

OECD - Corporate Tax Avoidance - Base Erosion and Profit Shifting (BEPS)

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit these gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from multinational enterprises (MNEs).

Research undertaken since 2013 confirms the potential magnitude of the BEPS problem. Estimates conservatively indicate annual losses of anywhere from 4 - 10% of global corporate income tax (CIT) revenues, i.e. USD 100 to 240 billion annually.

The Issues

For the first time ever in tax matters, OECD and G20 countries have worked together on the issue of international tax avoidance and evasion. More than a dozen developing countries have participated directly in the work and more than 80 non-OECD, non-G20 jurisdictions have provided input.

The plan was structured around three fundamental pillars: introducing coherence in the domestic rules that affect cross-border activities; reinforcing substance requirements in the existing international standards, to ensure alignment of taxation with the location of economic activity and value creation; and improving transparency, as well as certainty for businesses and governments which have identified 15 actions to put an end to international tax avoidance.

Fifteen areas have been reviewed with recommendations made to provide governments with the domestic and international instruments needed to tackle BEPS.

- 1 Addressing the tax challenges of the digital economy
- 2 Neutralising the effects of hybrid mismatch arrangements
- 3 Designing effective controlled foreign company rules
- 4 Limiting base erosion involving interest deduction and other financial payments
- 5 Countering harmful tax practices more effectively, taking into account transparency and substance
- 6 Preventing the granting of treaty benefits in inappropriate circumstances
- 7 Preventing the artificial avoidance of permanent establishment status.
- 8-10 Aligning transfer pricing outcomes with value creation
- 11 Measuring and monitoring BEPS
- 12 Mandatory disclosure rules
- 13 Guidance on transfer pricing, documentation and Country-by-Country reporting

- 14 Making dispute resolution mechanisms more effective
- 15 Developing a multilateral instrument to modify bilateral tax treaties

The final package of BEPS measures includes new minimum standards on: country-by-country reporting for the largest companies, which for the first time will give tax administrations a global picture of the operations of multinational enterprises; treaty shopping, to put an end to the use of conduit companies to channel investments; curbing harmful tax practices, in particular in the area of intellectual property and through automatic exchange of tax rulings; and effective mutual agreement procedures, to ensure that the fight against double non-taxation does not result in double taxation.

The BEPS package also revises the guidance on the application of transfer pricing rules to prevent taxpayers from using so-called "cash box" entities to shelter profits in low or no-tax jurisdictions, and redefines the key concept of Permanent Establishment, to curb arrangements which avoid the creation of a taxable presence in a country by reliance on an outdated definition.

The BEPS package offers governments a series of new measures to be implemented through domestic law changes, including strengthened rules on Controlled Foreign Corporations, a common approach to limiting base erosion through interest deductibility and new rules to prevent hybrid mismatch arrangements from making profits disappear for tax purposes through the use of complex financial instruments.

Throughout the OECD recommendations are based upon the very clear foundation that tax should be charged in line with the economic and commercial realities rather than legal structures on paper.

Actions

The OECD will present the BEPS measures to G20 Finance Ministers during the meeting hosted by Turkey's Deputy Prime Minister Cevdet Yilmaz on 8 October, in Lima, Peru.

Following delivery of the BEPS measures to G20 Leaders during their annual summit on 15-16 November in Antalya, Turkey, the focus will shift to designing and putting in place an inclusive framework for monitoring BEPS and supporting implementation of the measures, with all interested countries and jurisdictions invited to participate on an equal footing.

However, it remains unclear as to how exactly the group of countries will work together to implement these recommendations. Countries will work at different speeds to implement the recommendations, governments will change, some countries will try and opt out of certain recommendations, and some have already decided not to wait

and have gone on and have introduced their own unilateral measures (such as the UK with diverted profits tax and Australia with the multinational anti avoidance law).

Conclusion

Nearly 90 countries are working together on the development of a multilateral instrument capable of incorporating the tax treaty-related BEPS measures into the existing network of bilateral treaties. The instrument will be open for signature by all interested countries in 2016.

The BEPS recommendations were made by the OECD after a transparent and intensive two-year consultation process between OECD, G20 and developing countries and stakeholders from business, labour, academia and civil society organisations – however, there will now be a period of uncertainty as the exact mechanics of implementation are considered.

Companies operating cross border now need to tune into the progression of the BEPS project as countries now look to implement both domestic rule changes and multilateral international instruments which will change the way in which they are taxed and that tax authorities operate. With the best will in the world this will not be a straight forwards or easy process, and we are likely to have several years of confused and disordered international tax policy (both domestic and international) as governments and tax authorities come to terms with the changes – this is very definitely the end of the beginning rather than the beginning of the end.

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