BIAC THE VOICE OF BUSINESS AT THE OECD

BEPS POSITION PAPER
December 2015

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 have not been sufficiently considered or addressed.

At the March 2015 meeting of the BIAC Tax Committee, a substantial number of member organizations expressed 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. This document has been updated following the release of the OECD's final reports in October 2015. 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 we believe this is the best way of achieving that success. We call on the OECD to continue to include us in the completion of outstanding work, and the development and implementation of the G20 proposed framework for implementation.

General comments

Many of the concerns identified in this Position Paper are common across the range of Action Items. We feel they are worth repeating up front as their importance continues to grow as the follow-up and implementation work commences.

Economic impact: There is great concern that the economic consequences of the recommendations have not yet been fully considered. Countries should be undertaking realistic assessments of the tax revenues they may be due under the consensus reached, rather than assuming that implementation will bring additional tax revenues. The possibility should be understood that overly strict regulation could force economic activity out of countries. Countries should not rush to implement proposals with such aims in mind when the actual impact on their tax revenues has not been determined - this could undermine the BEPS process and bring about unintended economic implications. Although uncertainty, double-taxation, disputes and compliance burdens are a focus of business, we are also concerned about the broader economic impact, which may include, for example, the impact on the efficiency of markets, or the sustainability of certain legitimate non-tax driven commercial transactions and structures (for example, cross-border infrastructure projects or regionalisation of certain functions to improve quality and efficiency). 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.

Complexity & Compliance: 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 recommendation is clear. This will be critically important in ensuring that the recommendations are uniformly adopted, whilst avoiding overlaps. The challenges that will be brought about through the interaction of different timelines and domestic implementations should not be underestimated. They could lead to double taxation and a significant compliance burden on both businesses and tax authorities and create uncertainty that will delay necessary investments. We look forward to the OECD's development of an inclusive framework to support and monitor the implementation (as proposed by the G20 Finance Ministers) to assist in maintaining international co-operation and as much consistency in timing and application as is possible. We would encourage the OECD to seek agreement from involved countries on effective dates after which new rules and guidelines will apply; even with the OECD's work on Action 14, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

Scoping: As part of the implementation framework, we believe it would be helpful to target the scope of each recommendation more narrowly to increase the chance of developing the necessary inter-governmental co-operation. 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. Countries should be encouraged to avoid overly-broad implementation that could lead to a less uniform international tax regime.

Timing: As well as the timing concerns raised above in relation to the potential economic impact and the potentially disjointed international adoption of the recommendations, we also have a more general timing concern that impatient countries and tax authorities may seek to commence full implementation of recommendations where it has been agreed that further work is required. For example, critically important work remains in relation to profit attribution to permanent establishments and specific rules in relation to financial services and insurance businesses.

Reaching consensus

BIAC has strongly supported the OECD as the best organisation to deliver a successful consensus outcome under the BEPS mandate and recognises the phenomenal work that the OECD has done in brokering compromises and consensus wherever it has been possible. However, despite the OECD's claims, we are concerned that in many instances it has proved difficult (and occasionally impossible) for member governments to reach consensus. This has resulted in a lack of clarity and a degree of ambiguity. For example, whilst the OECD has not recommended solutions regarding the "digital economy", the door has been left open for countries to implement solutions unilaterally which, if implemented, could lead to double taxation.

Understanding the economic impact

It remains 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". We are concerned that the public announcements and discourse have been optimistic in terms of the amounts of additional tax that will be collected as a result of the BEPS recommendations, due in part to the conclusions reached in Action 11, and strengthened by the impression that the expectation of additional tax receipts was in some way a pre-requisite of reaching a broad consensus. Whilst we understand the public and political pressure surrounding the project elevated a need for consensus in agreeing that businesses should be taxed on all profits, most countries who have offered a public opinion on the matter seem to have assumed that the implementation of the proposals will increase their tax revenues substantially.

In reality, depending on which of the proposals are introduced by themselves and/or other countries, there could be many countries that do not receive additional tax revenues. There may be cases where overly strict regulation pushes economic activity out of some countries. If not dealt with by rigorous impact assessments both at international and domestic levels, we are concerned that this expectations gap could lead to countries budgeting for higher tax revenues than they will receive. The resulting pressure could end in countries opting not to implement all of the proposals uniformly, an outcome that would result in double taxation and more pressure on individual tax authorities to aggressively audit taxpayers in an attempt to collect *more* tax rather than *the right amount* of tax based on the consensus agreed. A failure of the BEPS project in such a manner is not in the interests of business, governments or the public and will significantly increase the costs of tax administration and tax compliance.

Complexity and compliance burden

The BEPS recommendations 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 recommendations, but also their complexity and the different timelines that will need to be followed to implement them (for example, the adoption of revised OECD Guidelines into domestic law, or different processes for implementing domestic recommendations). Public and considered consultation and strong commitment by countries to work together (supported by the OECD's implementation framework to be developed in 2016) are essential to avoid fragmentation.

We would encourage the OECD to seek agreement from involved countries on effective dates after which new rules and guidelines will apply; even if the OECD's work on Action 14 is successful in improving dispute resolution, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

We support the OECD's statement that VAT registrations should not create PEs, and we would encourage tax administrations to heed this and not assume that PEs exist where a company is registered for VAT (or vice versa), which would result in significant compliance burden. 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.

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 and the complex new transfer pricing analyses that only apply to transactions between affiliates could greatly increase the compliance cost and tax liabilities associated with various intra-group activities. 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 and encourage additional guidance to be developed to provide greater certainty.

Appropriate resources for tax administrations

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 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.

Multilateral implementation

The ultimate success of the BEPS project will be the multilateral implementation of specific, measurable, achievable and realistic recommendations on a timely basis. Whilst much work on implementation mechanisms is still to come throughout 2016; we encourage early discussions on approaches to enhance credibility and likely success of the project. We make the following recommendations in this regard:

- The G20 proposed engagement framework should be prepared and managed by the OECD Secretariat;
- 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 be limited to addressing specific abuses;
  - draft legislation should be prospective in application and be published with a minimum period for detailed stakeholder consultation; and
  - an impact assessment should be prepared to evaluate any compliance burdens created.
- We encourage the OECD to coordinate the implementation so that national measures have a reasonable degree of consistency.

BEPS Action Item-specific comments

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

We <u>greatly</u> welcomed the original 2014 report (*Addressing the Tax Challenges of the Digital Economy*), but we consider that the final 2015 report does not go far enough by recommending only that such countries are mindful of their treaty obligations until further review in 2020. There is concern amongst BIAC members that some countries are considering withholding taxes on digital transactions, and whilst the final report recognises that this is not recommended, it neither discourages such action nor identifies the treaty obligations and implications that such taxes could breach. Such unilateral action 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. BIAC looks forward to participating in ongoing monitoring and evaluation characteristics of digital trade that may cause BEPS concerns.

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 three important points on the final report:

- It is not clear which countries intend to implement any or all of the recommendations, when they plan to do so, or how the interaction with the local legislative processes will result in differences between countries in terms of application or timing. Implementation through a combination of complex changes to domestic laws, bilateral treaty provisions and potentially a multilateral instrument increases the uncertainty on timing further. We welcome the development of an inclusive monitoring framework in early 2016 to assist international cooperation but retain concerns in particular regarding the risk of double taxation, increased compliance burden and uncertainty that will arise from countries implementing at different times.

- Even if implemented in a coordinated manner, 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"). The accompanying expanded examples 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. By relying on countries to opt not to tax such transactions at their discretion increases uncertainty and the risk of double taxation.

Strengthen CFC rules (Action 3)

The broad nature of the OECD's final CFC proposals 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 were almost impossible. This was 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. We urge the OECD to consider CFC rules further when addressing any future BEPS concerns that the monitoring and analysis highlight.

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

The final report on Action Item 4 will have serious implications for groups' economic activity and their ability to obtain tax deductions for funding costs. The proposals have been made without a clear articulation of how they specifically target BEPS activities. The OECD's proposals are likely to restrict interest deductions for a significant number of non-aggressive taxpayers, particularly those investing in infrastructure or long term projects where it remains unclear whether they would qualify for the proposed exemptions. 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.

However, given the options previously put forward in discussion drafts, we do welcome the broadening of the corridor approach to a range between 10% and 30% of EBITDA and the relative simplicity it brings. However, this approach could have serious consequences if detailed work is not undertaken to determine appropriate ratios, taking into account the funding requirements of different industries. Where ratios are set too low, this could substantially raise the cost of capital for low-risk taxpayers undertaking commercial transactions. We are disappointed that the proposals do not recommend more strongly the elements of the proposals that would seek to limit double taxation, such as the ability to carry forward unutilised interest capacity (especially for start-ups and companies in loss-making positions) or give credit for all withholding taxes suffered.

Additionally, we note that 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 be resolved, particularly so that proposals do not contradict the regulatory agenda.

Whilst we welcome the attention that the OECD plans to give to the group wide ratio rules, financial services and insurance industries 2016, we have serious concerns that so much work remains outstanding in this area at a time when countries are otherwise being encouraged to start implementing the rules.

Prevent treaty abuse (Action 6)

We are concerned that significant uncertainty remains 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. The existing provisions and Guidance could provide more clarity (e.g. low taxed branches with substance, calculation of head office tax rate). Broad disapplication of treaty benefits could create substantial withholding tax burdens and negatively impact cross-border trade.

The final proposed minimum treaty standards are at the very least expected to create a significant compliance burden for taxpayers (especially where both a simplified LOB and a PPT rule are adopted in certain treaties), and will potentially bring into scope legitimate structures that ought to be entitled to treaty benefits. We remain 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.

Whilst we recognise that the OECD has further work to do regarding the commentary on LOB rules and the impact on non-CIVs and pension funds and welcome the OECD's commitment to consult on such matters, we remain concerned that the in order for this to be taken into account as a meaningful component of the multilateral instrument negotiations, this work must be completed swiftly.

Preventing the artificial avoidance of PE status (Action 7)

Whilst many of our members welcome the move away from the ambiguous language of the discussion draft that sought to establish a PE where persons "negotiated the material elements of contracts", we are concerned that the final deliverables introduce new concepts that were not open to consultation and so retain ambiguity. Whilst we welcome the move to recommendations that a dependent agent PE is only established where a person "plays the principal role" in negotiating contracts, we urge the OECD to undertake additional consultation and provide tax authorities with additional guidance to clarify the meaning further. Similarly, the meanings of "complementary functions that are part of a cohesive business operation" in relation to fragmentation and "at the disposal of" regarding fixed places of business should be more tightly defined to ensure consistency in implementation.

It is disappointing that recommendations regarding PE thresholds have been released before the guidance that will follow on profit attribution. We are concerned that tax authorities will seek to establish the existence of PEs based on new concepts before providing business with any certainty regarding the attribution of profits to these newly defined PEs. For instance, the example of a PE being triggered by an agent who convinces customers to accept standard contracts without any authority to make deviations is very different to the previous definitions. Additionally, we would welcome the confirmation that PEs can be loss making.

It is more disappointing still that the changes required to the OECD Model Treaty, OECD Guidance and domestic/multilateral implementation thereof will undoubtedly be disjointed, and we fear that some tax authorities may seek to apply the new concepts to open periods, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and wait until there is a consistent understanding of the concepts before updating the Model Treaty and Guidance.

Transfer pricing (Actions 8-10)

We have consistently acknowledged the need to update international tax rules on Transfer Pricing (TP), 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 TP and its continued viability. We are hesitant in agreeing with the OECD that the final report's recommendations have been finalised without a departure from the ALP.

We welcome the confirmation that where clear contractual arrangements exist that are supported by economic reality, then recharacterisation is not generally required. However, we are concerned about the complexity of the process, the level of detail required, and the consequences it will entail in the practical application. For example, the modifications do not clearly address the relevance of or extent to which (control and) performance of DEMPE functions and risk should contribute to calculating price under the ALP. These are not generally factors that are taken into account by unrelated parties. We welcome the reiteration that the most appropriate TP methodology should be used, and the OECD's commitment to developing guidance on profit split methodologies. However, we note that with this work expected to remain incomplete until 2017, a significant period of uncertainty remains, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and prioritise these areas accordingly.

We welcome the confirmation that tax authorities should only be permitted to consider *ex post* outcomes as presumptive evidence about the appropriateness of the *ex ante* pricing arrangements where taxpayers cannot demonstrate that the uncertainty was appropriately measured in the pricing methodology adopted. However, the distinction between foreseen and unforeseen is subjective and very difficult to make. Additionally, there are many areas of the report that appear ambiguous which will allow countries to take divergent positions. We believe that there remains a significant risk of divergence in interpretation and extent of these approaches, and ultimately of tax authorities using hindsight to recharacterise non-abusive transactions.

Whilst we would welcome the simplicity that the elective regime for Cost Contribution Arrangements (CCAs) could provide, without a commitment from a significant number of countries to implement such a regime it remains the case that businesses will still face a significant compliance burden in satisfying the countries that do not implement it. If a significant number of countries could be encouraged to implement the elective regime at least in part (e.g. service CCAs) this would address these concerns in some cases.

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.

BEPS Data (Action 11)

Whilst the business community generally agrees that insufficient data is available and that such data would be useful (and are thus supportive of the initiative), there has not been significant engagement with business in this area. We would welcome the opportunity to assist the OECD in its further work on identifying and analysing data on BEPS.

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 TP documentation. We consider it would be a useful addition (perhaps under the framework to be developed in 2016) if peer review mechanisms could 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. For example, there remains ambiguity around areas such as the practicalities of reporting Master Files on a business line basis whilst maintaining a global overview, and many countries are already seeking to implement the country-by-country reporting elements recommendations before the guidance and XML schema are even released. Without further 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 TP documentation rules across countries will limit the resulting increase in compliance costs for companies, and we urge the OECD to encourage consistency in this area.

Make dispute resolution mechanisms more effective (Action 14)

We congratulate the OECD on the significant steps forward that have been taken in its work on Mutual Agreement Procedure (MAP). The recommended minimum standards on MAP and peer reviews is a welcomed development in the final report. We welcome the OECD FTA's MAP Forum as the best place for peer reviews to be undertaken, and encourage the OECD and governments to commit appropriate resource to ensure that the minimum standards can be upheld. The full picture of the success of the minimum standards on MAP (and the success of the BEPS Project as a whole) cannot be judged with reference only to tax authorities' data; we would welcome the opportunity to also be consulted as part of the OECD's monitoring framework.

We also congratulate the OECD on securing the commitment of 20 countries to binding arbitration and we urge the OECD to allocate necessary resource to ensuring this area is successful. We hope that this will demonstrate to non-participating countries the benefits of such a process to its participants and hope that this will become an international standard that other countries are compelled to join.

Multilateral Instrument (Action 15)

We congratulate the OECD on securing the commitment of c.90 countries to participate in the development of this ambitious project in 2016. We recognise the benefits that could arise from a significant number of countries signing up to the instrument in order to swiftly and uniformly implement the OECD's proposals.

Whilst the detailed timeline and consultation requirements have not been made public; we hope that the OECD will seek to consult widely and take up BIAC's offer of support in its work on development of the Multilateral Instrument.