Base Erosion and Profit Shifting (BEPS) Update

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What is BEPS?

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).

In an increasingly interconnected world, national tax laws have not always kept pace with global corporations, fluid movement of capital, and the rise of the digital economy, leaving gaps and mismatches that can be exploited to generate double non-taxation. This undermines the fairness and integrity of tax systems.

The potential magnitude of the BEPS problem estimates annual losses of anywhere from 4 - 10% of global corporate income tax (CIT) revenues, i.e. USD 100 to 240 billion annually.

Background

BEPS is a global problem which required a global solution. For the first time ever in tax matters, OECD and G20 countries have worked together on an equal footing. More than a dozen developing countries have participated directly in the work and more than 80 non-OECD, non-G20 jurisdictions have provided input. . On September 16, 2014, the OECD released the first seven deliverables promised under the BEPS project (the 2014 BEPS package). In many respects, the Final Reports released incorporate the recommendations included in the 2014 BEPS package, as well as various other BEPS reports the OECD has released over the past two years.

The resulting package provides countries the tools they need to ensure that profits are taxed where the economic activities generating the profits are performed.

Milestones

- The OECD's Action Plan on BEPS published a 40 page Action Plan. The Plan was squarely focused on addressing these issues in a coordinated, comprehensive manner, and was endorsed by G20 leaders and finance ministers at their summit in St. Petersburg in September 2013.

- The final BEPS package has been developed and agreed in just two years. This package was presented by OECD Secretary-General Angel Gurría to G20 Finance Ministers at their 8 October 2015 meeting in Lima and was subsequently presented to G20 Leaders at their summit in Antalya on 15 -16 November 2015.

- Fifteen action areas endorsed by the G20 in July 2013, which will enable governments with the domestic and international instruments needed to tackle BEPS.

Recent Developments

On 27 January 2016, 31 countries signed the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of country-by-country (CBC) reports, pursuant to the OECD Convention on Mutual Administrative Assistance in Tax Matters. The MCAA requires each jurisdiction’s competent authority to provide a notification regarding the jurisdiction’s readiness and intentions with respect to CBC reporting, including that the jurisdiction has in place legislation to require CBC reporting for fiscal years beginning on or after the date of the notification. The MCAA provides for CBC reports to be exchanged as soon as possible and no later than 18 months after the end of the fiscal year covered by a report. Additional countries may sign the MCAA in the future.

These reports form the basis of FATCA and CRS reporting now in place for many jurisdictions including the US, all of Europe and many other jurisdictions which continue to sign up to the exchange of financial information across the world.

On 28 January 2016, the European Commission published an Anti-Tax Avoidance Package containing new measures against corporate tax avoidance in the European Union (EU) that follow the recommendations developed in the OECD BEPS project. Most significant are the proposals for an Anti-Tax Avoidance (ATA) Directive and an EU CBC Reporting Directive.

The ATA Directive proposal, if adopted, would establish a new level of harmonization in the field of direct taxation in the EU. The proposal implements several of the BEPS recommendations, but it also goes beyond those recommendations on certain points. It includes new provisions on interest deduction limitations, exit taxation, controlled foreign company taxation, treatment of low-taxed foreign income, anti-abuse rules, and hybrid mismatches.

The CBC Directive, if adopted, would amend the existing EU directive on exchange of information within the EU, would require Member States to ensure that CBC reports are filed in all Member States. The content to be included in the CBC reports is in line with the BEPS The CBC Directive contains rules on establishing mandatory automatic exchange of CBC reports within the EU and requires the first reports to be exchanged to include information for fiscal years starting on or after 1 January 2016. The CBC Directive would require Member States to implement both secondary reporting mechanisms recommended by the OECD (local filing and surrogate parent entity filing). In addition, there would be an option for multinational groups that are present in more than one Member State to designate one of their EU-based entities to satisfy the filling requirement for all the EU entities of such group. In this case, the Member State of the designated entity would automatically exchange the report with the other Member States where the group is present.

Next Steps

- As a next step, the proposed Directives will be discussed in the Council of the European Union later this year, which has the authority to adopt directives. It is worth noting that adoption requires unanimous consent by all Member States.

- As many countries have expressed a willingness to follow the OECD’s recommendations. The G20 and OECD countries have agreed to work toward a consistent and coordinated implementation of the BEPS recommendations.

- The recommendations in the Final Reports will likely lead to a significant increase in international tax disputes and compliance costs around the world

- The concern is that in finalising the reports too many compromises have been made resulting in ambiguous recommendations that may be interpreted in a manner that serves a particular country’s self-interest. Many of the difficult issues such as the allocation of taxing revenue between source and residence countries have not been dealt with and consequently the Final Reports do not appear to cover the significant divergence of views between countries with respect to these types of issues. One of the main reasons for developing BEPS was to try and prevent such disputes.

- However, it is clear that BEPS will have an impact. Boards of international companies will likely face some difficult choices in which tax strategies to adopt.

The Final Reports are summarised in the report available on the OECD website (see below):

http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf

What can YOU and WE do to be prepared?

1. **What to look out for**
   - Know what changes are coming, companies need to keep a close watch on what's coming out of the BEPS initiative and what countries are talking about taking action on their own ahead of any kind of agreement.
   - The bigger you are and the more American you are, the more you need to be paying attention.
   - The large multinationals that do sophisticated tax planning are very aware of the BEPS project and the recommendations coming out of it. It's the next level of company that is not paying considerable attention to it.

2. **Prepare Information Reports**
   - While much of the BEPS project remains a work in progress, one of the more concrete elements to emerge from discussions is the CBC reporting of companies' economic activity.
   - DCTSL has already implemented the necessary steps to ensure that, where relevant the appropriate reporting for our clients and their respective entities is in place and will be undertaken in the correct manner and in line with the required reporting dates. Such reporting requirements cover FATCA and CRS on all our clients, where applicable.
   - Companies will also need to prepare a so-called master file providing an overview of its transfer-pricing policies and allocation of income and economic activity as well as local files for each country about transfer pricing practices specific to that jurisdiction.

3. **Take Stock of Risks**
   - Companies need to take a hard and objective look at where they may be at risk in light of the current rhetoric and proposals coming out of BEPS. Strategies that might have appeared to be clever tax planning before BEPS may now be under scrutiny by quite a few countries and could result in taxation by multiple jurisdictions.

4. **Restructure, If Needed**
   - After a company has examined its risk areas under BEPS and has determined that a strategy may not hold up under additional scrutiny, it may want to restructure.
   - DCTSL can and does assist in any structuring or re-structuring in collaboration with the necessary advisers to ensure the appropriate tax planning is in place and that the appropriate reporting procedures are in place.

If you would like further information on any of the reporting regimes in place and what it means for you please do not hesitate to contact us.

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