



BIAC has been supportive of the OECD's Base Erosion and Profit Shifting ("BEPS") project since its inception, and has provided constructive and detailed input from the international business community in response to all discussion drafts. Although we value the openness of the consultation processes, and acknowledge the efforts of OECD and G20 member governments and the OECD Secretariat, we are anxious that some serious business concerns are not being sufficiently considered or addressed.

At the March 2015 meeting of the BIAC Tax Committee, a substantial number of member organizations expressed substantial concerns over the direction of certain aspects of the BEPS project, and the potential significant negative economic consequences of several Action Items, and it was agreed to set those out in a short document. Following that meeting, BIAC conducted a survey of its members in order to prepare a consensus document to explain its concerns. This Position Paper<sup>1</sup> represents the consensus feedback BIAC has received, covering general comments in relation to the entire project, as well as comments on specific Action Items. We would reiterate, despite the concerns noted below, that we want the BEPS project to succeed. We will continue to approach this project – both before and after the adoption of the recommendations by the G20 – in a constructive, flexible and incremental way as the best way of achieving that success.

## General comments

Many of the concerns identified in this Position Paper are common across the range of Action Items. We have expressed these concerns to the OECD before, and also understand the pressure of the BEPS timetable, but we feel they are worth repeating as their importance continues to grow, not only as the project moves towards completion, but also beyond that to subsequent implementation.

**Scoping:** It would still be helpful to more narrowly target the scope of each Action to increase the chance of developing the necessary inter-governmental consensus. At present, many proposals appear to go beyond the scope required to effectively target BEPS related activities. We strongly believe that "success" in the BEPS project would be achieved with a set of detailed, well-defined proposals that can be (and are) implemented consistently. It is not necessary to cover every issue that could arise under every Action Item. We should seek to avoid overly-broad proposals that countries are likely to implement differently.

**Economic impact:** There is great concern that the economic consequences of the proposals have not yet been fully considered, and that recommendations may be adopted without a proper impact assessments. Although uncertainty, double-taxation, disputes and compliance burdens are a focus of business, we are also concerned about the broader economic impact that may not have been considered so far. These might include, for example, the impact on the efficiency of markets, or the sustainability of certain legitimate non-tax driven commercial transactions (for example, cross-border infrastructure projects). We believe that the justified targeting of BEPS activities must be integrated with larger economic concerns related to creating jobs and growth through cross-border trade and investment.

**Clear guidance:** In a number of areas, the BEPS Action Plan proposes substantially new and complex rules to tackle avoidance. Given the pressures of the ambitious timeframe, there have been very few opportunities to explore how these complex proposals can be adopted and implemented on an international basis. Both tax authorities and businesses will need detailed implementing guidance to ensure that the intention of each Action Item is clear. This will be critically important in delivering recommendations that are uniformly adopted, avoiding further overlaps. There is no information at this point over how and if such guidance will be developed, and this should be made clear at the earliest possible opportunity.

---

<sup>1</sup> This is intended to be a "living" document, and will be updated for subsequent OECD/G20 actions

**Interaction of the Action Items:** Although the project is approaching its conclusion, there is no clear strategy to identify how the different Action Items interact with each other or how the proposals will be brought together. We know that the OECD is aware of the issue, and has, on many occasions, said that such interactions will be considered. But we do not, at the moment, see the mechanism through which that will occur. BIAC is concerned that certain BEPS issues will be targeted by multiple Action Items. Unless a clear review process clarifies those interactions, and considers the ramification of the immediate adoption of multiple recommendations at the same time, there could be swift and unintended consequences. Although we fully understand that the timetable is politically-mandated, it is crucial to consider these interactions before widespread implementation.

## Clearly defining the target

Many of the OECD's discussion drafts do not begin by clearly defining the abuses they intend to tackle. Given this lack of focus, we are concerned that non-tax motivated commercial transactions and structures could be unintentionally impacted by the breadth of the OECD's proposals – for example, the overly-broad denial of treaty benefits or the lowering of the thresholds for Permanent Establishments (PEs). There should be a much sharper focus on specific abuses (which starts with clear articulation of such abuse), and on designing a narrow and proportionate responses. The proportionate nature of the response should also be informed, where possible, by empirical data on the extent and scale of BEPS in each of the relevant areas.

## Reaching consensus

BIAC has strongly supported the OECD as the best organisation to deliver a successful consensus outcome under the BEPS mandate. However, we are concerned that in many instances, it has proved difficult (and occasionally impossible) for member governments to reach consensus. This has resulted in discussion drafts containing numerous, sometimes conflicting options. We recognise that these discussion drafts were non-consensus documents (and we welcomed the opportunity for early consultation). However, our concern is increasing that it will not be possible to secure the agreement of all countries to deliver rules with sufficient clarity and objectivity. A lack of consensus will lead, and in some cases, has already led, to unilateral BEPS measures.

## Complexity and compliance burden

The BEPS proposals are likely to create significant implementation difficulties and greater compliance burdens, not only for Multinational Enterprises (MNEs), but also governments - this is in part due to the substantial number of proposals, but also the complexity of the recommendations. For example, the two-tiered approach to Transfer Pricing Documentation (TPD) will require businesses to add more information to local files that is not currently required by most countries. Thus, a project initiated to streamline documentation has delivered the opposite. Furthermore, Country-by-Country Reporting (CbCR) will require significant resources in designing new IT solutions to gather the requisite data. In addition, proposed amendments to the Transfer Pricing Guidelines (TPG) for Risk and Recharacterisation suggest that significantly more effort will be required to analyse transactions and contracts. BEPS proposals will also have implications for indirect taxation, for example, the recommendations under Action 7 on PE Status would result in an unmeasurable increase in the number of monthly VAT submissions. Other Action Items (for example, Actions 2, 3, 4, 7 and 12) are also likely to require significant additional resource to ensure compliance with new, complex and sometimes contradictory rules.

Tax administrations already receive significant amounts of information that they often struggle to process. We are concerned that without additional resources, tax administrations will face difficulties in effectively using this additional information and in dealing with the expected increase in requests for exchange of tax information between countries. It may actually become more difficult to identify risks, or to target abuse, to the advantage only of the most aggressive taxpayers.

We believe a greater focus on tax administration would be beneficial - for example, through fully integrating the work of the Forum on Tax Administration - and the use of targeted risk-based measures. This could include materiality thresholds and other risk-identification tools to target higher risk taxpayers/issues that represent the most substantial sums of lost tax revenues. Such approaches reduce the burden on the vast majority of compliant taxpayers, freeing up resources for more productive, value-creating activities. Cooperative compliance also has an important role to play in this area.

## Understanding the economic impact

It is a matter of some regret that, owing to the political nature of the timetable, the BEPS project could not begin with a detailed economic analysis of the abuses identified in the Action Plan, including the scale and importance of “double non-

taxation” and “tax competition”. On the latter concept, we continue to support the work of The Forum on Harmful Tax Practices to ensure that tax competition is always linked to the taxation of genuine and substantive economic activity. Differences in domestic tax systems can indeed create unintended arbitrage opportunities that should be addressed, but we also believe that some intended differences in domestic tax systems driven by appropriate policy rational can have a positive impact on the global economy by encouraging investment and growth. In this regard, the recent Action 11 discussion draft acknowledges difficulties in distinguishing BEPS activities from the impact of genuine incentives in a specific economy. Any broad recommendations to reduce the availability of tax incentives should be informed by those difficulties.

There are certain key Action Items, for example, PE Status (7) and Interest Deductibility (4), where the economic (tax and non-tax) implications of the proposals could be substantial. Although it will not be possible for all Action Items, in the areas where the economic impact is likely to be large but unknown, we encourage the OECD to attempt to model the micro- and macroeconomic impacts on cross-border trade and investment. Part of that impact relates to the uncertainty that proposals (e.g. Action 7) can create, making it difficult for MNEs to appraise investment proposals, and potentially creating compliance burdens that outweigh the economic benefit of a project.

## **Discouragement of related party trade**

Many of the BEPS Action Items apply only in an intra-group context and could significantly increase the cost of performing various functions or undertaking certain transactions inside a group of related companies.. For example, the recommendations to lower the PE threshold could greatly increase the compliance cost associated with various intra-group activities, and the proposals relating to Cost Contribution Arrangements (CCAs) could apply non-arm’s length restrictions to related party transactions. In some cases, taxpayers may, effectively, be forced to conduct business with third parties to mitigate excessive tax cost or uncertainty. This would reduce commercial and economic efficiencies and hamper international trade (as well as, quite possibly, lowering the wages and benefits in outsourced functions – especially in developing countries). We believe that these effects should be considered in greater detail before we go too far down a road that could discourage the vertical integration of functions.

## **Inconsistent Implementation and Unilateral Actions**

As noted at the beginning of this document, further clarity is required on how the BEPS project will be brought together and coordinated to assist countries and taxpayers in understanding where interactions between actions exist, how the most important issues will be tackled, how rules will be implemented and how best to ensure compliance – hopefully encouraging countries to work towards consensus. This would reverse the emerging trend where certain participating jurisdictions have already proposed unilateral measures that are directly or tangentially related to the BEPS Action Plan. Unilateral actions cause confusion as to what the BEPS Action Plan is targeting, and increase the likelihood of inconsistent implementation.

## **Appropriate resources for tax administrations**

Many governmental concerns relate to difficulties in effectively implementing existing tax laws, rather than a need for new laws. Tax laws are often complex, and their application by taxpayers (and tax administrations) takes time and expertise. At present, resource-constrained governments, even in developed countries, struggle to review all information received to effectively target aggressive avoidance. The situation is even more difficult in developing countries. We are concerned that the BEPS Action Plan recommendations will result in additional layers of complexity, with tax administrations having to deal with more information, more overlapping rules and more interactions between their own rules and other countries.

Best practice recommendations would be welcomed that set out how tax administrations should be funded and resourced, to ensure that adequately trained experts are dedicated to effectively implementing new laws, and targeting the most significant risks, maximising the recovery of lost tax revenues. Based on the BEPS recommendations, any additional resource will likely be consumed by gathering information and trying to administer an increasingly complex set of international rules (with the added difficult of proliferating information exchange requests and a significant uptick in disputes).

## **Multilateral implementation**

Ultimate success of the BEPS project will be multilateral implementation of specific, measurable, achievable and realistic Actions on a timely basis. Whilst much work on implementation mechanisms is still to come, we encourage early discussions on approaches to enhance credibility and likely success of the project. We make the following recommendations in this regard:

- The OECD should remain involved to assist in implementation, and we would welcome clarity over that involvement.
- A post-BEPS engagement process should be formalised to enable the recommendations to be implemented in a way that accords with the original aims of the BEPS project but also protects trade and investment.
- As a first step, all countries should agree to key principles to be followed in any domestic legislation used to enact BEPS proposals. Such principles could include that:
  - the policy objective should be clearly stated;
  - the policy objective should be consistent with the BEPS recommendation, and in particular, should address specific abuses;
  - draft legislation should be published with a minimum period for detailed stakeholder consultation; and
  - an impact assessment should be prepared to evaluate any compliance burdens created.
- Coordination of implementation should also be encouraged so that national measures have a reasonable degree of consistency. We encourage the OECD to consider how it can best assist with consistent implementation.

## BEPS Action Item-specific comments

### Address the tax challenges of the digital economy (Action 1)

We understand that the Digital Taskforce will be meeting towards the end of 2015 to consider how BEPS proposals are likely to address concerns relating to the Digital Economy. We greatly welcomed the original 2014 report (*Addressing the Tax Challenges of the Digital Economy*), but there is a concern amongst BIAC members that a number of countries are considering withholding taxes on digital transactions. Such proposals will certainly result in double or even multiple-taxation unless there is a very clear and strong consensus as to how the profits of digital business transactions should be taxed. If necessary, more time should be taken to ensure that consistency can be achieved. In addition, it is vitally important that individual countries do not take unilateral action.

### Neutralizing the effects of hybrid mismatch arrangements (Action 2)

While we do not defend hybrid mismatches as a general policy matter, we do want to make two important points:

- The complexity of the proposed rules will create substantial compliance difficulties, and will complicate the allocation of taxing rights between jurisdictions, increasing the risk of double taxation (e.g., the rules on “imported mismatches”). We understand that the accompanying commentary may provide clarity on some issues, but at the price of still further complexity,
- The financial services industry continues to be concerned that insufficient attention has been given to how the proposals will impact instruments deemed important by banking regulatory authorities for systemic liquidity. Care must be taken not to undermine the alternative instruments that regulatory regimes permit to ensure that banks are able to raise adequate regulatory capital. Special provisions should be developed to accommodate mismatches arising from down-streaming of externally issued hybrid regulatory capital. Additionally, repo and stock lending markets play a vital role in the operation of financial markets - the proposals could significantly impact transactions in those markets as they are often facilitated by related party dealings. Any requirement to prove that no hybrid mismatch exists could create a disproportionate compliance burden for taxpayers, but also swamp tax authorities with unnecessary information.

### Strengthen CFC rules (Action 3)

The broad nature of the OECD’s CFC proposals for a minimum standard illustrate the difficulty in reaching a consensus position on even the basic purpose of rules, with clear disagreements between governments over whether such rules should tackle profit shifting from the parent entity, or foreign-to-foreign abuse. Without clear agreement over the underlying principles, the chances of delivering clear, proportionate and practical solutions will be almost impossible. This is an opportunity missed to refine a useful tool, based on well-understood concepts of “active” and “passive” income in ways that could reduce dependence on subjective, fact-intensive enquiries while at the same time limiting the compliance burden and risk of double taxation.

## Limiting base erosion via interest deductions & other financial payments (Action 4)

Proposals under Action Item 4 will have serious implications for groups' economic activity and their ability to obtain tax deductions for funding costs. These proposals (to date) have been made without a clear articulation of how they specifically target BEPS activities. Indeed, the OECD's proposals are likely to restrict interest deductions for a large number of non-aggressive taxpayers. The lack of support for the arm's length principle in Action Item 4 also undermines legitimate commercial reasons for having intercompany debt. A group's cash position and decisions on how to deploy cash should not be limited by rules that are not based on the arm's length principle.

We have substantial concerns about the appropriateness and practicality of global group-wide tests. This approach could create the perverse incentive to increase overall leverage for tax purposes, which runs counter to the lessons of the financial crisis. Although a fixed ratio approach on a jurisdiction-by-jurisdiction basis is a preferable, and is a relatively simpler approach, it could also have substantial negative consequences if detailed work is not undertaken to determine an appropriate ratio, taking into account the funding requirements of different industries. A ratio set too low could substantially raise the cost of capital for the majority of low-risk taxpayers undertaking commercial transactions. Where fixed ratios are used, flexibility should be permitted regarding the use of asset values or earnings based approaches.

Interest is the "raw material" for financial services businesses. Although a 'net interest' approach is endorsed, it is important that the outstanding questions facing the financial services industry are resolved, particularly so that proposals do not contradict the regulatory agenda.

## Prevent treaty abuse (Action 6)

The newly proposed minimum treaty standards are expected to create a significant compliance burden for taxpayers (especially if both a LOB and PPT is adopted by certain countries), and will potentially bring into scope legitimate structures that ought to be entitled to treaty benefits. We are concerned that:

- Structures not involving treaty shopping may be unintentionally caught by broad rules.
- There will be increased cross-border investor uncertainty, especially for pension fund investors and sovereign wealth funds, where the potential for tax treaty abuse is low.
- Uncertainty for Collective Investment Vehicles (CIVs) will be unavoidable, and the time taken to receive repayments of tax deducted at source will impact the Net Asset Values of funds.
- Source country tax authorities may experience additional demands to process an increased volume of reclaims, placing further pressure on already resource constrained administrations.

If the broad scope of the proposals is not clarified, there will be uncertainty as to whether treaty relief is available in ordinary commercial circumstances. This uncertainty risks undermining the usefulness of treaty networks in facilitating trade and promoting economic growth. Whilst we recognise that tax administrations require assurance that treaty benefits are only being granted in appropriate circumstances, anti-abuse rules should be applied in a proportionate and targeted manner. Broad disapplication of treaty benefits could create substantial withholding tax burdens, and negatively impact cross-border trade

## Preventing the artificial avoidance of PE status (Action 7)

The potential introduction of new language for determining whether a taxpayer has a PE gives rise to concern. This is particularly the case in relation to digital businesses where the report issued under Action 1 raises further questions about the potential for taxing a digital presence. A lack of clear principles or consensus agreement over the interpretation of standards presented in the newly proposed commentary would contribute to an increase in difficult-to-resolve disputes. This concern is greatly increased because the proposals include a number of new and (to date) undefined terms and appear to substantially lower the existing threshold (compared to the current OECD model). Additional guidance or clarification needs to be provided on the attribution of profits to a PE. Unfortunately, this is not expected until the end of 2016, some time after tax administrations will have started to reflect the OECD's proposals in their practices.

Although BIAC welcomes the narrowing of the options in its latest discussion draft, more detailed guidance and definitions are needed to better target the proposals at BEPS activities and to facilitate practical implementation.

## Transfer pricing (Actions 8-10)

We have consistently acknowledged the need to update international tax rules on Transfer Pricing, especially in relation to intangibles. However, aspects of BEPS project illustrate fundamental differences in opinions between countries over the Arm's Length Principle (ALP) in Transfer Pricing and its continued viability. Proposals further increase the subjectivity of the ALP – for example, in the draft guidance on risk and recharacterisation, which proposes examples that appear to broadly support recharacterisation in situations where the contract is clear, and where the relationship as a legal matter is beyond doubt. Although the OECD has continually supported the ALP, a number of Action Item recommendations suggest that governments are losing confidence in the ability of the ALP to appropriately price transactions. These are fundamental issues that must be resolved in a frank way before recommendations are finalised. Examples of potential departures from the ALP include:

- special measures that go beyond the ALP to reallocate profits between related parties;
- considering all alternative options realistically available at the time a transaction is entered into;
- using a comparison of pre- and post-tax results as a factor to be considered in recharacterisation; and
- the rejection that related party transactions can exhibit elements of moral hazard.

OECD proposals will increase the difficulty of relying on third party comparables, thus, indirectly promoting the use of the profit split method. This is alongside the subjective and complex criteria for characterizing transactions and attributing risk and returns (including diminishing the role of the contract and the separate entity concept). All developments taken together create the potential for a significantly increased compliance burdens and an increased number of disputes, with the attendant risk of double (or greater) taxation. The potential introduction of special measures, in the absence of global consensus and effective guarantees against double taxation, exacerbates this concern.

If the application of the ALP is to become increasingly complex, it would be appropriate to explore practical options, such as globally accepted safe harbour pricing methods for particular transactions to reduce the burden and uncertainty for both sides.

Financial services institutions face regulatory pressures that differentiate them from groups operating in other sectors. The OECD's 2010 report on the attribution of profits to PEs remains relevant for the taxation of this sector. BIAC cautions against special measures or general principles that move away from this well-established approach.

## Re-examine transfer pricing documentation (Action 13)

BIAC fully supports the recognition under Action 13 of the importance of protecting the confidentiality of commercially sensitive information. This protection should apply across all three pillars of transfer pricing documentation. Peer review mechanisms should be developed to monitor jurisdictions' adherence to appropriate confidentiality standards, and to ensure that the OECD's proposals are uniformly adopted.

The Action 13 recommendations will create substantial burdens for business and effective compliance will require much preparation. The deadline for compliance with the OECD's proposals is quickly approaching, and BIAC is concerned by the delay in releasing implementing guidance. Without such guidance, much of the necessary preparation is impossible. Such implementing guidance should, where possible, leverage data reported under similar regimes (for example the EU's CRD IV for banking organisations) to streamline the compliance burden for as many taxpayers as possible. Only uniform transfer pricing documentation rules across countries will limit the resulting compliance costs for companies.

## Make dispute resolution mechanisms more effective (Action 14)

Again, we acknowledge very recent work by the OECD in this area, but would strongly reiterate that an inability to make major progress on improving international dispute resolution under Action 14 would represent a failure of the process. Many proposals and the interactions between the Action Items will create double taxation. BIAC encourages progress to ensure:

- widespread adoption of mandatory, binding arbitration;
- substantial improvements to MAP best practices, with effective peer reviews or monitoring to ensure adoption; and
- closer working and collaboration with the Forum on Tax Administration to foster the growth of Cooperative Compliance programmes to address BEPS concerns and the use of alternative methods such as the use of a global dispute resolution forum (with mediation services).