SQUIRE PATTON BOGGS

THE OECD BEPS PROJECT

Update on Implementation Efforts and Implications Around the Globe

This article is the first in a series of three that will discuss the ever-changing international tax environment in light of the Organisation for Economic Co-operation and Development's (OECD) effort to address the perceived global problem of base erosion and profit shifting (BEPS). In this first article, we begin with an overview of the BEPS key focus areas and provide an analysis of the current environment in which legislative changes will be made. The second article will provide a country-by-country survey of BEPS-type legislation that is being implemented or considered around the world. The third article of this series will discuss how BEPS is influencing tax reform proposals in the US and the practical limits of implementing such reforms due to administrative and funding challenges.

Overview

In 2013, the G20 Leaders endorsed the OECD's two-year plan to address BEPS, particularly with respect to multinational corporations (the "BEPS Project"). The OECD's aim is to curtail tax planning strategies that inappropriately exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no relevant economic activity, resulting in little or no overall corporate tax being paid.

The BEPS Project includes 15 specific actions ("Action Plan") that governments can implement to ensure profits are taxed where the economic activities generating such profits are performed. In addition, the Action Plan is intended to provide businesses greater certainty by standardizing requirements and thereby reducing disputes over the application of international tax rules. In September 2014, the OECD presented the first stage of the BEPS Project by releasing reports on seven of the 15 action points. These reports included two final reports assessing the challenges of a digital economy (Action 1) and the feasibility of a multilateral instrument to implement the BEPS measures (Action 15), an interim report describing harmful tax practices (Action 5), and reports containing draft recommendations on how to address hybrid mismatches (Action 2), treaty abuse (Action 6), transfer pricing (Action 8), and transfer pricing documentation, including country-by-country information reporting (Action 13).

The remaining nine action points that are scheduled to be presented later this year include strengthening rules on controlled foreign corporations (Action 3), limiting base erosion from interest deductions and other financial payments (Action 4), continuing work on countering harmful tax practices (Action 5), preventing artificial avoidance of "permanent establishment" status (Action 7), assuring transfer pricing outcomes in line with value creation (Actions 8-10), improving the availability and analysis of data on BEPS (Action 11), requiring taxpayers to disclose aggressive tax planning arrangements (Action 12), and making dispute resolution more effective (Action 14).

The OECD and G20 countries have agreed to an Implementation Package, which was published in February 2015. This package includes three key elements that are intended to enable implementation of the BEPS Project at a country level: (1) a mandate to launch negotiations on a multilateral instrument to streamline the implementation of tax treaty-related BEPS measures (Action 15); (2) implementation guidance for country-by-country reporting in 2016 and a related government-to government exchange mechanism to start in 2017 (Action 13); and (3) criteria to assess whether preferential treatment regimes for intellectual property (e.g., patent boxes) are harmful (Action 5).

Developing a Multilateral Instrument to Give Effect to BEPS Measures (Action 15)

The OECD believes there is significant need for a single, multilateral instrument that modifies existing bilateral tax treaties to reflect the outcome of the BEPS Project. An ad-hoc group hosted by the OECD and open to participation from all countries will undertake this work and is set to hold its first meeting by July 2015, with the goal of concluding the drafting of the instrument by December 31, 2015. It was agreed, however, that countries participating in the drafting process will not be required to sign the multilateral instrument once it is finalized. This demonstrates the challenges the OECD will face in realizing their goals as any changes proposed by the OECD must still be implemented legislatively in the local jurisdictions in order to effectuate the changes.

Country-by-Country Reporting – Transfer Pricing Documentation (Action 13)

Revised standards for transfer pricing documentation and a template for country-by-country reporting were published in September 2014. The country-by-country template will require multinationals to provide information on revenues, profits, taxes accrued and paid, and some activity indicators. Preparation and filing of the country-by-country reporting by multinationals with a turnover in excess of €750 million is expected to start in 2016 so that the first pieces of information are obtained by tax administrations by 2017. Information will be filed in the multinational's primary country of residence and will be automatically exchanged with countries meeting certain conditions, in particular confidentiality and proper use of the information. Many taxpayers have expressed serious concern about the heavy compliance burden this reporting format will have on them, as well as the difficulty in identifying and tracking the data in a manner that will allow them to be in compliance with the rules.

Harmful Tax Practices – Agreement on Patent Box Regimes (Action 5)

Although no consensus was reached regarding the treatment of certain intellectual property (IP) regimes in the first phase of the BEPS project, all OECD and G20 countries have now endorsed a compromise solution. This solution requires nexus between the location of the activities generating the income eligible for the preferential tax treatment and the jurisdiction offering the preferential regime. Countries with IP regimes that are inconsistent with the nexus approach are expected to take steps to amend those regimes beginning in 2015, with new entrants to such IP regimes not permitted after June 30, 2016. There has also been agreement on providing a five-year grandfather clause for existing regimes (i.e., taxpayers benefitting from an existing regime that does not comply with the nexus approach will not be able to receive additional tax benefits from those regimes after June 30, 2021).

The OECD is working on the practical implementation of the nexus approach, in particular as relates to determining the eligible income, tracing the related expenses, and limiting the risk of abusive entries before the grandfather clause expires and with respect to measures regarding transparency to ensure the comprehensive reporting of tax rulings through automatic exchanges of information. Guidance on practical implementation will be provided in the second phase of the BEPS Project.

Looking Ahead

The OECD continues to release discussion drafts and receive public comments on the Action Plan. The OECD Committee of Fiscal Affairs is undertaking a significant amount of technical work to publish the second stage of the BEPS Project in late 2015. An overall package taking into account the need for a comprehensive approach to the BEPS Project is expected to be delivered by the end of 2015. The goal of the BEPS Project is to develop tools that countries can use to shape fair, effective and efficient tax systems to implement the Action Plan. Some actions (e.g., OECD transfer pricing guidelines and commentary to the OECD Model Tax Convention) will result in changes that are directly realized once finalized by the OECD. Other actions will require implementation by countries to take effect, either through domestic legislation, new or amended bilateral tax treaties, or multilateral instruments.

The OECD recognizes that countries retain their sovereignty over tax matters and may implement the recommended measures in different manners, provided they do not conflict with international legal commitments. As such, the OECD has stressed that the success of the BEPS Project will largely depend on the cooperation of the highest levels of leadership demonstrating a clear commitment to this global approach. Although the OECD, G20 and certain non-OECD G20 Members support the BEPS Project, whether such countries will be successful in actually making the necessary changes given their respective legislative environments remains to be seen.

BEPS and Implications Around the Globe – "Jumping the BEPS Gun"

As the OECD moves forward with development and implementation of the BEPS Project in an effort to shore up a global consensus on the rules of international taxation, certain governments have chosen not to wait until the BEPS Project is finalized to take action. For example, as we have previously highlighted, even the UK – one of the biggest proponents of the BEPS Project – has taken independent action to address the perceived improper shift of profits from the UK by enacting "diverted profits tax" legislation effective April 1, 2015. Similar efforts are being taken by other countries around the globe including, notably, Australia, which has put forth numerous BEPS-type proposals this spring.

In the US, Congress is presently in the middle of an intense debate over how to reform the Internal Revenue Code of 1986 (Code) and is specifically examining numerous and fundamental changes to US international taxation. As former US House Ways and Means Committee Chairman Dave Camp (R-MI) recently noted, "[t]he rapid changes in global tax policy constitute both a challenge and a threat as the United States considers a long-overdue reform of our nation's tax laws. The bottom line is that change is coming – if not here at home, then it is certainly coming from overseas. So now is the time to engage. 2015 is a very important year. We need tax reform now."

What other BEPS-type efforts are being considered and implemented around the globe, and how might this impact overall efforts to finalize and implement the BEPS Project? How will the BEPS Project and these other efforts around the globe impact US efforts to reform the Code? Stay tuned for our upcoming articles to find out.

Contacts

Mitch Thompson
T +1 216 479 8794
E mitch.thompson@squirepb.com

Linda Pfatteicher
T +1 415 954 0347
E linda.pfatteicher@squirepb.com

Katie A. Sunderland
T +1 202 457 6168
E katie.sunderland@squirepb.com

Brandon C. Román
T +1 202 457 5330
E brandon.roman@squirepb.com