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BEPS ACTION PLANS FINALISED: WHAT THEY MEAN FOR MNEs



For the past two years, multi-national enterprises (MNEs) and their advisors have been following the OECD's progress on its 15-point Action Plan aimed at addressing base erosion and profit shifting - BEPS for short. With the release of final reports on 5 October 2015, the OECD has delivered its recommendations as promised, before the end of 2015.

The intention of the BEPS project was that MNEs would have a degree of certainty against which they could assess their tax planning structures and plan how to manage their global tax cost going forward. Unfortunately, as countries decide whether, and to what extent, they implement the recommendations, the prized goal of coherence regarding how countries' tax laws treat structures used by international business is unlikely to be achieved.

Instead, the one certainty it seems MNEs can count on is the fact that - for the foreseeable future - the global tax environment will be chaotic. That said, MNEs should not assume it will be "business as usual". Given the international trends, MNEs should take steps to ensure their tax structures reflect the commercial realities of how their business operates globally and they should be prepared to be transparent about their business structures. And, going forward, MNEs need to continue monitoring the changes countries make as they pick and choose which BEPS recommendations they implement.

Background

In recent years, governments around the world have become concerned that their tax bases are shrinking because more-and-more MNEs have implemented strategies that take advantage of gaps and differences in tax rules between countries. They have also recognised that steps they've taken to eliminate double taxation, though conducive to cross border trade and investments, can also facilitate double non-taxation (for example, where a deduction in one country is not subject to tax as income in another jurisdiction). They also know that there is a growing public perception that, as compared to domestic businesses, MNEs are not paying their fair share of taxes because they can avail themselves of legal cross-border planning techniques. As a result, the G-20 governments asked the OECD to review the principles on which international tax law is based and to make recommendations on how to fix the system.

The OECD-led BEPS project aimed to help countries secure their tax bases by adopting rules that ensure the tax burden on MNEs aligns with where the economic activities that generate their profits take place. To achieve this, the OECD set out to create a single set of consensus-based international tax rules. In July 2013 they issued the 15-point Action Plan. In doing so, the OECD recognised that most issues set out in the Action Plan can be addressed through a combination of changes to domestic tax laws and changes to bi-lateral tax treaties. They also recognised that development of a multilateral instrument to modify bilateral tax treaties of countries in a synchronised way with respect to BEPS issues would be beneficial. (Such an instrument would be more efficient than having countries renegotiate their tax treaties country by country which could take decades to achieve).

Core principles of the BEPS project

Though each Action Plan deals with a specific issue and the approaches recommended to deal with each issue varies, three basic principles underlie all the BEPS proposals:

Coherence

This is achieved when the tax rules of different jurisdictions ensure that income earned by an MNE is subject to tax and the MNE cannot minimise or eliminate tax by exploiting differences in the way countries treat a particular amount. (For example, coherence is achieved when a taxpayer gets a deduction for an expense in one country and the amount is taxed as income in the recipient's country.)

Substance

This is the principle that taxation of an MNE's profits should happen in the jurisdiction where the business activities that generate that profit occur.

Transparency

This relates to disclosure by taxpayers about both where their business activities are carried out and their tax planning activities. Transparency will provide tax authorities with information about an MNE's activities, helping them to identify risk areas so they can focus their tax audit resources.

How has the OECD done?

The OECD should be commended for issuing its recommendations on schedule. Going forward, however, a big challenge still exists because not all countries appear ready to implement the proposals. The reality is that, though countries agreed that BEPS, by its nature, requires coordinated responses, some countries are taking a wait-and-see approach, some will pick and choose among the proposals, and some will go beyond what the OECD suggests.

That said, there are some areas where the OECD proposals are likely to have an impact. The recommendations on hybrid mismatch arrangements are one such area. Hybrid mismatches are arrangements designed to allow an MNE to claim a tax deduction in two different countries, or a tax deduction in one country without there being a corresponding tax charge in another, or achieve multiple foreign tax credits for one amount of foreign tax paid.

The OECD's proposals for combatting such mismatches are very well thought out and will result in eliminating the tax effectiveness of hybrid planning into or out of a country where that country implements the OECD recommendations, as the UK has already announced it will do effective 1 January 2017. Proposed changes to the European Union Parent Subsidiary directive will also deter some of these arrangements. But, in order to achieve wider coherence of international tax law on things like cross-border financing planning, more will need to be done as MNEs will inevitably move from these mismatch arrangements to other structures that help manage their global tax burden.

The OECD work related to transfer pricing documentation will also likely have a real impact. As countries move towards adopting the OECD standards of a master file and local file approach to documentation, as well as adopting Country-by-Country Reporting as part of documentation requirements, more consistent documentation will result. A number of countries have already indicated that they will adopt the OECD standards. The UK, Australia and the Netherlands, for example, have indicated they will adopt the recommended OECD standards for fiscal years beginning on or after 1 January 2016. As well, in a recent discussion draft released by China's State Administration of Taxation, China has proposed going even further than the OECD recommendations with further documentation requirements for special issues.



The OECD work in this area will ultimately result in more information being available to tax authorities about how MNEs conduct their businesses internationally, and the prices they charge for transactions between non-arm's length entities. This information will allow tax authorities to identify areas of potential risk in how an MNE reports profits for tax purposes and help to improve transparency, allowing the authorities to better understand how MNEs are structured and where they report profit for tax purposes around the globe. Given these requirements, MNEs should take a close look at their global operations to ensure that the way they report profits for tax purposes respects the commercial realities of how their businesses are conducted.

One other area where the OECD could achieve some success is with respect to its recommendations targeting treaty abuse. Under these recommendations, if an MNE has a holding company in a territory but it does not have any real substance in that territory, the MNE will not be able to benefit from any of that country's tax treaty provisions. As more and more countries adopt the OECD recommendations targeting treaty abuse, MNEs will have to reconsider the use of holding company structures in jurisdictions where they have no substance.

One key OECD goal - the achievement of coherence among the tax laws impacting MNEs - has already been diluted. The UK and Australia, for example, have already drifted away from the hoped for coordinated approach by enacting domestic laws even before the OECD completed its work. The UK's enactment earlier this year of the Diverted Profits Tax (DPT), which came into effect on 1 April 2015, is a prime example of a measure aimed squarely at profit shifting. The DPT is a 25% tax on profits diverted from the UK to other countries. Australia's Multinational Anti-Avoidance Law (MAAL) is another example of a domestic law that pre-empts the outcome of the base erosion and profit shifting debate. MAAL is a targeted measure aimed at addressing about 30 foreign multinational businesses (with a global turnover greater than \$1 billion Australian) that are suspected of diverting profits using artificial structures to avoid a taxable presence in Australia. Both the DPT and the MAAL could potentially increase the risk of tax disputes between tax authorities. Indeed, the US has been openly critical of the DPT and MAAL, both of which it sees as being motivated by politics and a drive for revenue, rather than a desire for a more coherent international tax system.

Another big question mark related to coherence comes from the uncertainty about what changes the world's largest economy, the US, might implement. The US Treasury Department, which is in charge of tax policy, has been lukewarm in terms of its support for the BEPS proposals. And even if the US Treasury Department is supportive of some measures, given the current political stalemate in Washington, meaningful BEPS actions being taken by the US could be delayed for some time.

Implications for MNEs

Though it seems clear that the much talked about goal of coherence will not be met, MNEs need to pay attention to how BEPS will impact them. MNEs should review their operations to ensure that their tax planning is aligned with the economic substance of how they conduct their business. They should be prepared for the introduction of measures designed to provide increased transparency of their operations and their tax planning, such as the new transfer pricing documentation requirements including Country-by-Country Reporting. And, they should be aware of changes specific countries implement that will impact tax planning arrangements they currently have in place. MNEs need to begin preparing for a new reality and they should be particularly cautious about instituting structures that may prove costly to unwind if future changes make them ineffective.



Conclusion

Change is coming - and it is coming on many different fronts, adding to the complexity of tax planning and compliance. And, because the political process will play out in each country at different speeds, MNEs can expect to continue facing a chaotic environment going forward. Now, more than ever, MNEs need good advisors to help them navigate through the changes, minimise risks, and help them identify legitimate tax saving opportunities that may exist.

Contact your BDO adviser for more information on how the OECD's BEPS recommendations could impact your business.



CONTACT

BDO Certified Public Accountants SA
449 Mesogion Av., 15343 Agia
Paraskevi - Athens, Greece

Telephone: +30 211 10 32 000
Telephone: +30 210 82 53 078/9
Fax: +30 210 82 52 133
info@bdo.gr

www.bdo.gr

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