



BASE EROSION & PROFIT SHIFTING

Harnessing Synergies Towards Sustainable Growth

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Introduction

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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



What is BEPS?

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

2014 deliverables

Action 1

Action 2

Action 6

Action 13

2015 deliverables

Action 3

Action 4

Action 7

Action 9

Action 10

Action 11

Action 12

Action 14

Action 5

Action 8

Action 15



The 2014 Deliverables – Action 1

- 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?



The 2014 Deliverables – Action 2

- 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



The 2014 Deliverables – Action 5

- 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



The 2014 Deliverables – Action 6

- 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



The 2014 Deliverables – Action 8

- 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



The 2014 Deliverables – Action 13

- 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?



The 2014 Deliverables – Action 15

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



The 2015 Deliverables – Action 3

- 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



The 2015 Deliverables – Action 4

- 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



The 2015 Deliverables – Action 7

- 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



The 2015 Deliverables – Action 9

- 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



The 2015 Deliverables – Action 10

- 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



The 2015 Deliverables – Action 11

- 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



The 2015 Deliverables – Action 11

- 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



The 2015 Deliverables – Action 11

- 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



The 2015 Deliverables – Action 12

- 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



The 2015 Deliverables – Action 14

- 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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