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Should We Expect Every Country to Implement BEPS, Regardless of the Economic Implications?

Devising the Plan Is Only the Beginning

When the Organisation for Economic Co-operation and Development (OECD) released their base-erosion and profit shifting (BEPS) reports last fall, the real work began for countries to implement the recommendations contained in the reports. Each participating country is now in the process of deciding when, how or even whether they will implement the suggested changes. Even as many countries lost tax revenue as a result of BEPS planning techniques, other countries have benefited from BEPS strategies over the years. As a result, a question arises as to whether certain countries will choose to not implement the OECD's recommendations, since to do so would be harmful to their economies, particularly countries that have a material proportion of their wealth generated from structures designed to maximize tax efficient structures.

What Are the Easy Wins?

In general, many have accepted that several of the OECD's recommendations will be adopted without much resistance, such as country by country reporting (CbCR). Although not universally true, many of the developed countries have taken steps to implement CbCR for the 2016 tax year in accordance with the OECD's recommendations. In addition, over 30 countries have signed up to the Multilateral Competent Authority Agreement for the automatic exchange of CbC reports. Indeed, at the European Union (EU) level, it looks possible that CbCR will be the subject of binding regulation, with the biggest issue possibly being whether the reports will be made public or whether they will be restricted to tax authorities. It also seems likely that some tax authorities will agree to automatic exchange of information in relation to tax rulings. The EU has again taken a lead in this area, with the member states of the EU unanimously agreeing to the automatic exchange of information on cross border tax rulings.

What Might be Difficult to Implement?

As one of the OECD's goals is to design "new international standards [...] to ensure the coherence of corporate income taxation at the international level", the objective must be to create coherence in the interpretation of what constitutes taxable income as opposed to solely the coherence or conformity of tax rates.

For example, hybrid instruments have been an area of perceived abuse and one that the OECD has specifically addressed in its reports due to the "double dip" that is involved. The paying country treats the instrument as debt and obtains an interest deduction, while the receiving country treats the instrument as equity and receives a dividend that may not be taxable (and may also not be subject to dividend withholding tax under a bilateral income tax treaty). Some of the more widely used hybrid instruments are the Luxembourg Convertible Preferred Equity Certificates (CPECs).

Interestingly, the OECD reports do not specifically describe Lux CPEC arrangements in the examples, resulting in some wondering whether CPECs were intentionally bypassed by the report.

Although the OECD's objective is to have consistent treatment of hybrid instruments and eliminate this tax planning technique, not all jurisdictions will agree that hybrid instruments are detrimental to their nation's economy. The fact that different jurisdictions may reasonably differ on hybrid instruments, for example, renders "coherence of corporate income taxation" virtually impossible to achieve unless all states agree to the basic principles. As the OECD report acknowledges on the first page of the background to the OECD reports, "taxation is at the core of countries' sovereignty and the interpretation of financial instruments cannot be legislated for without infringing upon that sovereignty." Even from an EU perspective, the European treaties provide that taxation is an area of law that requires all 28 member states of the European Union to agree on before any change can be legislated for on a supranational level. Given that the state of Luxembourg has over €3.5 billion of net assets under management and 86% of GDP consists of services predominantly to those assets, it is questionable whether Luxembourg will rush to adjust its legislative provisions to prohibit the use of hybrid instruments. In fact, Luxembourg recently released its tax reform proposals and the corporate taxpayer provisions focused on lowering the overall effective tax rate and limiting the use of tax loss carryforwards, and did not contain any BEPS–specific related provisions.

Similar to Luxembourg, countries such as Malta, Cyprus, Singapore, and Switzerland have all benefited from providing low effective tax rates to attract investment that in turn generate revenue and jobs to create strong economies. Although some countries like Switzerland have begun to make changes to their system to be in compliance with BEPS, by providing a uniform rate available to all companies (much like Ireland has had for years), others may be less willing to make significant changes to their tax laws for fear the investment will fade away.

Naming and Shaming Companies Into Paying Their Fair Share

Much of the recent media focus has been on naming and shaming household–name companies for failing to pay their "fair share" of tax. We have also seen the European Union aggressively targeting multinationals for utilizing what they deem to be inappropriate tax structures. Commentators have noted that public demand for increased accountability for corporations using aggressive tax avoidance measures will ultimately result in those corporations changing their financing structures so as to avoid controversy and maintain their corporate reputation.

At the same time, the US has been objecting to the EU cases because the US claims they have a right to tax the earnings that Europe is currently trying to tax. The US is concerned that if other jurisdictions tax these earnings first, the only thing the US will get is cash repatriation that brings along foreign tax credits with no requirement to pay any additional tax revenue to the US. (The EU response to this is that the US doesn't have a right to these taxes more than the EU does, particularly given that the profits were generated on EU soil.) As a result, it is quite possible the US will determine it is in its best interest to support the countries that are not aggressively asserting that US multinationals have not paid their fair share as this still gives the US a chance (albeit slight) to tax those revenues once they are repatriated to the US.

So while many jurisdictions will determine that BEPS–related initiatives will be beneficial financially, certain jurisdictions – including possibly the US – may be hard pressed to find the economic incentive to implement many of the OECD's recommendations.

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