Cristal Advocates

What is the future for tax planning?

Forward thinking

December 2018

1 Introduction

In the last decade or so, tax planning by multinational groups has moved from an obscure, minority interest to the subject of news headlines. The 2008 financial crisis focused media attention on the behaviour of multinationals, including their tax arrangements; governments which needed to raise tax revenues to finance bailouts began to examine the ways in which tax systems were being exploited to minimise tax; and information technology developments provided the means for journalists to gain access to massive amounts of previously confidential documents dealing with international tax structuring.

In the new environment, any existing or planned international structure is potentially subject to public scrutiny. But there is still a great deal of confusion about the conclusions that should be drawn from what is observed. For any one who is not a tax practitioner, it can be hard to see the difference between tax planning, tax avoidance and tax evasion. Many commentators choose to treat all three in the same way and the term 'tax dodging' has been used by activists to characterise a wide range of behaviours they deem unacceptable.

The purpose of this article is to shed some light on the differences between planning, avoidance and evasion and provide an overview of the various ways in which recent changes to the international tax system are tackling the challenges they present to tax authorities.

2 Overview of tax planning, avoidance and evasion

Tax evasion is characterised by deliberate actions to minimise tax for example, by concealing income, falsifying expenses, smuggling goods to avoid import taxes, or fraudulently claiming repayments of tax (particularly VAT). Most jurisdictions treat these activities as criminal offences and sanctions will often include imprisonment.

Tax avoidance, in contrast, relies on the tax legislation itself to minimise tax, for example by creating a legal form to characterize a transaction in a way that is non-taxable where in substance it is taxable. Cases of tax avoidance often involve the creation of complex chains of transactions purely to minimise tax, using legislation in a way not originally intended by the lawmakers. They do not rely purely on concealment of transactions from the tax authorities. Tax avoidance can be combatted by anti-avoidance legislation, such as section 91 of the Ugandan Income Tax Act, but it is not usually characterised as criminal activity.

Tax planning also utilises legislation to minimise tax, but the key difference from avoidance is that planning follows the intention of the legislation and does not involve arrangements which rely on form rather than substance to create a specific tax result. For example, a multinational might decide to establish a new manufacturing facility in a special economic zone where it would be eligible for a tax holiday and exemption from import taxes on imported raw materials and components.

Clearly there may be some blurring between the three, for example, very aggressive tax avoidance may rely on concealment of some parts of a transaction in a tax haven, and hence might be perceived as being not much different to tax evasion; tax planning involving special economic zones, with their tax benefits, has been heavily criticised as exploiting opportunities unduly favourable to powerful corporations to the detriment of the economic interests of the investee country and analogous to tax avoidance.

3 Base Erosion and Profit Shifting Initiative

In 2012 the G20 mandated a major effort to coordinate measures against what it termed Base Erosion and Profit Shifting ('BEPS') by which was meant the aggressive tax planning that was reducing tax revenue by shifting corporate profits into low or zero tax jurisdictions. The underlying rationale for this effort was that whilst most countries already had tough national legislation against tax avoidance, multinationals with activities across many countries were able to take advantage of the arbitrage between different tax systems to minimise their overall tax burden, because each subsidiary of a multinational group is normally treated as a separate taxpayer subject to tax on the basis that it deals with fellow subsidiaries on an arm's length basis. There was also a widely held view that competition between countries had resulted in a 'race to the bottom' enabling multinationals to relocate significant financial and intangible assets to very favourable tax jurisdictions in exchange for modest commitments to investment and job creation.

The result of the BEPS initiative was a programme of 15 actions designed to tighten up and more closely coordinate existing national and international tax rules to reduce the scope for tax avoidance and aggressive tax planning. This programme has been widely adopted by developed and developing nations, though there has been criticism that it does not adequately meet the needs of the latter group. This is perhaps not surprising: the BEPS programme was initiated by the G20 which is dominated by developed economies, and protection of their own tax bases was likely to be uppermost in their collective minds during the discussions preceding the launch. But it should be noted that the G20 also commissioned the OECD to prepare a report on the impact of BEPS on developing countries which was issued in 2014. The two-part report highlights the following BEPS issues as particularly important for developing countries:

a) Excessive payments to related parties related to loans, services and intangibles;
b) Supply chain structures designed to shift commercial risks and associated profits to low tax jurisdictions;
c) Difficulties in obtain information to enforce legislation, particularly transfer pricing rules;
d) Abuse of double tax treaties to obtain unintended tax benefits;
e) Use of offshore structures to avoid tax on gains related to assets located in the relevant jurisdiction; and
f) Pressure to implement wasteful tax incentives to attract investments.

Whilst most of these are covered in the 15 actions to combat BEPS developed for the G20, items 5 and 6 are outside the scope of the 15 actions and it was felt that developing countries would need support to implement the BEPS actions and address these additional issues.

Thus in 2016 a new body was established to assist developing countries to combat BEPS: The Platform for Collaboration on Tax which brings together the OECD, UN, World Bank and IMF. Since its establishment the Platform has engaged extensively with developing countries and produced several toolkits to assist them in implementing the BEPS actions and address their specific issues of capital gains on indirect transfers of assets and wasteful tax incentives.

4 Country by country reporting for multinationals

Another BEPS initiative which is seen as seen as particularly important for developing countries is Action 13 which introduces country by country reporting for larger multinationals. As implemented, this will require the parent company of a group to provide to the tax authorities where it resides certain information on its activities in each jurisdiction in which the group operates. The information will include details of revenue from related parties, tax payments, assets and employees. This information will then be available to be shared with other tax authorities under bilateral or multilateral tax agreements, including information exchange agreements. The purpose is to enable the tax authorities to identify anomalies (e.g. companies with significant financial assets and profits but minimal employees and tax payments) and carry out further enquiries to determine whether there is evidence of abusive transfer pricing. Whilst it is likely that most parent companies will be in developed countries, clearly this reporting will give tax authorities in developing countries opportunities to increase their knowledge of the global activities of the multinationals which are active in their jurisdiction and identify tax leakages.

5 Multilateral Convention

Another key development in combatting BEPS has been the implementation of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, usually abbreviated to the MLI. This was rolled out in June 2017 and is designed to provide a quick way for signatories to implement the key changes to their tax treaties in order to combat various forms of BEPS flowing from treaty abuse. To date, more than 80 countries, including a large number of developing countries, have signed the MLI, though Uganda has not yet done so (and in fact does not have a very large network of tax treaties in place).

The BEPS initiative is intended to enhance the ability of tax authorities to ensure that multinationals pay tax where their key activities take place and value is created. It reinforces the doctrine of 'substance over form' and the arm's length principle as a basis for taxation. It is an evolutionary rather than a revolutionary change in approaches to international taxation. Some commentators have suggested that this evolutionary approach is the wrong one to take and effectively the existing rule book for taxing multinationals should be ripped up and a completely new approach taken, which sets aside the fact that multinationals operate through numerous separate legal entities each of which is a separate taxpayer. The alternative approach suggests that for tax purposes the global profits of a multinational should be allocated between all the jurisdictions in which they operate, regardless of the corporate structures used, based on some standard metric such as turnover, payroll or assets. Advocates of this approach, referred to as 'unitary taxation' or 'formulary apportionment', have suggested that this approach would be simpler than the current system of taxing individual legal entities using the arm's length principle to determine the tax base. Whilst simplification is always attractive it is difficult to see how consensus could be built between countries on how to adopt this approach in practice and the cynical might suggest that attempts at tax simplification to date have generally resulted in more complexity rather than less!

6 Conclusion

So to come back to the question in the title of this document: what is the future for tax planning? A wise philosopher of my acquaintance, who happens to be head of the international tax department of a European multinational, summed up his role as follows: 'My job is to ensure that each item of income generated by this group is taxed no more than once, and that a tax deduction is obtained for each legitimate expense incurred.' Given the complexity of the international tax system that has evolved over the last century or so, that seems sufficient challenge to justify his role (and mine too). The BEPS initiative and the more intense public scrutiny of multinationals have emphasized that there is little future for tax avoidance that relies on concealment or arrangements that rely on form rather than substance to determine the tax consequences of transactions, however the complexity of the tax system still creates opportunities for income to be taxed multiple times in the hands of different legal entities within multinational groups and for expenses to be incurred which don't result in an effective tax deduction. Whilst this continues, tax planning remains a legitimate activity for multinationals.

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From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates. He had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

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