



International Tax

## OECD Tax Alert

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### Report issued on base erosion and profit shifting

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The Organization for Economic Cooperation and Development (OECD) released its first report on base erosion and profit shifting (BEPS) on 12 February 2013. The OECD report is responding to the growing perception that governments lose substantial corporate tax revenue because profits are shifted to favorable tax locations and that traditional international tax principles may no longer be adequate for countries to develop appropriate responses to BEPS.

The 91-page report will be presented at the 15-16 February meeting of G-20 finance ministers and central bank governors in Moscow.

The goal of this report is to establish the case for action by showing the extent of base erosion and profit shifting. If the G-20 agree that a problem exists and that action is needed (which is likely), the OECD group will then consider work streams that will be undertaken to address the problem. The current plan is to present those work streams to the G20 in June 2013. The plan will (i) identify actions needed to address BEPS; (ii) set deadlines to implement actions; and (iii) identify the resources needed and the methodology to implement these actions. The report concludes that BEPS is a significant problem for both OECD member and non-member states, and that “the international common principles drawn from national experience to share tax jurisdiction may not have kept pace with the changing business environment.”

The report states that domestic rules and internationally agreed standards for sharing tax jurisdiction were developed in the early 20th century. They are grounded in a business environment typified by a lower degree of economic integration across borders and are unsuited to current business models characterized by high intellectual property value and rapid information and communication systems.

The areas of concern for the OECD working group are:

- International mismatches (double nontaxation);
- OECD model treaty concepts in the field of digital delivery of goods and services;
- Tax treatment of related-party debt, insurance and other intragroup financial arrangements;
- Transfer pricing, in particular, the shifting of risks and intangibles, the

- artificial splitting of assets between different legal owners, and transactions within a group that rarely would take place with third parties;
- The effectiveness of domestic anti-avoidance measures (e.g. general anti-avoidance rules, and controlled foreign company and thin capitalization regimes) to prevent treaty abuse; and
  - The availability of harmful preferential regimes.

The report challenges governments to address this perceived problem both globally and in a holistic manner, including consideration of matters such as source-based and residence-based taxation. The report recognizes that individual governments cannot act alone to address these issues.

The goals of the OECD BEPS group are to:

- Neutralize the effect of mismatches;
- Improve or clarify transfer pricing rules to address specific areas where the current rules produce undesirable results from a policy perspective (of which the current Working Party 6 intangibles work is only a part);
- Update solutions to the question of tax jurisdiction, particularly in relation to digital goods and services. This might require revision to the model treaty;
- Propose more effective anti-avoidance measures to be included in domestic law or international guidance;
- Draw up rules on the treatment of intragroup finance transactions, including deductibility and withholding taxes; and
- Propose solutions to counter harmful regimes more effectively, taking into account transparency and substance.

The report can be accessed at <http://www.oecd.org/ctp/BEPSENG.pdf>.

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