OECD Base Erosion & Profit Shifting (BEPS) Update

BIAC Meeting with TUSIAD

Will Morris, Chair BIAC Tax Committee
Istanbul, 24 Sept 2014
Where are we now?

- Developing **consensus positions** has continued to present challenges.
- Draft 2014 proposals presented to **G20 Finance Ministers** Sept 20/21, G20 Leaders in November.
- G20 has accepted and **endorsed OECD deliverables** and re-committed to finalising all actions in 2015.
- OECD recognises **interaction between 2014 and 2015 actions** (and some 2014 implementation issues still to consider).
- But OECD has stated that only at the end of the project will countries be able to make **tough compromises** on the totality of the package.
- Increased support from some countries for **effective dispute resolution**.
- Active **business engagement** must continue to avoid/mitigate unilateral or damaging solutions.
- Important to carefully **scope** 2015 work to ensure it is achievable.
Key BIAC Messages

- **Timing**: Because of the demanding timetable, business (and other stakeholders) should be involved in scoping and formulation as early as possible.

- **Success and scoping**: The scope of each Action Item should be narrowly targeted to allow sufficient effort in allowed time to produce workable, broadly-agreed upon results.

- **Clarity on national interests**: Transparency regarding national interests is crucial to ensure that realistic agreements can be reached.

- **Time for review**: We advocate inclusion of a review process to ensure holistic (rather than siloed) approach to Action Items.

  *Addressing these issues will be necessary to ensure that the final recommendations of the BEPS project are well designed and consistently applied. This will help ensure the development of a predictable international tax environment that is conducive to international trade and investment.*
2014 Actions

1. Digital Economy
2. Hybrid Mismatches
3. CFC Rules
4. Interest Deductions
5. Transparency & Substance
6. Treaty Abuse
7. PE Status
8. Intangibles
9. Risk & Capital
10. High Risk Transactions
11. BEPS Data
12. Disclosures
13. TP Doc & CBCR
14. Dispute Resolution
15. Multilateral Instrument
2014 update

1: Tax challenges of the digital economy
- The digital economy cannot be separated from the broader economy
- Task force will monitor progress in other areas

2: Neutralising the effects of hybrid mismatches
- Domestic law, and some treaty-related proposals
- ‘Primary’ and ‘secondary’ rules will with jurisdictional overlaps
- “Imported mismatches” to get further consideration
- OECD considering further aspects of regulated financial services and implementing guidance

5: Counter harmful tax practices more effectively
- Progress report on review of OECD member regimes
- Countries agree the need to strengthen substantial activity requirement (but no agreed method yet)
- Agreed transparency framework for preferential regimes

6: Preventing treaty abuse
- A ‘menu-based approach’ being developed. Combines Limitation of Benefits (LOB) clause and Main Purpose Test (MPT)
- OECD considering derivatives benefits test
- Acknowledges that flexibility will be needed due to interactions with hybrids, TP and other Actions

8: Transfer pricing: intangibles
- Finalised guidance on location savings & other market features and also on identifying intangibles, transactions w/ intangibles, and pricing
- Guidance on the ownership of intangibles will remain in draft
- Work on hard-to-value intangibles & “special measures” (to include guidance on excessive capitalisation, substance, and assumption of risk) outside ALS

13: Transfer pricing documentation & CbC
- A three tier approach adopted: CbC, Master File and Local File
- CbC template is high level risk assessment tool using aggregate data (implementation methods still to be agreed)
- Concerns: delivery, confidentiality, balanced costs, usefulness for govs – esp. Less Dev’d Countries

15: Multilateral instrument
- OECD concluded that an international instrument is legally feasible and that flexibility is possible
- Reaching broad consensus may be challenging
2015 Actions

1. Digital Economy
2. Hybrid Mismatches
3. CFC Rules
4. Interest Deductions
5. Transparency & Substance
6. Treaty Abuse
7. PE Status
8. Intangibles
9. Risk & Capital
10. High Risk Transactions
11. Multilateral Instrument
12. Disclosures
13. TP Doc & CBCR
14. Dispute Resolution
15. BEPS Data
### 2015 Actions

<table>
<thead>
<tr>
<th>3: CFC Rules</th>
<th>9: TP: Risk and Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Some countries may oppose tightening own rules over feared loss of competitive advantage</td>
<td>- First consultation doc expected late 2014</td>
</tr>
<tr>
<td>- Developing consensus will be a challenge</td>
<td>- OECD seeks to “realign the substance with pricing”</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4: Interest Deductibility</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- “Debt bias” seen by govts as a key BEPS issue</td>
<td>- “Special measures,” in or outside ALS on specific concerns on IP and risk/capital (esp. cash boxes); also recharacterisation</td>
</tr>
<tr>
<td>- A more mechanistic (non-ALS) approach may be proposed (similar to German limitation rules)</td>
<td></td>
</tr>
<tr>
<td>- Recharacterisation will have knock-on implications</td>
<td></td>
</tr>
<tr>
<td>- Interest allocation currently within scope</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5: Transparency and Substance</th>
<th>10: TP: High Risk Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 2015 proposals for tighter criteria &amp; the elimination of harmful regimes</td>
<td>- Relates to management fees and HQ charges</td>
</tr>
<tr>
<td>- Patent Box regimes may be called into question</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>7: Permanent Establishment Status</th>
<th>12: Disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Changes to definition of PE to prevent the avoidance of harmful regimes</td>
<td>- US already has Reportable (listed) Transactions and Uncertain Tax Positions rules</td>
</tr>
<tr>
<td>- Review of Agency PE (commissionaire) principle &amp; specific activity exemptions will be reviewed</td>
<td>- Nothing tougher expected (but a risk that country rules may differ)</td>
</tr>
<tr>
<td>- Risk of more subjectivity &amp; fewer ‘bright line’ tests</td>
<td></td>
</tr>
<tr>
<td>- “Digital PEs” &amp; “Prep &amp; aux” rules may be in scope</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>8: TP Intangibles</th>
<th>14: Dispute Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>- “Special measures” could = ad hoc/non-ALS responses to specific issues.</td>
<td>- Binding mandatory arbitration gaining ground, but some countries have serious concerns</td>
</tr>
<tr>
<td></td>
<td>- “Cooperative compliance” should also be promoted coordinating with the work of the FTA</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>15: Multilateral Instrument</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Consistent application of proposed rules could provide some stability for business, but the broad implementation will be challenging</td>
<td></td>
</tr>
</tbody>
</table>