

BDI – The Voice of German Industry

The Federation of German Industries

**The OECD BEPS-Action Plan;
Final reports and recent developments**

Ralph Brügelmann, Tax and Financial Policy

May 18th 2017

The OECD/G20 BEPS Action Plan

A long process

- In 2013 the OECD published the “Action Plan on Base Erosion and Profit Shifting”
 - 15 separate action points
- During 2015 the OECD published the final reports
- G20 finance ministers agreed upon the results at their meeting in Lima/Peru on October 8th 2015

- The OECD considers the cooperation of all OECD/G20 countries in the development of changes to the international tax environment in itself a significant achievement of the Project

OECD Action Point 1

Addressing the Tax Challenges of the Digital Economy

- The digital economy is increasingly becoming the economy itself
- Therefore it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes
- While the digital economy and its business models do not generate unique BEPS issues, however, according to the OECD some of its key features exacerbate BEPS risks
 - Definitions and exceptions of PE, transfer pricings, CFC rules

OECD Action Point 2

Neutralising the Effects of Hybrid Mismatch Arrangements

- The OECD recommends both, improvement of
 - The improvement of national rules, e.g.
 - denial of dividend exemption under specific circumstance
 - prevent hybrid transfers being used to duplicate credits for taxes withheld at source
 - Introduce/alter CFC rules to tax hybrid entities under the laws of the investor jurisdiction
 - Restrict the tax transparency of reverse hybrids
 - Harmonization of nation tax codes to prevent the exploitation of different definitions
 - Deduction without inclusion
 - Double deduction
 - Indirect deduction without inclusion → imported hybrid mismatches

OECD Action Point 3

Designing Effective Controlled Foreign Company Rules

- Definition of a CFC → control (legal/economic)
- CFC exemptions and threshold requirements → (absolute) minimum amount, low tax jurisdiction
- Definition of income → active/passive income; positive/negative definition
 - Dividends?
 - Substance carve out
- Computation of income
 - Which jurisdiction's rules should apply; are any specific rules for computing CFC income necessary?
- Attribution of income → to which taxpayer shall be attributed how much income, mostly control related
- Prevention and elimination of double taxation

OECD Action Point 4

Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

- OECD best practise approach
 - De minimis monetary threshold → remove low risk entities
 - Fixed ratio rule
 - Group ratio rule
 - Carryforward of:
 - Disallowed interest
 - Unused interest capacity
 - Additional targeted and specific rules

OECD Action Point 5

Countering Harmful Tax Practices More Effectively

- Countering preferential regimes
 - Mostly IP and risk related
- OECD modified Nexus Approach
 - Substantial activity required → cost based; qualified expenditure
 - Uplift
- Not part of directive EU 2016/1164 ATAD
- But Code of Conduct Group monitors the implementation of the Nexus Approach in EU Member States

- Improving transparency of tax rulings related to preferential regimes → DAC 3

OECD Action Point 6

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

- Various amendments of the OECD Model Convention to prevent treaty shopping:
 - A clear statement that the Contracting States wish to prevent tax avoidance
 - An anti-abuse rule based on the limitation-on-benefits (LOB) provisions (following e.g. US-treaties)
 - A more general anti abuse rule based on the principal purposes of transactions (principal purpose test)
 - To be taken up in the OECD Model Convention
 - Clarification that tax treaties are not intended to be used to generate double non-taxation

OECD Action Point 7

Preventing the Artificial Avoidance of Permanent Establishment Status

- Avoidance of commissionaire arrangements
 - No taxation of the commission of an agent instead of taxation of the profits derived from the sales
- Overhaul of Art. 5 paragraph 4 OECD Model Tax Convention
 - Restricting the specific activity exemptions according to which a permanent establishment is deemed not to exist
- Preventing splitting up of contracts
 - With respect to the 12 month period in Art. 5 paragraph 3

OECD Action Points 8 – 10

Aligning Transfer Pricing Outcomes with Value Creation

- Action 8: Transfer pricing issues relating to transactions involving intangibles
- Action 9: Contractual allocation of risks
- Action 10: Profit allocations resulting from transactions which are not commercially rational
- Revision of the OECD Transfer Pricing Guidelines:
 - To Section D of Chapter I
 - Prevent BEPS by transferring risks among, or allocating excessive capital to, group members
 - Prevent BEPS by engaging in transactions which would not occur between third parties
 - Commodity transactions
 - Comparable uncontrolled price (CUP) method can be regarded as an appropriate transfer pricing method
 - Can be reference to determine the arm's length price; reasonably accurate comparability adjustments possible

OECD Action Points 8 – 10

Aligning Transfer Pricing Outcomes with Value Creation

- Revision of the OECD Transfer Pricing Guidelines:
 - Revisions of the guidance on the transactional profit split method
 - Selection of the most appropriate transfer pricing method even in the absence of information on reliable, comparable uncontrolled transactions
 - Understanding value chains in the context of controlled transactions
 - Determining arm's length conditions for transactions that involve the use or transfer of intangibles under Article 9 of the OECD Model Tax Convention
 - Legal ownership of intangibles does not necessarily determine the entitlement to returns from the exploitation of intangibles
 - Associated enterprises performing important value-creating functions related to the development, maintenance, enhancement, protection and exploitation of intangibles can expect appropriate remuneration
 - An associated enterprise assuming a risk must exercise control over the risk and have the financial capacity to assume the risk

Aligning Transfer Pricing Outcomes with Value Creation

- Revision of the OECD Transfer Pricing Guidelines:
 - Section D on low value-adding intra-group services
 - Specifying common intra-group services with limited profit mark up
 - Developing a consistent allocation key for recipients of those intra-group services
 - Providing greater transparency
 - Guidance on the analysis of cost contribution arrangements (CCA)
 - No circumvent of the new guidance on the application of the arm's length principle in relation to transactions involving the assumption of risks, or on intangibles by contractual arrangements → delineating the actual transaction

OECD Action Point 11

Measuring and Monitoring BEPS

- There exists no consensus among economists what economic activity generates profits (R&D, production, sales)
 - Unclear where profits are generated
- Six BEPS indicators:
 1. Concentration of high levels of foreign direct investment (FDI) relative to GDP
 2. Differential profit rates compared to effective tax rates
 3. Differential profit rates between low-tax locations and worldwide MNE operations
 4. Effective tax rates of large MNE affiliates relative to non-MNE entities with similar characteristics
 5. Concentration of high levels of royalty receipts relative to research and development (R&D) spending
 6. Interest expense to income ratios of MNE affiliates in high-tax locations
- Indicators 2-4 and 6 are calculated from MNE, firm-level financial information from the ORBIS database
- Indicator 4: On average, large MNE affiliates had ETRs that were 3.3 percentage points lower than comparable non-MNE entities.

OECD Action Point 11

Measuring and Monitoring BEPS

- Estimation of BEPS: Disentangling real economic activity across countries from BEPS related activity
- Two BEPS Channels:
 - A global estimate of the revenue loss from BEPS based on analysis of profit shifting due to tax rate differentials
 - A global analysis of differences in effective tax rates between large MNE affiliates and comparable domestic companies reflecting mismatches between tax systems and tax preferences. (Indicator 4)
- The combination of the two effects results in estimates of the net global corporate tax revenues lost from BEPS at 4-10% of corporate tax revenues, or USD 100-240 billion at 2014 levels
- revenues takes into account a 95% confidence interval
- OECD assumption: The upper bound assumes that firms outside the sample have a 50% higher tax planning intensity than firms in the sample! This reflects:
 - Different degrees of coverage (Europe: Good (>50%); Non-Europe: Poor (<10%))
 - The tax planning intensity of firms in the sample located in poor covered countries shall represent the tax planning intensity of all firms in these countries

OECD Action Point 12

Mandatory Disclosure Rules

- The OECD does not set up rules for mandatory disclosure of information but discusses how mandatory disclosure schemes with respect to aggressive tax planning could be designed; design principles:
 - Mandatory disclosure rules should be clear and easy to understand
 - Mandatory disclosure rules should balance additional compliance costs to taxpayers with the benefits obtained by the tax administration
 - Mandatory disclosure rules should be effective in achieving the intended policy objectives and accurately identify relevant schemes
 - Information collected under mandatory disclosure should be used effectively
- Disclosure to tax authorities, not to the public!

OECD Action Point 13

Transfer Pricing Documentation and Country-by-Country Reporting

- Objectives of transfer pricing documentation requirements:
 - Ensuring that taxpayers give appropriate consideration to establishing transfer prices
 - Information necessary for tax authorities to conduct an informed transfer pricing risk assessment
 - Information needed for tax authorities to conduct an appropriately audit of the transfer pricing practices
- Master file: Overview of the MNE group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity
- Local file: Information relevant to the transfer pricing analysis related to transactions taking place between a local country affiliate and associated enterprises in different countries and which are material in the context of the local country's tax system
- Aggregate tax jurisdiction-wide information related to the global allocation of the income, the taxes paid, and indicators of the location of economic activity among tax jurisdictions in which the MNE group operates

OECD Action Point 14

Making Dispute Resolution Mechanisms More Effective

- Minimum standard e.g. access to MAP, resolving procedure, clarify interpretation and application of the convention
- Best practise standard includes both: Double taxation agreements and national legislation
 - E.g Art. 9 (2): Appropriate adjustment if profits are in accordance with the arm's length principle
 - Publish agreements reached
 - Participation in the Forum on Tax Administration's (FTA) MAP Forum
 - Implement bilateral APA programmes
 - MAP assistance with respect to recurring issues (not only a single tax year)
 - Suspension of tax collections procedures while a MAP case is pending
 - Guidance on possible interest and penalties in the mutual agreement procedure

OECD Action Point 15

Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

- The implementation of the OECD BEPS recommendations requires the renegotiation of almost all double taxation agreements
- Developed of a multilateral instrument to implement measures in the course of the work on BEPS and modify bilateral tax treaties
 - Voluntary participation
 - Equal participation
- Amendment of a bilateral treaty only if both countries participate/agree to the outcome

Implementation of OECD Action Points

Minimum Standard

- Action point 5 – Countering Harmful Tax Practices More Effectively
- Action point 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- Action point 13 – Transfer Pricing Documentation and Country-by-Country Reporting
- Action point 14 – Making Dispute Resolution Mechanisms More Effective

Recent developments

Discussion draft on BEPS Action points

- Discussion drafts were published when further clarification of BEPS action points seemed to be needed:
 - BEPS AP 2 – Hybrid mismatches; branch mismatch structures
 - BEPS AP 4 – Interest deduction; group ratio rule
 - BEPS AP 7 – Avoidance of PE status; Additional Guidance on the Attribution of Profits to PEs
 - BEPS AP 8 – 10 Transfer pricing; revised guidance on profit splits
 - BEPS AP 8 – 10 Transfer pricing; chapter IX TGP (business restructuring; profit potential)
 - BEPS AP 13 – Update on guidance on implementation of CbCR (April 2017)
 - BEPS AP 15 – Multilateral Instrument to Modify Bilateral Tax Treaties
 - BEPS AP 5, 13, 14 – Peer review documents
- Nov 24th 2016: AP 15 – adoption of the multilateral convention

Recent developments

New legislation / legal actions

- EU:
 - December 8th 2015 (EU) 2015/2376 – DAC III; automatic exchange of tax rulings in the EU (AP 5)
 - 2015/2016 DG COMP investigations in state aid (e.g. Fiat, Starbucks, Apple, Belgium excess profits)
 - Aligning transfer pricing with value creation (AP 8 – 10) by the backdoor
 - May 25th 2016 (EU) 2016/881 – DAC IV; country-by-country-reporting in the EU (AP 13)
 - July 19th 2016 (EU) 2016/1164 – anti-tax-avoidance directive 1 (ATAD 1) (AP 2, 3, 4)
 - October 25th 2016 (October package) – proposals for: ATAD 2; a common (consolidated) corporate tax base (CCCTB) and directive on double taxation dispute resolution mechanisms in the EU
 - February 21st 2017 political agreement in the ECOFIN Council on ATAD 2 (AP 2)
- OECD:
 - January 2017 – 57 MCAA signatories – but USA is still missing
- Open question: Design of the announced US tax reform?
 - Implementation of OECD-BEPS action points; Destination based cash flow tax; Other solutions?

Thank you!

Ralph Brügelmann

Senior Manager

Tax and Financial Policy

Rue Marie de Bourgogne 58, 1000 Brussels

Tel.: +32 2 792-1012

E-Mail: r.bruegelmann@bdi.eu