
BEPS - What are we headed for?

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With the BEPS^[1] (Base Erosion and Profit Shifting) project nearing its completion, it is time for the private sector and Stakeholders in general to get ready for the expected changes, whatever they will be.

We have entered into an era grounded on tax transparency, multilateral cooperation and information exchange.

In this scenario, Multinationals need not only warrant their “global consistency”, but should also understand their business environment, and be aware of any international tax development (at domestic/international level); they should also be able to have a good grasp of global trends (multilateral cooperation), while anticipating and assessing potential risk areas (and such transactions that tax authorities may be targeting), so as to avoid or limit tax audits and tax disputes, especially because tax disputes and tax audits are most likely to increase, after BEPS’ measures implementation.

As such, tax mitigation and the global structuring of MNEs groups will probably need to be revisited, since the number of risks has dramatically increased.

Ensuring economic substance is fundamental at this point in time.

Countries are urged to implement and comply with the suggested BEPS measures and it will be a challenge to see how the BEPS measures will interact with countries’ willingness to protect the competitiveness of their tax systems and their international commitment to fight tax avoidance and evasion.

Timing and consistency on implementation will be undoubtedly crucial for the success of the overall project.

Latest BEPS developments at EU and OECD level

Counteracting tax evasion and avoidance has become a top political priority at EU and international level due, to the severe financial crisis resulting from the weaknesses and misalignments of the international tax system dating as far back as the 1920s.

The rules – originally issued to prevent double taxation and to attract and facilitate companies operating cross-border – no longer seem to fit in today’ global reality and also because they probably contributed to the situations of double-non taxation that the BEPS project is attempting to eradicate.

It is now almost unanimous that the needed reform of the international tax principles may only be successfully and consistently implemented worldwide through international cooperation (avoiding any unilateral measures). The holistic approach adopted is the only acceptable one as it would be able to unravel the existent “puzzle” among national tax regimes and to help them work and cooperate together again in a joint effort to optimize efficiency levels.

At EU level, the main concern of the Commission is to review the current EU regulations framework and set forth a clear and effective framework for fair and competitive corporate taxation aligned with the global/borderless (and digital) economy that necessarily needs to take into due consideration respect for Treaty Freedoms, specificities of the internal market and the EU framework. The goal is that every single company must contribute with its share of tax in the same place where profits are realized and to have more growth-friendly tax systems in Europe.

Since the release, in December 2012 (prior to the publication of the OECD BEPS Report), of the E.U. Action Plan^[2] to counteract tax avoidance and evasion, considerable progress has already been made in specific areas.

In 2014, the main actions carried out focused on revising EU corporate tax rules, addressing digital taxation, and tackling harmful tax regimes (some of the developments include: revision of the Parent-Subsidiary Directive to prevent mismatches in national tax regimes; establishment of an Independent Expert Group to discuss the need of reform in the digital economy and investigations to tax rulings that have been formally opened as well as further work on Patent Boxes under the Code of Conduct on Harmful Business Taxation).

Recently, on 27 May, 2015, the EU Commission discussed a new approach to corporate taxation and new measures that could properly respond to tax abuses and limit aggressive tax planning, to ensure sustainable revenues and a level playing field in the internal market.

A new EU Action Plan is expected to be released before the Summer and it will probably include specific



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measures to ensure that profits in the Single Market are taxed where value is generated, including also a re-launching of the Common Consolidated Corporate Tax base – CCCTB and further guidance on the implementation of the BEPS measures that are being prepared in coordination with the OECD/G20.

With regard to EU efforts to reinforce tax transparency and to discourage companies from using rulings to shift profits and avoid taxes, back in March this year, the EU Commission enacted a package of measures [3] set to improve tax transparency in the internal market. These measures are intended to enhance cooperation between/among tax authorities and include an automatic exchange of information on cross-border tax rulings by Member States [every three (3) months].

Notwithstanding specific EU measures to fight tax avoidance in Europe, the EU has also been contributing and is actively involved in the OECD's work on the BEPS Action Plan.

The EU Action Plan addresses areas that are also included in the OECD BEPS project, such as: increase of automatic information exchange to include all forms of financial income and account balances; enhancement of regulations against aggressive tax planning; creation of a Platform for Tax Good Governance to assist the Commission in developing initiatives to promote good governance in tax matters in third countries, to tackle aggressive tax planning and to identify and address double taxation; establishment of a high-level group to study digital economy related-issues; review measures and current framework to prevent harmful tax competition; potentially increase corporate transparency by introducing country-by-country reporting.

Taking into account the specificities of the internal market and EU commitments at international level, the implementation of the OECD recommendations in the European Union is most likely to require some further adjustments to ensure observance of Treaty Freedoms.

The Commission assures that the new and forthcoming EU coordinated measures to counteract tax avoidance and evasion are not intended to penalize legitimate business, nor do they intend to either create uncertainty, or additional disproportionate administrative burdens for EU companies, as their purpose is to reduce barriers within the internal market, and ensure a level playing field for EU companies in Europe and abroad (while avoiding that unilateral initiatives be carried out by Single Member States).

Progress made at **international level** (OECD/G20) is truly remarkable. Starting with the number of Countries involved, i.e., both, developed and developing States acting on an equal footing, as well as any initiatives launched to consult with all interested Stakeholders, including the ambitious timeline set for the entire project.

The final OECD package for BEPS measures is scheduled to be delivered in November, during the G20 Leaders Summit.

The Stakeholders' consultation has been progressing rapidly – several discussion drafts have been released in 2014 and 2015, and different public consultations have taken place in each of the specific actions [4] of the OECD Action Plan[5].

Back in February 2015 this year, agreement was reached by OECD and G20 countries with regard to three important elements for the implementation of the BEPS Project which were included within the so-called "implementation package". It provides for: a) a mandate to launch negotiations on a multilateral instrument to allow a consistent implementation of tax treaty-related BEPS measures; b) guidance on country-by-country reporting and exchange of information; and c) agreement on the criteria to assess whether preferential treatment regimes for intellectual property (patent boxes) are harmful or not.

On 16 September 2014, the OECD issued expected first seven BEPS deliverables which were endorsed by G20 Finance Ministers at their meeting in Cairns (Australia) on 21 September 2014: the said deliverables included measures to help Countries ensure coherence of corporate income taxation at international level, restore the intended effects and benefits of international standards, and improve transparency, as well as improve certainty and predictability of the international framework.

The above Deliverables include:

two final reports on respectively, Action 1 (Report on tax challenges raised by the digital economy and necessary actions to address them) and on Action 15 (Report on the feasibility of developing a multilateral instrument to implement the measures developed in the course of the work on BEPS); and one interim Report on Action 5 (Harmful Tax Competition); as well as Four Draft Rules, respectively: Action 2 (Report on domestic and tax treaty recommended measures to neutralize the effects of hybrid mismatch arrangements); Action 6: (Report on treaty abuse related matters); Action 8: (Report on transfer pricing aspects of intangibles with a new chapter to be added to the OECD Transfer Pricing Guidelines); Action 13: (Report covering revised standards for transfer pricing documentation and a template for country-by-country reporting). An Explanatory Statement was also prepared to summarize the main contents of each deliverable. These seven deliverables have not been finalized yet due to any potential interaction with the work done within the remaining Actions (2015 deliverables).

The measures and guidance enacted so far are clear evidence that the BEPS Project [6] is progressing within the ambitious timeline set by the OECD. The suggested measures released until now, combined with the ones that should be released this year will contribute to eliminate double non-taxation due to base erosion and profit shifting, and to ensure that profits are taxed where economic activities engendering those profits are carried out and where value is created. Aim of the new framework is to provide stakeholders with clarity and certainty, while reducing international disputes (or improving existent mechanisms to settle such disputes).

More recently, and also in view of the preparations for the forthcoming implementation phase, the G20 held a symposium in Turkey to discuss the current state of agreements reached, any open points and guidance already released. The main issues on developing countries and their impact in their economies were also addressed. The symposium counted participants from 60 different countries and was divided into eight panels:

1. The G20 Tax Agenda: Shaping The New International Tax Environment;
2. Addressing BEPS in The Digital(ised) Economy: Artificial Avoidance of PE Status, Transfer Pricing,

- CFC Rules, Collection of VAT and Potential Options To Address Broader Tax Challenges;
- 3. Contributing to Financial Stability: The BEPS Work on Interest Deductibility and Hybrid Mismatch Arrangements;
- 4. Aligning Tax Rules to the Reality of Global Value Chains: The BEPS Work on Transfer Pricing and its Relevance for Developing Countries;
- 5. The Economists' perspective on BEPS: Data, Economic Analyses and Spill-Over Effects;
- 6. Implementing the International Consensus on BEPS with Practical and Effective Rules: Domestic Laws, Multilateral Instrument and Toolkits
- 7. From Bank Secrecy to Automatic Exchange of Information: Key Issues Related to Implementation;
- 8. Developing Countries and Automatic Exchange of Information: How to Benefit and Comply with the New Transparency Requirements on Bank Information.

The main considerations were made by participants in connection with implementation and the need of consistency in such implementation among countries, to avoid a second "BEPS wave" or the increase of uncoordinated unilateral measures.

The launching of a peer review on the BEPS Action Plan's implementation was suggested by the OECD in order to contribute to the required monitoring on implementation, while it was also confirmed that the OECD will continue providing guidance in the future.

Developing Countries' representatives at the meeting agreed that a multilateral instrument to amend the network of existing bilateral tax treaties might be an efficient tool for both, developing and developed countries, but stressed that there was still a lot of work needed in this area. From the side of the business world, three key issues were particularly stressed to ensure successful implementation: coordination among countries, clarity and predictability of the suggested measures, and consistency of interpretation.

With regard to the digital economy, the collection of VAT was suggested as an option to address the specificities of the digital economy, and it was emphasized that for the sake of clarity, precise definitions should be provided (e.g., "digital presence").

In the transfer pricing area, special emphasis was given to the importance of having a clear analytical framework on re-characterisation and non-recognition due to the potential increase of disputes in this area.

It was also confirmed that the recommendations on hybrid mismatches will include both treaty changes and domestic law recommendations.

In the area of automatic information exchange, the resolution was adopted that the Common Reporting Standard (CRS) is the standard to be applied worldwide and that further implementation measures on country-by-country reporting are being prepared.

Will countries still be able to compete among themselves in this new BEPS Scenario?

Taxation is a matter of countries' sovereignty.

The BEPS Action Plan is not aimed at limiting such prerogative, but rather at restoring and strengthening countries' taxing rights by ensuring that they can safeguard their tax bases from the economic activities that generate them - countries will continue to be free to set up and design their own corporate tax systems.

However, harmful tax competition is a matter of great concern, since it can distort the market and create an unlevelled playing field among businesses operating domestically and those operating globally and can create undue benefits (from preferential tax regimes).

Action 5 of the BEPS Action Plan specifically addresses the topic and re-vamps the work that the OECD has been following ever since 1998 (OECD Report on Harmful Tax Competition). These Actions focus on "Countering harmful tax practices more effectively, taking into account transparency and substance", with a narrow focus on "improving transparency, including a compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime".

The EU is also focusing on this particular area of concern - in its Code of Conduct on Harmful Tax Competition (and more recently on occasion of the EU Platform for Tax Good Governance) - to support Countries in finding the right practices to ensure fair competition and reduce tax-related distortions.

Under the BEPS initiatives, both, the EU and the OECD are analyzing the existing criteria to identify any harmful tax regimes/practices and are proposing to supplement such key criteria with a new one, i.e., "activity nexus approach/test" (substantial activity test), which would be most useful.

One of the ultimate BEPS goals is to eliminate preferential tax regimes lacking an authentic rationale, however, the new BEPS set of measures should not keep taxes from being used for non-fiscal purposes (e.g., R&D incentives).

In the worldwide BEPS context, tax incentives should be granted if the following requirements are met: they are a legitimate outcome of a policy decision, grounded on a legitimate justification, ensuring transparency of its goals, where the possibility of abuse to exploit any such benefit is limited.

EU and OECD are awaiting measures to be released in 2015, which will certainly add further developments to the topic.

Concluding Remarks

The outcome of the BEPS Action Plan is still unclear, although even the greatest skeptics agree that BEPS-related measures will be soon implemented by most countries worldwide, or at least by the vast majority.

As such, it is crucial that companies prepare in advance for the anticipated changes, so as to minimize any potential risk, especially because there is now a wider base of stakeholders that companies need to

respond to (far beyond the scope of Tax Authorities). Reputation, increased global compliance and the tax affairs of companies made news headlines. Therefore it is critical that tax be dealt with by moving it to the boardroom.

Some of the expected and desired outcomes of the BEPS Action Plan will probably include a decrease of double taxation as well as of double non-taxation situations; it will (or it should) create greater certainty and consistency in applying tax rules; ensuring an alignment of taxable profits with substance; the arm's length principle will be preserved; harmful tax practices will be limited; unilateralism will be averted and taxpayers' confidentiality ensured. And, at last, the public trust in the international tax system will be re-instated.

The key for the success of the project? Balance, mutual cooperation, and consistency.

"So what we need to do is fix the rules and develop better co-operation. And if we do that we put an end to double non-taxation.

[But] we need to be balanced. Double taxation is bad [and] multiple taxation is worse because that will harm cross-border investment. And that is what we need, for growth and for employment". [7]

[1] The acronym "BEPS" (Base Erosion and Profit Shifting) was defined by the OECD by making reference to "tax planning strategies that exploit gaps and mismatches in tax rules to make profits "disappear" for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall tax being paid. (<http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>)

[2] COM(2012) 722 includes short and long-term measures on how to fight abusive behaviors.

[3] COM(2015) 136; for further insights see: http://ec.europa.eu/taxation_customs/taxation/company_tax/transparency/index_en.htm

[4] Action 1 - Addresses the tax challenges of the digital economy; Action 2 - Neutralising the effects of hybrid mismatch arrangements; Action 3 - Strengthening CFC rules; Action 4 - Limiting base erosion via interest deductions and other financial payments; Action 5 - Countering harmful tax practices more effectively, taking into account transparency and substance; Action 6 - Preventing Treaty Abuse; Action 7 - Preventing artificial avoidance of PE status; Action 8, 9 & 10: Assuring that transfer pricing outcomes are in line with value creation for intangibles, risks & capital, and other high-risk transactions; Action 11 - Establish methodologies to collect and address data on BEPS and actions to address it; Action 12 - disclosure of their aggressive tax planning arrangements; Action 13 - Re-examine transfer pricing documentation; Action 14 - Make dispute resolution mechanisms more effective; Action 15 - developing a multilateral instrument.

[5] The action Plan includes 15 Actions devoted mainly to restore international consistency in corporate income taxation to complement current standards to avoid double taxation with a set of instruments designed to counteract double non-taxation; align taxing rights with substance; improve transparency.

[6] The OECD BEPS Report was released in February 2013 by the OECD with the purpose of providing governments with clear international solutions for counteracting corporate tax planning strategies that take advantage of the gaps and loopholes existing in the current tax framework to artificially "re-locate" profits to locations where they are subject to more favorable tax treatment (to avoid/limit: double deductions; deductions coupled with non-taxation; artificial separation of taxation from income generating activities), and to curb harmful tax competition or specific tax policies set by national governments.

Its ultimate aim is supporting countries to re-shape their tax systems efficiently and in a coordinated way, and to promote international transparency and exchange of information.

[7] Pascal Saint-Amans (<http://www.bbc.com/news/business-32730305>)