Ready for action

International Tax

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Bill Dodwell asks what should we make of the BEPS project’s outcomes?

The 13 papers covering the 15 actions in the G20/OECD Base Erosion and Profit Shifting (BEPS) project were released on 5 October, shortly before a meeting of the G20 finance ministers.

The first point is perhaps amazement that 62 countries have managed to agree plans to change international corporate tax in just over two years. Too many people refer to BEPS as an OECD project when it's not; it is G20-led, involves the OECD member states and, more recently, a dozen developing countries have pitched in too. The OECD secretariat has managed the project, but all the working groups are made up from finance ministry and tax officials from the participating countries. This is a project of governments.

There has been much public consultation. The secretariat has organised public meetings on almost all actions, where anyone is free to attend and speak. Anyone can respond to the consultations – and all comments have been placed on the OECD website for public viewing. Special meetings have been arranged for non-governmental organisations, trade unions, academics, business and advisers to convey their views. The secretariat has also organised a range of regional meetings to ensure that developing countries can learn about the project – and feed into it.

The participating countries have made political commitments to implement 'minimum standard' measures. The actions set at this high level are: transfer pricing; treaty abuse; permanent establishment (taxable presence); harmful tax practices; dispute resolution; and country-by-country reporting to tax authorities where, for the first time, the G20 and OECD have mandated the form of domestic legislation. Many countries are starting to enact law or regulations to require multinationals to provide this information in the set format. The UK has produced its enabling law and statutory instrument, as have Australia, China, Ireland and Spain, among others. The US has confirmed that it will soon produce its own regulations.

The result is that large amounts of data will be provided to tax authorities in 2017, which will be shared with others in 2018. The data will not enable any country to issue tax assessments, but it will aid authorities when making risk assessments so as to focus enquiries productively. It also seems likely that tax authorities will start sharing rulings and unilateral advance pricing agreements from 2016 or 2017, under the harmful tax practices action. This too will help other authorities gain a much better understanding of a multinational's global tax position.

The new, agreed approach to transfer pricing will be used by almost all G20 and OECD countries, since all but Brazil use arm's-length pricing and its use is mandated in both the OECD and UN model treaties. There will be a new edition of the *Transfer Pricing Guidelines* in 2017 – but many countries are already applying the new approaches. This starts by looking at the legal agreements in place – but then asks whether they are borne out in practice. Profit, fundamentally, follows people-based activities, not legal allocation.

There is new guidance on risk, which questions whether an entity has both the financial capacity to bear the risk and also the skilled people to control it. Risk management activities can be sub-contracted, but high-level control cannot – and non-executive directors do not have that required control.

Other changes will take longer to put in place. A conference to negotiate a multilateral instrument starts on 5 November and already 90 countries have signed up. The aim is that the instrument should amend bilateral double tax treaties in permanent establishment, treaty abuse and dispute resolution. The instrument should be ready for signing in 2017 – lowering the threshold for recognising a taxable presence and imposing new restrictions on treaty shopping.

Two important ‘best practice’ actions will require domestic legislation. Since they have not been agreed as ‘minimum standard’ not all BEPS countries will adopt them. The actions are interest restrictions and hybrid mismatches.

Hybrids took the prize for the longest paper, at more than 400 pages, since it included many examples to help countries enact legislation. It is hoped that hybrids will cease to be effective even if only one country enacts the rules. This is because of the linked approach, where the primary rule disallows a deduction for a hybrid expense and the secondary rule – applied if the primary rule is not enacted – taxes the equivalent income (or disallows a second deduction). The UK and Australia have confirmed they will implement this action, probably from 2017, although several other countries may also do so.

Limiting interest expense is complex to get right and the paper allows a range of options for countries to choose. The basic approach follows the German ratio-based limits, now adopted by six other European countries. The UK government has declared it will implement BEPS actions, so we must expect proposals for 2017 onwards.

We are thus likely to find the international tax rules significantly different in 2017. The challenge for governments is to enact what they have agreed – and to keep working together.