

Tax insights

BEPS: 2015 and beyond



Snapshot

This edition of *Tax insights* takes a look at key developments in the OECD base erosion and profit shifting (BEPS) project to date and what is in store for the remainder of 2015. In particular, it features:

- Our views on some of the key BEPS developments so far;
- A review of global actions on BEPS-related matters; and
- Consideration of the future challenges of implementing the BEPS recommendations.

Throughout this edition of *Tax insights* there are useful links to each of the referenced BEPS deliverables and related Deloitte tax analyses.

The OECD BEPS achievements so far

One of the most impressive outcomes of the BEPS project to date is the OECD's adherence to a timetable that appeared incredibly tight when first announced, particularly when the complexity of the issues and the variety of stakeholders are taken into consideration.

The OECD produced a formidable array of material in 2014 on the BEPS project, including detailed draft and final deliverables and a raft of further public consultation documents. Calendar year 2015 has so far proved to be no quieter, with some further BEPS deliverables and commentaries already released, such as the discussion draft on interest and other financial payments.

There has also been a shift in focus towards implementation issues, evidenced by, for example, the implementation guidance release on Country-by-Country ("CbC") reporting.

A list summarising the key BEPS actions and deliverables released to date, together with links to related analysis by Deloitte, is set out at the conclusion of this document.

Key BEPS developments

Country-by-Country ("CbC") reporting

The reporting requirements of Action 13 will provide global tax authorities with **unprecedented insight into the tax profiles of multinational enterprises**. The CbC reporting template requires multinational groups to report the amount of revenue (related party and unrelated party), profits, income tax paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets annually for each tax jurisdiction in which they do business.

In addition, multinational groups are also required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities which each entity conducts.

This wealth of information will make it possible for tax authorities to compare outcomes between jurisdictions and thereby target enterprises for appropriate reviews and audit activity.

On 6 February 2015, the OECD released [guidance](#) on the implementation of transfer pricing documentation recommendations and CbC reporting. The guidance provided answers to taxpayers' questions regarding:

- which groups will be subject to the reporting requirements;
- the use of the CbC report by jurisdictions;
- the mechanisms for government-to-government exchange of CbC reports; and
- the timing of preparation and filing of the CbC report.

Multinational groups with **turnover in excess of EUR750mn (approximately AUD 1bn) in the previous financial year will be required to file CbC reports** with the tax authority in the parent entity's location.

Based on a high level review of the financial reports of the ASX 200, approximately half of these groups would be required to file CbC reports with the ATO.

However, the proposed approach does raise **concerns about revenue authorities seeking to use the information provided to follow a "formulary apportionment" approach to transfer pricing**. The OECD has specifically cautioned tax authorities against using such an approach in the February guidance release.

Impacts and recommended actions

We expect the measures will drive a significant increase in audit activity across a range of industries. Multinationals groups subject to the rules should **assess their audit readiness** with respect to their transfer pricing policies, structures and documentation. These groups should also consider how the new documentation requirements will impact their current transfer pricing policies and processes, and determine how best to gather relevant data so as to comply with the requirements going forward.

Proposed changes to the tax treatment of interest and related payments

The design of the proposed hybrid measures in the Action 2 deliverable has resulted in a series of recommendations which are both comprehensive and targeted.

Importantly, since the proposals rely primarily upon the introduction of domestic law remedies to address undesirable cross-border mismatches, **it should be relatively straightforward for countries to adopt the recommendations should they wish to do so**. This should be a much simpler and more effective approach than requiring countries to agree on multilateral or bilateral action.

The proposed changes recommend addressing specific mismatch scenarios, including the **denial of a dividend participation exemption for deductible payments**, together with a broader **set of 'primary' and 'defensive' rules** which will impact the tax outcomes arising under many current financing structures.

The commentary accompanying the recommendations (expected by September 2015) will provide further guidance on the practical application of the rules, together with further insights on the interaction of the rules with the

OECD Model Tax Convention and related tax treaty issues.

Complementing the proposals above is the [Action 4 discussion draft on interest deductions and other financial payments](#). This discussion draft considers three options to address concerns relating to BEPS through deductible payments such as interest.

One approach being considered would have the effect of **limiting deductible payments of interest and other financial payments by reference to a multinational group's level of external debt**. This method would involve a **group-based cap on interest expenses**, parts of which would be allocated to each country based on various measures such as assets, earnings or a combination of these approaches.

The second approach discussed would involve **limiting the deductibility of interest by reference to a fixed ratio**, such as assets or earnings. Finally, the discussion draft considers the use of a combination of the above models, with a carve-out from the rule available for certain groups.

Should one of the above models be implemented, it would **significantly impact the tax implications of internal gearing** within multinational groups. In addition, there may be considerable practical, implementation and compliance issues associated with the adoption of these approaches.

The growing impact of the BEPS project in the Australian landscape was evident in the Federal Labor opposition's [media release](#) of 2 March 2015. The media release advocates thin capitalisation changes consistent with the Action 4 paper, together with changes to address hybrid

mismatch arrangements consistent with the Action 2 paper.

Specific issues for banks and insurance companies, other financial sector entities and infrastructure projects are also considered in the discussion draft.

Additional targeted rules

In addition, the discussion draft notes that more targeted rules may also be required and provides a “menu” of possible rules for consideration.

Country-specific BEPS developments

The media coverage of the BEPS project and the tax affairs of multinational enterprises has catapulted the (some might say unlikely) topic of international tax firmly into the public spotlight and the crosshairs of governments across the globe.

Some of the wider impacts of the BEPS project we have seen recently include:

Harmful Tax Practices – the end of the “Double Irish”

The OECD’s work on [Action 5](#) and the associated media coverage of large e-commerce companies using these types of structures led to an upsurge of public pressure to address the issue of the “Double Irish” structure.

The Irish Government announced in their 2014 Budget that it would legislate to limit the use of the so-called “Double Irish” structure (with effect from 1 January 2015 for new entrants).

However in the same Budget these changes were announced (and in which the Irish Government reaffirmed its support for the BEPS project), it also outlined a proposal to pursue an [Irish “Knowledge Development Box” regime](#) along the lines of preferential patent box regimes which have emerged in many other EU countries.

Proposed alterations to the UK patent box regime

The OECD and the EU have accepted the UK/German compromise on the future of patent boxes. Germany was concerned with the alleged competitive advantage the UK patent box provided over its fellow EU member states.

The revised regime (the so-called “Modified Nexus” approach) will combine elements of the current regime and the nexus approach proposed in the Action 5 deliverable and will require tax benefits to be directly connected to research and development (R&D) expenditure in that jurisdiction. There will also be amendments in relation to qualification of expenditure, grandfathering and tracking qualifying R&D expenditure.

The UK has indicated that the legislative process to make appropriate changes to its existing intellectual property regimes will commence in 2015.

The OECD has agreed upon Transitional provisions for existing regimes, such as denying access to such regimes from (no later than) 30 June 2016, and setting 30 June 2021 as the latest date for benefits arising under such regimes to be available.

“Diverted profits tax” (DPT)

The UK [announced](#) on 5 December 2014 that it will introduce a DPT with effect from April 2015. The measure is intended to apply to multinationals conducting economic activity in the UK who artificially shift profits from the country for tax purposes.

Draft legislation was released on 10 December 2014. An interesting feature of the DPT is that it is intended to be a tax outside the scope of traditional tax legislation, including, for example,

tax treaties. This approach is quite novel and raises concerns about the potential for double taxation.

The implications that arise from a country seeking to take such a unilateral approach to issues which are currently being considered by the BEPS project is discussed later in this document.

Shortly after the UK announcement of its intention to introduce a DPT, the Federal Treasurer, the Hon. Joe Hockey MP, indicated Australia was considering introducing similar measures, saying:

“... [the Australian Government] is “absolutely determined to ensure that companies that earn their profits in Australia pay tax to the Australian government”

US inversions & comments on BEPS

On 22 September 2014 the US Treasury announced its intent to issue regulations that would limit the ability of US companies to pursue ‘inversions’. Amidst the political gridlock that typifies Washington D.C., this was a rare example of action on tax matters. There have been many recent examples of **US companies using takeover activity to effect a tax-efficient move from the US to another jurisdiction**, thereby potentially reducing their US tax base.

In contrast, US Treasury official Robert Stack has on several occasions, expressed the need for caution in relation to the BEPS project. In particular, he has expressed concerns about non-US countries seeking to impose tax in a manner inconsistent with transfer pricing principles at the expense of US multinational enterprises. This is another example of the underlying tensions likely to emerge between countries over the coming year as the BEPS deliverables move towards finalisation and implementation.

Hybrids – Countries already taking action

Separate to the BEPS Action 2 deliverable, but consistent with the underlying purpose of the proposals, several Governments have announced, and/or taken, action to address concerns relating to hybrid mismatch arrangements.

Spain, France and Japan have implemented measures to address hybrid mismatch arrangements consistent with recommendations contained in the Action 2 paper. Germany has created a taskforce to consider proposed measures, and the UK has released a consultation document on a possible approach to addressing hybrid mismatches.

In **Australia**, changes were legislated on 16 October 2014 to remove certain unintended outcomes arising from the interaction of the (former) dividend participation exemption and the thin capitalisation rules. The changes aligned the dividend participation exemption with Australia’s Debt/Equity rules.

However while the changes deal with the “mismatch” arising between certain provisions in the Australian tax law, they have also opened up new cross-border hybrid financing approaches.

Australian developments

2014 G20 Chair

In its role as president of the G20 during 2014, Australia championed the BEPS project and its importance to securing the tax revenue base for all countries. **Australia has signed up to the Common Reporting Standard for the Automatic Exchange of Information with the first exchanges of information expected to occur in the income year ended 30 June 2018.**

Corporate tax report

In the context of the debate about multinational tax matters, came the publication of a report

authored by the Tax Justice Network/United Voice into the tax profiles and practices of the ASX 200, entitled “**Who pays for our Common Wealth? Tax Practices of the ASX 200**”.

Second Commissioner of Taxation Andrew Mills comments on the Tax Justice Network/United Voice report:

“... I must point out that misleading reports like the one put out by United Voice recently, do the tax system no favours whatsoever ... **Using questionable research to make misleading (and in some cases just blatantly wrong) claims that some large taxpayers don't pay any tax or pay very little tax undermines confidence in the system and achieves the exact opposite of what organisations like United Voice claim to be advocating.**”

While the underlying **technical analysis and methodology of the report left much to be desired**, the associated media coverage of the report and support from elements of the Senate, particularly the leader of the Greens, Senator Milne, resulted in the establishment of a **Senate inquiry into “Corporate Tax Avoidance”**.

The matter was referred to the Economics References Committee to report by 15 June 2015 and public hearings are expected in April 2015.

ATO perspective on BEPS

In September 2014, Mark Konza, Deputy Commissioner of Taxation provided an overview of the ATO's views on the BEPS project. One of the themes of this [speech](#) was the need for tax authorities to also adopt a global view:

“As multinationals are operating across borders seamlessly by taking a global, top down view to structure their operations across countries, administrators and policy makers need to do the

same. We must move from a single, isolated country view and replace it with a global view. Unprecedented international collaboration is needed to help build this view.”

The speech also provided insights into the ATO's view on a number of key areas of the BEPS project including strong support for the proposed measures addressing hybrid mismatch arrangements (Action 2), acknowledging that, while the ATO is reviewing a number of current cases involving hybrid arrangements, Australia currently has no tax law with which to address these matters.

Mr Konza also expressed support for BEPS projects on Treaty abuse (Action 6), Intangibles (Action 8) and CbC reporting (Action 13).

“For the first time, multilateral co-operation and collaboration between tax administrators is becoming the norm of how we do business.”

G20

The OECD's progress on the BEPS project was also endorsed by the leaders of the G20 at meetings held in 2014 in both Cairns and Brisbane and the more recent G20 Finance Ministers and Central Bank Governors meeting in Istanbul.

In addition, the G20 secured widespread support for countries to adopt the **Common Reporting Standard (CRS)** for the **Automatic Exchange of Information**, which is generally intended to be implemented by countries in 2017 or 2018 as set out in the [status of commitments by the OECD](#). The CRS is seen as a key tool in ensuring international tax compliance by multinational enterprises.

Further consultation is expected on critical areas of concern such as access to, and protection of, confidential and commercially sensitive information and managing the compliance obligations which such reporting requirements will impose.

Treasurer support for BEPS

The Federal Treasurer, the Hon. Joe Hockey MP, recently set out the Australian government's achievements on BEPS in a [speech](#) at the Tax Institute of Australia:

"In particular we have put in a substantial effort to ensure multinationals pay taxes in Australia on the income they earn here.

We have done this through a number of initiatives.

Firstly, with other tax administrations, we have been mapping the global operations of some multinationals that operate in the digital economy.

Secondly, under our leadership, G20 Finance Ministers will tackle base erosion and profit shifting to make sure companies pay their fair share of tax. We have also agreed to increase transparency and crack down on tax evasion.

Thirdly, Australia has taken a leadership role in the automatic exchange of tax information. We have taken another step in the fight against evasion and automatically exchange information with Switzerland based on the OECD's common reporting standard.

...

The ATO is embedded in the offices of dozens of multinationals operating in Australia. By 30 June 2015, the ATO will have conducted around 200 reviews and 41 audits of the highest risk multinationals."

Key questions for the year ahead

Will everyone stay the course?

The UK announcement of its DPT poses an interesting issue in the context of the BEPS project. While the measures are intended to address undesirable tax practices, **the available information suggests the DPT is intended to operate outside of existing tax legislation, including, for example, tax treaties.** A common theme underpinning the BEPS project is that the project is seeking to amend, improve and supplement existing tax law, rather than introduce new approaches to taxation.

If implemented in the manner currently proposed, it may create an **uncomfortable precedent** for the OECD, G20 and developing countries. If the UK chooses to pursue such a unilateral approach, it would seem difficult to rebuke other (perhaps developing) countries, who might also seek to take such a unilateral approach where they feel it better suits their interests than measures proposed by the BEPS project.

Is the US "on board"?

There has been considerable debate as to the likelihood of, and extent to which, the US will adopt the recommendations of the BEPS project.

However, recent announcements by US Treasury officials have shown positive signs that the US will support many of the key BEPS project recommendations:

- A US Treasury official recently **confirmed the US will begin CbC reporting for income years commencing after 1 January 2016**, consistent with the OECD's recent implementation guidance, but using a template developed by the US;
- **US Treasury representatives have also recently expressed support for the BEPS project under Action 4**, and noted the similarity of the proposal to the

US president's current tax reform proposals on these matters. The comments included indications of support for a possible "primary" limitation on interest deductibility of 10% of EBITDA, deliberately set at a low level, to be supported by a more detailed secondary group-wide allocation approach.

- However, **the US has expressed concerns about several of the Transfer Pricing proposals, particular those dealing with risk and intangibles.** It appears there is some way to go before a consensus view emerges on these key issues which are likely to be of particular focus in the coming months as major Transfer Pricing deliverables are finalised.

Implementation challenges

As the BEPS project approaches its climax in 2015, there will be an increasing focus on implementation guidance and associated issues. In this respect, a key issue will be the ease with which the recommended measures can be introduced into law in each country.

For many of the recommendations, the speed of implementation may be greatly improved where the proposed Multilateral Instrument is successfully developed and broadly adopted by countries involved in the BEPS project, such that any required amendments to bilateral tax treaties can be adopted swiftly.

Other measures will require changes to domestic laws to be implemented, such as in relation to hybrid mismatch arrangements. In many cases, the OECD has provided some discretion to countries as to how these measures are to be adopted, and as such the timing and consistency of these measures may be less certain.

Australia – tax reform process & Senate enquiry

From an Australian perspective there would appear to be something of a convergence of several tax issues emerging in 2015.

The first is the **Tax Reform White Paper process, with the Tax Issues Paper scheduled for release on 30 March 2015.** The paper is intended to provide a basis for discussion of key issues requiring reform in the Australian tax system across a full range of taxes.

Given the extensive coverage of the BEPS project, the tax affairs of multinational enterprises and **the Treasurer's contemplation of an Australian version of a DPT**, it may be that these issues will influence the debate on the tax reform process and key issues.

Similarly, as noted above, a **Senate enquiry into corporate tax avoidance** is due to report by 15 June 2015. With the publicity and attention surrounding BEPS and the Tax Justice Network report, it seems likely that the themes underpinning BEPS may have a part to play in the Senate enquiry process.

For those with an eye on international tax matters, the remainder of 2015 promises to be a very interesting year.

The 2014 BEPS timeline

30 January 2014

Discussion draft on transfer pricing documentation and [country by country reporting](#) released for public comment. [Deloitte analysis](#)

14 March 2014

[Discussion draft on Action 6](#) (Prevent Treaty Abuse) of the BEPS Action Plan. [Deloitte analysis](#)

19 March 2014

Release of [discussion drafts on Action 2](#) (Neutralise the effects of hybrid mismatch arrangements) of the BEPS Action Plan. [Deloitte analysis](#)

24 March 2014

Release of [discussion draft on Action 1](#) (Tax Challenges of the Digital Economy) of the BEPS Action Plan. [Deloitte analysis](#)

4 August 2014

OECD releases [public request for input on BEPS Action 11](#) (Establish methodologies to collect and analyse data on BEPS and the actions to address it).

16 September 2014

OECD releases [first BEPS recommendations](#) to G20 for international approach to combat tax avoidance by multinationals – reports released on:

- [Action 1](#) (Challenges of the digital economy). [Deloitte analysis](#)
- [Action 2](#) (Hybrid mismatch arrangements). [Deloitte analysis](#)
- [Action 6](#) (Prevent the abuse of tax treaties). [Deloitte analysis](#)
- [Action 8](#) (Transfer pricing issues in the area of intangibles). [Deloitte analysis](#)
- [Action 13](#) (Transfer pricing documentation and country-by- country reporting). [Deloitte analysis](#)

- [Action 15](#) (Feasibility of developing a multilateral instrument). [Deloitte analysis](#)
- [Action 5](#) (Countering harmful tax practices). [Deloitte analysis](#)

31 October 2014

Release of [discussion draft on Action 7](#) (Prevent the Artificial Avoidance of PE Status) of the BEPS Action Plan. [Deloitte analysis](#)

3 November 2014

Release of [discussion draft on Action 10](#) of the BEPS Action Plan.

21 November 2014

Release of a [discussion draft on follow-up work on Action 6](#) (Prevent treaty abuse) of the BEPS Action Plan. [Deloitte analysis](#)

16 December 2014

Release of two discussion drafts on Action 10 of the BEPS Action Plan:

- [Cross-border commodity transactions](#) and
- [Profit splits](#)

18 December 2014

OECD releases discussion drafts regarding:

- [Two new elements of the OECD International VAT/ GST Guidelines](#)
- [Action 4](#) (Interest deductions). [Deloitte analysis](#)
- [Action 14](#) (Making dispute resolutions more effective).

19 December 2014

Release of discussion draft on [Actions 8, 9& 10](#) (Risk recharacterisation and special measures).

6 February 2015

First steps toward [implementation of OECD/ G20 efforts](#) against tax avoidance by multinationals. [Deloitte analysis](#)

Contacts

For more information, please contact

Vik Khanna

Partner

+61 (3) 9671 6666

vkhanna@deloitte.com.au

David Watkins

Partner

+61 (2) 9322 7251

dwatkins@deloitte.com.au

Mark Hadassin

Partner

+61 (2) 9322 5807

mhadassin@deloitte.com.au

Fiona Craig

Partner

+61 (2) 9322 7770

ficraig@deloitte.com.au

Claudio Cimetta

Partner

+61 (3) 9671 7601

ccimetta@deloitte.com.au

For further information, visit our website at www.deloitte.com

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