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OECD issues action plan to tackle base erosion and profit shifting

OECD – Aggressive tax planning – Hybrid Instruments – Transfer Pricing

On July 19, 2013, the OECD published its Action Plan on Base Erosion and Profit Shifting (BEPS).

Background

On February 12, 2013, the OECD released its report on BEPS. The report was commissioned by the G-20 and looked at whether current profit allocation rules and guidelines allow for taxable profits to be allocated to jurisdictions other than where the actual taxable business activity is carried out. According to the OECD, some multi-national enterprises (MNEs) use tax planning strategies that allow them to pay as little as 5% in corporate income taxes, whereas smaller businesses pay up to 30%.

The OECD has now issued its Action Plan, developed in co-operation with governments and the business community, which provides concrete strategies for states concerned about BEPS. The Action Plan also includes timelines for implementing the report's recommendations.

The BEPS Action Plan

In its introductory remarks, the OECD refers to the effects of globalization and the opportunities this has created for MNEs to minimize their tax burden. It also addresses the weakness of the existing consensus that is mainly based on double tax treaties.

The Action Plan acknowledges that governments lack adequate instruments to fight BEPS. In this respect, it suggests that governments need to pay more attention to the prevention of double non-taxation (particularly if this is the result of mismatches between domestic legislation), the avoidance of treaty abuse and to ensuring more transparency in respect of the tax planning strategies of MNEs, while at the same time providing legal certainty for the latter.

In order to tackle these issues, the OECD has made 15 recommendations:

1. Address the tax challenges of the digital economy by examining issues such as the ability of companies to have a significant digital presence in the economy of another country without being liable to taxation.
2. Neutralize the effects of hybrid mismatch arrangements by changing the OECD Model Tax Convention and proposing recommendations regarding domestic rules.

3. Strengthen CFC rules by developing recommendations regarding the design of domestic CFC rules.
4. Limit base erosion via interest deductions by preventing the use of debt financing to achieve excessive interest deduction or to finance the production of exempt or deferred income.
5. Counter harmful practices more effectively through transparency (e.g. by promoting compulsory spontaneous exchange on rulings related to preferential regimes) and substance requirements.
6. Prevent treaty abuse by changing the OECD Model Tax Convention and proposing recommendations regarding domestic rules.
7. Prevent artificial avoidance of permanent establishment status through, for example, the use of commissionaire agreements and exemptions for specific activities. This can be achieved by changing the OECD Model Tax Convention.

8-10. Assure that transfer pricing outcomes are in line with value creation as it relates to the transfer and use of intangibles (8), risks and capital (9), and other high risk transactions (10), by updating the Transfer Pricing Guidelines.

11. Establish methodologies to collect and analyse data on BEPS, taking into account taxpayer confidentiality and the administrative costs for tax administrations and businesses.
12. Require taxpayers to disclose their aggressive tax planning arrangements, taking into account the administrative costs for tax administrations and businesses.
13. Re-examine transfer pricing documentation to enhance transparency for tax administrations, taking into account the compliance costs for businesses.
14. Make dispute resolution mechanisms more effective, e.g. by including arbitration provisions in the OECD Model Tax Convention and facilitating access to Mutual Agreement Procedures.
15. Develop a multilateral instrument to implement BEPS measures, taking into account relevant public international law and tax issues.

The OECD calls for swift implementation of the abovementioned action points, which should be developed in more detail in the period from now until the end of 2015**.**

EU Tax Centre Comment

The Action Plan is a first step toward a coordinated action against BEPS strategies. However, it still requires more research and does not yet provide clear-cut recommendations for tax administrations.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

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