Tax & Financial Services Policy Group

OECD Releases Final BEPS Recommendations – Now What?

On Oct. 5, 2015, the Organization for Economic Cooperation and Development (OECD) released a set of final reports on its 15 point action plan to address Base Erosion and Profit Shifting (BEPS). In an accompanying explanatory statement, the OECD also included plans for additional work on technical matters and a timetable on monitoring its implementation.

BACKGROUND

The OECD launched its BEPS 15 point action plan to reduce aggressive tax planning and modernize the international tax system in July 2013. The OECD subsequently released interim reports in September 2014 on 7 of the 15 action items. The 2015 reports consolidate the OECD's previous efforts to deliver a final set of recommendations to address BEPS.

The 2015 reports were presented to and endorsed by the G20 finance ministers at a meeting in Lima, Peru, Oct. 8, 2015. The BEPS package is now awaiting final approval from G20 leaders, who will gather in Antalya, Turkey on Nov. 15 and 16 to decide whether to endorse the package of recommendations.

Although the final BEPS recommendations are intended to be a comprehensive package, OECD/G20 member states are, in many cases, embracing the implementation of some proposed measures, while fully or partially rejecting others. In the end, some could argue that the effort to harmonize global tax rules will instead further deepen disparities among global economic partners.

ISSUES

The 2015 reports include a wide range of issues, including, but not limited to:

- A study on the magnitude of BEPS and its economic impact;
- Detailed guidance on the arm's length principle in the area of transfer pricing;
- Key changes to Model Tax Convention to eliminate double taxation, including changes to the definition of Permanent Establishment (PE) to better reflect the current digital business model;
- Criteria to ensure fair tax competition;
- Limits on interest deductions for related and unrelated parties, with net interest deductions limited to a fixed ratio of EBITDA;
- Recommended changes to domestic laws which relate to cross-border taxation; and

- Measures to address BEPS issues that are exacerbated by the digital economy, without adopting significant economic presence test that was discussed in the 2014 deliverable
- Recommendations for better and more timely dispute resolution mechanisms through mutual agreement procedures (MAP)

NEXT STEPS

The 2015 reports also included a brief discussion of a "post-BEPS environment," focusing on implementation of the BEPS recommendations. The report emphasizes that certain provisions, such as revisions to the transfer pricing guidelines, are immediately applicable, while others require changes that must be implemented through treaties or amendments to domestic law.

The 2015 reports indicate that OECD and G20 countries will continue to together in the BEPS project framework to ensure consistent and coordinate implementation. The OECD and G20 countries will also complete work on any areas that require further attention in 2016 and 2017. Areas that will require additional work include:

- Finalizing transfer pricing guidance on the application of transactional profit split methods
- Addressing details of a group ratio carve-out
- Developing a strategy to expand participation of non-OECD and non G20 countries to address aggressive tax planning
- The attribution of profits to PEs, in light of recent changes made to the definition of PE
- Commentary on the Limitation on Benefit (LOB) rule
- Special rules for insurance and banking sectors in the area of interest deductibility

The OECD and G20 countries have agreed to work together on the BEPS initiative until 2020 to complete any remaining work and monitor the implementation of the approved measures. The G20 has requested a proposal outlining a framework for these next steps by February 2016.

As the OECD works to secure final endorsement from the G20 leaders, there are two big questions for policymakers, lawmakers, and tax directors to consider. First—how is BEPS going to impact U.S. efforts to overhaul its corporate tax code? Second—with more than 50 countries expected to adopt the BEPS guidelines, what are the immediate impacts on U.S. multinationals? According to an Oct. 6 report by Thomson Reuters, nearly half of the multinational companies surveyed are not prepared to meet the reporting requirements under BEPS. Among the 180 executives surveyed across 35 jurisdictions, BEPS guidelines on transfer pricing and the country-by-country requirements pose the greatest concern to tax planners.

Following OECD's release of its BEPS recommendations, U.S. Treasury Deputy Assistant Secretary Robert Stack offered cautious support for the OECD's efforts on BEPS, noting while the final recommendations would help tax administrators curb harmful practices and protect their tax bases, more needs to be done in terms of clarifying the standards and improving the dispute resolution mechanisms. Stack also noted that in the area of transfer pricing, Treasury did not anticipate having to make substantial changes to existing law.

The top tax writers on Capitol Hill remain a little more skeptical about the OECD's work, however. House Ways and Means Chairman Paul Ryan weighed in, stating that BEPS is a "consequence of a broken and neglected American tax system" and that he believes the OECD's efforts to address base erosion and profit shifting will only encourage U.S. companies to shift their businesses overseas. As Ryan and Senate Finance Chairman Orrin Hatch continue to review the recommendations, both lawmakers have expressed frustration at the Obama administration for being unresponsive to their inquiries and the general lack of outreach to Congress on the BEPS project.

VIEW FROM EUROPE

In the EU, there is in general strong political and public support for the OECD's work on BEPS. However, there are important separate developments in the bloc which need to be understood in order to obtain the full picture. Indeed, the fight against corporate tax avoidance and aggressive tax planning is a top priority of the European Commission ("EC"), the EU's "civil service" and body which proposes EU-wide legislation.

These EU developments have been driven at least partly by numerous and continuing press stories reporting on large sales by certain companies being lightly taxed, if at all, in the countries where they were made. The EU has been working on a response for some time. To some extent the changes are therefore ahead of the OECD BEPS work in timing and in their likely impact on and concern to EU Member States and companies trading in the EU.

A key plank of the EU reforms is however quite new. The European Commission announced its own Action Plan on a "Fairer Corporate Tax System in the EU" on Jun. 17, 2015. This expresses strong support for the OECD BEPS reforms and the measures in the EC Action Plan are very much aligned with the OECD's work. However, as indicated by the European Commission, they are at the same time shaped to meet the EU's own particular challenges and needs. The intent is to produce a common EU approach to corporate tax reform to prevent 28 different approaches from undermining the EU single market. The EU has unique features – free movement rules, the single market, a currency zone, binding legislation – that require tailor-made measures.

The EC Action Plan proposes measures on transparency but this is also an existing focus of the Commission. Indeed, the day after the OECD's announcement, EU Member States agreed unanimously on the automatic exchange of information on cross-border tax rulings. That agreement was, unusually, reached only some seven months after the Commission issued its proposals on the subject (March 2015). The EC Action Plan proposes to build on this first step towards greater tax transparency.

The idea behind the tax rulings transparency initiative is to increase cooperation between EU Member States on tax matters and act as a deterrent from using tax rulings as an instrument for tax abuse. The automatic exchange of information on tax rulings will enable Member States to detect abusive tax practices by companies and take the necessary action in response. It is expected that this initiative will deter tax authorities from offering selective tax treatment to companies once this is open to scrutiny by their peers. This will go back five years (down from 10 in the original proposal, but still a significant period of retroactivity).

New legislation is not the only weapon being used in this area in the EU. Tax rulings are also the subject of high-profile investigations by the Commission under EU State aid law. The issue in those cases is whether particular rulings are selective in favor of particular companies and not applied equally to all companies within a particular EU Member State. The OECD's BEPS project will not impact these cases since they simply concern equality of rulings within a Member State (and indeed concern past rulings). However, the analysis in tax rulings of transfer pricing arrangements is central to several of the State aid cases and one of the key issues impacted by BEPS is the manipulation of transfer pricing (also an issue looked at in the Commission's Action Plan). Therefore, there is a link between the State aid cases and more general changes.

Another area of change is at the EU Member State level. In response to the existing political and public pressure, some states are ahead of the OECD BEPS and EC Action Plan. For example, the UK has already implemented its own "diverted profits tax" to target contrived structures and Ireland has said that it will phase out its so-called "double Irish" loophole.

Finally, the European Parliament (consisting of elected representatives and one of the EU bodies which has to approve legislation proposed by the Commission) has been in on the act via its "Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect". The committee issued its draft report in July 2015, which "regrets" the lack of significant practical progress to tackle aggressive tax planning by multinational companies. Importantly in the current context, the committee expressly commented that the EU's and OECD's activities are complementary but, echoing the Commission, that the EU must go further than the OECD's BEPS proposals in terms of coordination and convergence aimed at avoiding all forms of harmful tax competition within the EU. In particular, "the EU could put in place more effective tools to ensure fair tax competition and the right of Member States to operate effective taxation on profits generated in their territories".

The committee did however welcome in its report the "good progress" of the OECD on BEPS and expresses strong support for it (reflecting general opinion in the EU). It "strongly supports the OECD BEPS project; calls for its ambitious scope and calendar to be fully complied with and for the OECD, its Member States and all the other countries involved to set up a strong monitoring tool to assess progress in the implementation of those guidelines and possibly take corrective action."

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- ***Matthew Hall, Partner***
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The committee also recognizes the need for coordination in the EU and OECD parallel approaches: "[The committee] recommends that institutional links and cooperation between the OECD and the [European] Commission be strengthened in order to continue to ensure the compatibility of the two processes and avoid double standards; stresses that the OECD approach is still based on soft law and that its action should be complemented by a proper legislative framework at EU level, e.g. in the form of an anti-BEPS directive, since such voluntary agreements are not sufficient for an integrated area like the EU, with a single market, a common currency and common sets of rules in most areas of government."

This makes the point that, going forward, EU and OECD actions against base erosion and profit shifting will inevitably be increasingly interrelated. Clearly, however, the EU will remain very active on its own as the Commission pushes forward, amongst other things, its June 2015 Action Plan.

The next meeting of the European Parliament's Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect will take place on Oct. 15, 2015 in Brussels. The meeting will be webcast and it will be very interesting to hear the members' reactions to the OECD BEPS proposals.

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