

BASE EROSION & PROFIT SHIFTING

Harnessing Synergies Towards
Sustainable Growth

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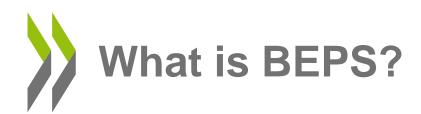
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Base Erosion and Profit Shifting (BEPS)

- > What is BEPS?
 - > Tax sovereignty, tax treaties and globalisation
 - The rise of double non-taxation and stateless income
 - > The need for a global response
- ➤ OECD/G20 BEPS Action Plan
 - > 2014 Deliverables
 - > 2015 Deliverables



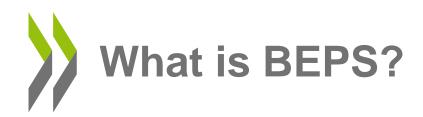
Background

- Increased scrutiny on many high profile companies
 - Parliamentary and Congressional enquiries
- > Generally, these cases have not involved illegal or unlawful conduct
 - Raises questions about the effectiveness of the international taxation rules
- Against the backdrop of fiscal policies of austerity and consolidation
- Governments and citizens demand action



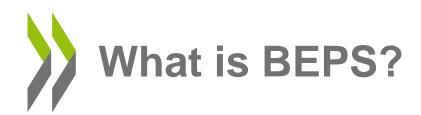
The pre-eminence of Tax Sovereignty

- > Need to understand the historical context
- > Pre-eminence of tax sovereignty
 - > Every nation has the sovereign right to tax
- ➤ As commerce becomes more global and involves cross border trade conflicts between the taxing rights of states have increased
- > This can lead to double taxation



The rise of the Tax Treaty

- ➤ Need to avoid double taxation not a new challenge
 - ➤ In the 1920s the League of Nations identified commissioned a panel of economists to advise on how to deal with the challenge of double taxation
- > First model tax treaty comes into existence in 1928
- ➤ The OECD's work over the years has been focused on making sure that countries adopt and adhere to these treaties to facilitate cross border trade while minimising double taxation



Globalisation

- > MNEs represent a large proportion of global GDP
 - > Intra-firm trade represents a growing part of overall trade
 - > Shift to global operating models based on matrix management organisations and integrated supply chains
- ➤ Growing importance of services in the global economy
- ➤ the increasing centrality of intellectual property to value-creation



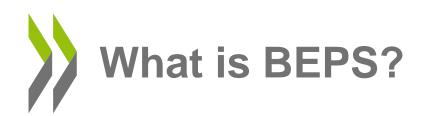
A system under pressure

- ➤ Over time, MNEs have identified and taken advantage of some of the gaps that exist between the domestic tax laws and tax treaties
 - > Treaties are negotiated on a bilateral basis and there are more than 3,000 of them in existence today
- ➤ Rules designed to prevent double taxation are now facilitating:
 - ➤ Double non-taxation
 - ➤ Less than single taxation
 - > Stateless income



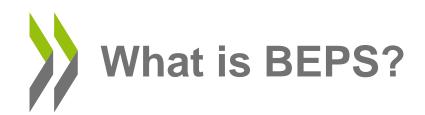
A system under pressure (continued)

- ➤ These strategies are collectively referred to as BEPS and generally involve:
 - > Separating the location where profits are reported from the location where the actual economic activity or value creation occurs
 - > Shifting costs into high taxing countries and shifting profits into low taxing countries
 - > Some elements of the digital economy have exacerbated some of these problems in the international tax system, especially the rise of intangible assets



Consensus-based international framework at risk

- Framework no longer fully meets its objectives of allocating taxing rights between countries on the basis of where companies operate
- > The current situation creates an uneven playing field
 - > Especially for businesses that are not MNEs
 - > Leads to distorted allocation of resources
- ➤ These flaws in the current system undermine the sovereign right of countries to set tax policy



Consensus-based international framework at risk (continued)

> Tax results that comply with the technical tax rules but fail the common sense test have resulted in increased litigation

Growing threat of unilateral action

➤ As a result of this growing concern over BEPS activities, many countries have considered 'unilateral' action to protect their tax bases



The BEPS Action Plan

The BEPS Action Plan

- > 15 point Action Plan
- Endorsed by the G20 Leaders at their meeting in St Petersburg, September 2013
- OECD and G20 working together on an equal footing
 - > OECD Member and accession countries
 - > G20 countries
 - ➤ In consultation with developing, non-OECD and non-G20 countries



The BEPS Action Plan

- ➤ The BEPS Action Plan is focused on achieving a better alignment between:
 - > the location of taxable profits; and
 - the place where economic activities and value creation occurs
- ➤ A key focus of the BEPS Action Plan is to eliminate double non-taxation, while avoiding double taxation



The BEPS Action Plan

- > Secure revenues and protect tax bases
- ➤ Improve integrity of international tax rules by creating a single set of consensus-based rules
 - Must act quickly to prevent the unravelling of the existing consensus-based international tax framework
- Provide greater certainty and predictability to taxpayers
- Need to avoid unnecessary compliance burdens and restrictions on legitimate cross border activity



The BEPS Action Plan - Approach

- ➤ OECD/G20 Project OECD countries working with G20 nations on an equal footing
- ➤ The OECD strives to be consultative and transparent working with:
 - Business (including through BIAC)
 - ➤ Labor (including through TUAC)
 - Civil society organisations and
 - > academic researchers



The BEPS Action Plan - Approach

- For example, over the last 12 months the OECD has:
 - Released numerous discussion drafts and received more than 3,500 pages of comments
 - > Held 5 major public consultations
 - The OECD's public webcasts of these consultations and our updates have attracted over 10,000 viewers
- ➤ The work of the OECD is done entirely by consensus

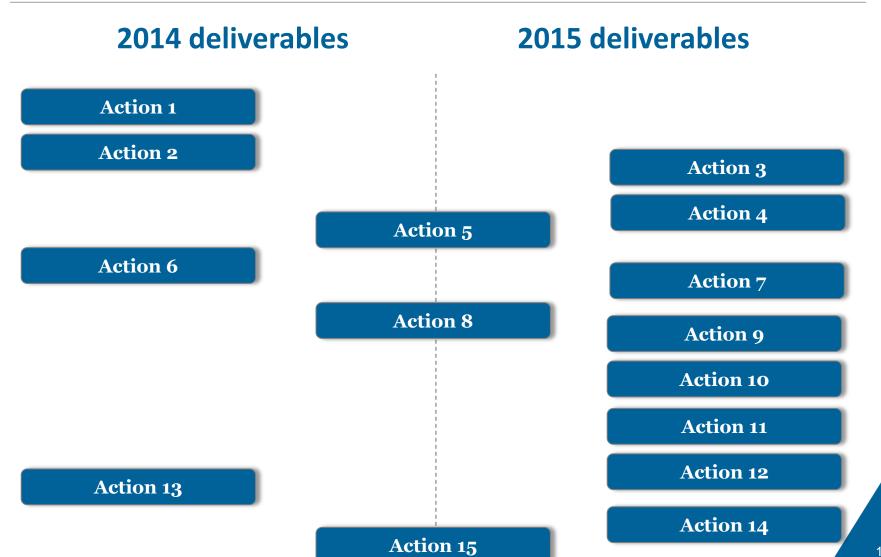


The BEPS Action Plan - Timeline

- ➤ G20 Leaders have adopted an ambitious timeline for the BEPS Action Plan:
 - ➤ 2014 deliverables 7 Actions
 - > 2015 deliverables 8 Actions
- ➤ OECD developing detailed plans for implementation of the 15 Actions
- ➤ All actions due to be completed by December 2015



The BEPS Action Plan - Timeline





- ➤ Action 1 Digital economy
 - ➤ To address the tax challenges of the digital economy
 - ➤ What is the digital economy?
 - Are there BEPS issues that are distinct to the digital economy?
 - > Should there be special rules for the digital economy?



- ➤ Action 2 Hybrid mismatches
 - To neutralise the effects of hybrid mismatch arrangements
 - Changes to the Model Tax Convention
 - Recommendations regarding the design of domestic rules
 - Careful consideration of the interactions between the two



- ➤ Action 5 Harmful tax practices
- > To counter harmful tax practices more effectively, taking into account transparency and substance
 - Elaborating a methodology to define a substantial activity requirement for intangible regimes
 - Modified nexus approach
 - Transfer Pricing approach
 - Improving transparency through compulsory spontaneous exchange on rulings
 - Conducting reviews of member countries and
 G20 countries on an equal footing



- ➤ Action 6 Treaty Abuse
 - > To prevent treaty abuse
 - Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances
 - Clarify that tax treaties are not intended to be used to generate double non-taxation
 - Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country



- ➤ Action 8 Transfer Pricing: Intangibles
 - Assure that transfer pricing outcomes are in line with value creation
 - Revisions to the OECD Transfer Pricing Guidelines:
 - Definition of intangibles
 - > Identifying transactions involving intangibles
 - Arm's length conditions for transactions involving intangibles
 - > Treatment of local market features and corporate synergies
 - Connection with Actions 9 and 10 work on risk, recharacterisation and hard to value intangibles



- > Action 13 Transfer pricing documentation
 - > Re-examine transfer pricing documentation
 - Country-by-country reporting template to provide details on:
 - Profits, sales, employees and assets
 - > Risk assessment tool for tax administrations
 - ➤ How to be implemented?



- > Action 15 Multilateral instrument
 - > Develop a multilateral instrument
 - Report identifying relevant public international law and tax issues
 - Develop a multilateral instrument December
 2015



- ➤ Action 3 Controlled Foreign Corporations
 - > To strengthen CFC rules
 - > Set of "building blocks" for effective CFC rules:
 - Threshold requirements (such as low taxation, de minimis exception and avoidance requirements)
 - > Definition of control
 - > Definition of attributable income
 - > Rules for attributing income
 - Rules to prevent or eliminate double taxation



- ➤ Action 4 Interest deductions
 - ➤ To limit base erosion through excessive interest deductions
 - ➤ Best practices in the design of domestic rules to prevent base erosion through the use of interest expense and other financial payments
 - Transfer pricing rules to limit base erosion via interest deductions and other financial payments



- ➤ Action 7 Prevent the artificial avoidance of Permanent Establishment Status
 - Changes to the definition of Permanent Establishment (PE) to prevent artificial avoidance of PE status
 - Identify various avoidance strategies
 - Develop recommendations to address these avoidance strategies



- Action 9 Transfer pricing: Risks and capital
 - Prevent BEPS by transferring risks among, or allocating excessive capital to, group members
 - ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital



- ➤ Action 10 Transfer pricing: Other high risk transactions
 - To prevent BEPS where parties are engaging in transactions which would not occur between third parties
 - Connection with Actions 8 and 9 work on intangibles, risks and capital



- ➤ Action 11 Methodologies to collect and analyse data on BEPS and countermeasures
 - ➤ Establish methodologies to collect and analyse data on BEPS and actions to address it
 - ➤ Develop recommendations regarding indicators of the scale and economic impact of BEPS
 - Ensure that tools are available to monitor and evaluate the effectiveness and economic impact of BEPS countermeasures on an ongoing basis



- Action 11 Methodologies to collect and analyse data on BEPS and countermeasures (continued)
 - This will involve developing an_economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it.
 - Must consider the need for taxpayer confidentiality and the administrative costs for businesses and tax administrations



- ➤ Next steps on Action 11
 - > Request for Input
 - ➤ Working closely with WP2 country delegates
 - ➤ Draw upon data that individual countries may have in relation to specific behaviours and specific measures designed to address BEPS
 - Continue to develop and refine our economic analysis
 - > Specific consultation with academics
 - ➤ More detailed consultation paper likely



- ➤ Action 12 Disclosure of aggressive tax planning arrangements
 - Require taxpayers to disclose their aggressive tax planning arrangements
 - Compare the existing mandatory disclosure regimes
 - > Design mandatory disclosure rules



- ➤ Action 14 Make dispute resolution mechanisms more effective
 - Design tax treaty measures to make dispute resolution mechanisms more effective
 - Improve the functioning of the mutual agreement procedure and limit the occurrence of double taxation to a minimum





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