax departments will have plenty to do in 2015. Despite the overwhelming coverage of the BEPS project, most BEPS changes will not come into effect until 2016 or later. The priority for many in early 2015 will be to grapple with their diverted profits tax position, and to prepare for the imminent introduction of CBCR.

**DOMINIC ROBERTSON**

T +44 (0)20 7090 3848
E dominic.robertson@slaughterandmay.com

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