Major changes
International tax reform and transparency
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Introduction

I am pleased to send you this briefing on the two key current tax issues affecting multinationals: the reshaping of the international tax framework and transparency.

Tax is in the headlines in a manner few could have envisaged – even a year or two ago. This has led to a range of issues for business to consider, from the OECD’s Base Erosion and Profit Shifting project, to calls for greater levels of information about taxation.

My view is that this enhanced level of interest in taxation will continue, with consequences for us all – not just those in the media spotlight. Whilst specific events will come into focus and then fade, the general level of interest will remain higher than it has been over the last thirty years.

Conducting business in this new environment may require changes in communication strategy. For some businesses, the new approach could lead to different approaches to business strategy.

Given the level of coverage and some of the ill-informed commentary on taxation and business matters, we believe that business and advisers, such as Deloitte, need to enhance our communications about tax and business both externally and with our internal stakeholders.

The pace of change from the OECD’s work is far faster than we have ever seen. The first two papers on actions from the BEPS plan are already available. Five of the fifteen actions are due to be finalised within twelve months. We think that the most important areas for business are:

• The taxation of intangibles, including structures involving centralised operating models, structures relying on exemptions from permanent establishment (taxable presence) rules and limited risk entities.

• The taxation of hybrid entities and hybrid instruments.

• The deductibility of intragroup interest.

• Provision of information to tax authorities.

The political momentum behind BEPS is significant, so we can be assured that changes will take place. Business input is needed by the OECD and home country tax authorities to help frame the new international tax accord in such a manner as supports global trade, avoids double taxation but equally is more in tune both with modern business activities and current public sentiment.

OECD Tax Director Pascal Saint-Amans has said that he expects the OECD actions will lead to increased taxable profits, as governments take action to limit certain business strategies previously accepted. Companies need to consider the possible impacts of the BEPS project and some may wish to start taking different actions now.

This briefing covers the details of the OECD’s Action Plan; how it is being managed and how to give input. It also looks at other important developments, such as the possibility of US tax reform. Finally, it covers the difficult area of transparency.

I hope you will find it useful. My partners and I would be happy to discuss the issues.

Andrew Hodge
Changing the International tax framework

The OECD’s Base Erosion and Profit Shifting project

In July 2013, the OECD delivered its fifteen point Action Plan to the G20 Finance Ministers. The G20 has the lead role in taking forward Base Erosion and Profit Shifting (BEPS), although the G8 has expressed its support at its June 2013 summit. Details of G8 actions are included in the Appendix.

OECD Tax Director Pascal Saint-Amans has said he expects that multinational companies will end up paying more corporate tax as a result of the forthcoming changes. All G20 governments and OECD Members have signed up to the Action Plan; it is not something that simply involves a small number of countries. The Action Plan covers four main areas:

- Addressing challenges of the digital economy.
- Establishing international coherence.
- Restoring international standards.
- Transparency and instruments.

There are fifteen actions, which will be covered by two of the OECD’s existing Working Parties, a new Working Party, and a digital taskforce. Some actions are due to be reported on by September 2014 and others have a further 12-15 months. This is a rapid process for an international body and more than 20 governments.

The working groups involve countries such as China, India, Indonesia, South Africa and Brazil that are not members of the OECD, but which are members of the G20. The United Nations is also participating, to represent the interests of developing countries.

Detailed comments on the fifteen actions are set out in the Appendix.

The work on the Digital economy is likely to take place in several stages. There is currently a desire by governments not to treat digital separately from non-digital. The first piece of work is aimed at considering how digital activities need to be considered in the other actions. For example, the taxation of digital activities has implications for the work on permanent establishments, intangibles and transfer pricing. The digital taskforce will also consider the role of sales taxes.

The work on Coherence covers four areas: hybrids (arbitrage), CFC regimes, best practices in restricting relief for interest and harmful tax practices.

The OECD has done considerable work on hybrids, which is why it is able to produce its recommendations within a year. It is expected that this will look at changes to tax treaties as well as recommendations for national legislation. The UK considers it is well-placed, in the sense that it has had anti-arbitrage rules for some time. The work on CFCs is favoured by some governments which consider that tighter CFC rules could counter certain planning by multinationals. However, the experience within the EU and other open economies generally is that taxing international activities through CFC rules is hard to achieve without making a country uncompetitive.

The review of interest relief is one area that might lead to change in the UK. An increasing number of countries have general restrictions on interest: most recently France, Mexico and Australia have announced changes. The review should ideally support some ways of taking action here, whilst ruling out other less helpful approaches. As a supporter of working towards international consensus, it is thought unlikely that the UK would wish to consider unilateral action – and the current regime is the result of clear choice by the coalition government and its predecessors.

Restoring international standards covers three actions: treaty abuse, updating the permanent establishment definition and transfer pricing rules, as they primarily affect intangibles, risk and capital.

OECD Action Plan reporting timeline

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*Intangibles

* A revised Chapter 6 of the OECD Transfer Pricing guidelines (covering intangibles) is expected to be issued in September 2014.
The permanent establishment definitions in double tax treaties set out when a business has a taxable presence in a country – and when it does not. It is fair to say that the current definitions do not adequately reflect the transformation in communications and business practice that has taken place over the last decade. We should expect greater restrictions on when a place of business is truly preliminary or auxiliary (and thus not taxable), the removal of benefits from commissioner structures (already unavailable in the UK due to our common law legal system) and perhaps less emphasis on contracts.

The Intangibles discussion document considers when and how returns from intangibles should be shared between companies contributing towards their development or exploitation. There is a focus on a greater alignment between people and profits.

Other issues such as risk allocation, different ways of pricing transactions that would be unlikely to occur between unrelated parties and pricing the use of capital are also on the agenda.

The final area includes transparency to tax authorities – which covers the introduction of a template showing the profits and tax paid by the multinational in each country where it conducts business. The aim is to improve risk assessment by tax authorities.

Changes in any of these areas could affect business strategies. Considering the potential impact and how to manage possible changes to strategies is vital.

The outcome of the project will be a series of proposals. Some will involve changing the Model Tax Treaty; others will involve changes to the Transfer Pricing guidelines; yet others will involve changing national law. In all cases, governments remain in control of change and will need to reach agreement on broad outcomes. Implementing changes to international treaties will be challenging in practice; the OECD notes that there are over 3,000 tax treaties.

How to provide input on the Action Plan
Control of the OECD’s Action Plan rests with the Committee for Fiscal Affairs (CFA) – a committee of government officials from the OECD Member States. The UK’s representative is Mike Williams, Director, Business and International Tax at HM Treasury. He is one of several vice-chairs of the CFA.

The OECD’s Working Parties and taskforces are staffed by a mixture of OECD officials (part of the of the OECD’s Centre for Tax Policy and Administration) and secondments from member states’ tax administrations.

The main business input to the OECD comes from BIAC – the Business and Industry Advisory Committee. The BIAC tax committee is made up of individuals nominated by the business organisations across OECD Member States (the CBI for the UK). The current chair of the BIAC tax committee is Will Morris, from GE, who also chairs the CBI’s tax committee.

The OECD will publish, for consultation, papers on the different elements of the Action Plan. Anyone is welcome to comment and there will then be public discussion meetings at the OECD headquarters in Paris.

The first two documents have been released: a Discussion Paper on Intangibles and a White Paper on Transfer Pricing documentation. The deadline for submitting comments on these papers was 1 October and the public meeting for both areas will be on 12-13 November 2013.

Those not wishing to make direct comments may feed in comments to the CBI’s tax committee or to Deloitte, which will be making its own submissions.

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### United States tax reform

A global search on the popularity of searches involving the word ‘tax’ shows that the term shows up frequently in Europe, Australia and the United States. However, the key topic in the United States is not tax avoidance, but tax reform. This means an effort to reduce tax rates for both individuals and companies, financed by cuts in tax reliefs. Whether or not tax reform should raise money, or be revenue neutral, is a matter for political discussion. However, neither of the main parties sees tax reform as delivering tax cuts overall.

Delivering tax reform will require bipartisan agreement. The Senate’s Finance Committee is chaired by Democrat Senator Max Baucus. The House of Representatives’ Ways and Means Committee is chaired by Republican Dave Camp. These committees are the only committees empowered to write tax law, for ultimate approval by the full House in each case.

Senator Baucus and Representative Camp have toured key US cities over the summer to explore with citizens and business the principles behind tax reform.

For corporations, tax reform should see a cut in the federal tax rate from 35%, financed by reduced tax allowances. This could include reduced allowances on depreciable assets, the removal of LIFO accounting for inventory and possibly additional restrictions on interest deductions. There has been speculation that there could be a change in US international taxation, such that it might in future prove beneficial to repatriate non-US earnings.

Should each committee consider that there could be support in both Houses for tax reform, they could each produce draft Bills in the autumn. Bills produced in each House need to be reconciled before a final Bill could be enacted. With support, a tax reform bill could become law by early 2014 – before the next elections to Congress.
Transparency

Transparency by companies
The issue of transparency – meaning here the level of public disclosure by companies of their tax affairs – continues to be part of the political and media agenda. Exchequer Secretary David Gauke has urged companies to say more about their tax position. Margaret Hodge MP, chair of the Public Accounts Committee, has called for publicly-quoted companies to publish their tax returns. The House of Lords Economic Affairs Committee in its July 2013 report *Tackling corporate tax avoidance in a global economy: is a new approach needed* called for the Treasury to “…consider a series of anti-avoidance measures for the shorter term, such as:

(iii) a requirement on companies with large operations in the UK to publish a pro forma summary of their corporation tax returns, so as to bring about greater transparency.”

Charities and campaigners have called for multinationals to provide ‘country-by-country’ reporting, which they define as publishing details of the balance sheet, profit and loss, employees and corporate tax borne, for each country in which the multinational operates.

It is clear that the majority of British business does not consider that this form of reporting would be a sensible response. Stephen McPartland MP wrote to the FTSE100 companies to seek their views. He published the responses on his website. The clear response was that most companies were committed to increased transparency about their tax affairs – but that country-by-country reporting would not deliver helpful information and would be costly to prepare.

A small number of companies have published some country information. Mining companies Rio Tinto and Anglo-American have published details of profits and total taxes collected and borne. A couple of companies in other sectors have published similar, but less detailed, information.

The CBI has said it is opposed to country-by-country reporting, as it does not consider it informative. It produced in May 2013 its statement of seven tax principles for consideration by its members. The principles are reproduced on page 7. Two key points on transparency are covered:

- The importance of being transparent with HMRC about the company’s affairs.
- The value in increasing public understanding of taxation – by adopting a range of approaches relevant to the particular company.

Deloitte supports this approach. It is clear that some politicians, and some in the media and in NGOs have limited understanding of business operations and the tax rules applicable. Explanations about group taxation drivers are more helpful than reams of numbers.

It is also clear that there is limited call outside the UK for country-by-country reporting, beyond the introduction of project reporting for extractive companies (see page 7 for details). No doubt the issue was debated privately by G8 Member States before the Lough Erne summit, which did not call for public reporting, but instead focused on additional high-level reporting to tax authorities, to aid better risk assessment. The European Parliament does remain keen on country-by-country reporting, though, and led a move to include some limited reporting for banks in the recent CRD4 Banking Directive. There has been some discussion in a working group of the Council of Ministers about extending reporting. It is understood that some Member States were opposed in principle and others thought that if the issue was to be considered the Commission should produce a proper proposal with an impact assessment. Any such plans would need majority approval by the Council of Ministers; it seems that there isn’t the requisite majority currently.
There is one proposal to publish details of profits tax paid in a single country. In February 2013, the Australian Assistant Treasurer announced a consultation on proposals for publishing information about the tax position of companies. The proposal is that “… for corporate tax entities with a reported total income for the year of AU $100 million (about £60 million) or more, the Commissioner would publish their Australian Business Number and name, as well as their reported total income, taxable income and income tax payable.” Reported total income would be gross accounting income and would include exempt income and foreign income. Tax losses would not be reported.

This idea appears to have been picked up in the UK by the Shadow Chancellor, Ed Balls. In May 2013, the Labour Party produced a policy document Corporate Tax: transparency and reform. It has some comments on transparency, noting “Multinational groups can and should be able to structure however they wish, but there is no reason why they should not have to produce a simple statement of the amount of corporation tax they pay in the UK, in a way that all of us can understand, experts and non-experts alike.”

Both these approaches would give details of tax actually payable in respect of an accounting year. However, there would be no explanation as to why taxable income differs from accounting income. It seems inevitable that there would be pressure on companies to provide some explanation of the main differences.

Given that there are no standards for additional reporting or commentary on tax issues, companies will need to consider whether their stakeholders would benefit from additional reporting and, if so, how best to deliver that information.

The Hundred Group has published for some years details of the total tax contribution from the UK’s largest companies. The benefit of reporting the total tax contribution is that it recognises that the tax borne and collected by a multinational is considerably more than just the tax borne on its profits. The CBI has highlighted that in the UK over 30% of total UK tax is borne by companies – which also collect the vast bulk of the remaining tax. The biggest components of tax borne are employers’ national insurance, corporation tax and PRT, business rates and irrecoverable VAT. If a company were to decide to publish high-level figures about its tax position, the total tax contribution is more reflective of the value contributed to society than simply the corporate tax paid on its profits.

Companies are required to report their tax position via their financial statements in accordance with the applicable accounting standards. Increased scrutiny of tax has led to many considering how to improve their disclosures through this key communication channel. Alongside this, many Boards are looking to develop a responsible approach to the management of taxes that balances the needs of various stakeholders and which would not cause embarrassment if the strategy were to make front-page news.

Improved financial reporting of taxes could be achieved by, for example, including comments in the front half of the annual reports on tax policy and key tax risks, in line with existing reporting norms. In addition, for some companies the explanatory notes to the financial statements could be improved to provide greater clarity regarding the tax reconciliation and rate commentary. Not all profits and taxes are included in the profit and loss account, so explaining this and highlighting the total tax could be helpful. The language in the accounts note is often obscure; a better explanation of important components could be helpful. Sometimes the cash tax paid is materially different to the current tax charge; again, giving details of the reasons for this helps inform investors and other stakeholders. The captions in the tax charge note merge various items and use obscure language. In the right case, there could be benefits from expanding the note and explaining a little more what individual items mean, with their impact on the group. Companies may also wish to provide greater disclosure of subsidiaries in the group, their activity and jurisdiction in order to allay any concerns regarding the activities of certain entities in particular jurisdictions.

The conclusion is that companies need to consider what individual approaches work best. One final point: companies do need to make sure that they comply fully with statutory requirements – particularly those around subsidiaries. Work by a UK charity, ActionAid, has highlighted that not all members of the FTSE100 have complied with the obligation to list all subsidiaries, either in the annual financial statements or in the annual return sent to Companies House.
CBI Tax Planning principles
The CBI has published seven tax principles intended to promote and affirm responsible business tax management by UK businesses:

Tax Planning principles

1. UK businesses should only engage in reasonable tax planning that is aligned with commercial and economic activity and does not lead to an abusive result.

2. UK businesses may respond to tax incentives and exemptions.

3. UK businesses should interpret the relevant tax laws in a reasonable way consistent with a relationship of “co-operative compliance” with HMRC.

4. In international matters, UK businesses should follow the terms of the UK’s Double Taxation Treaties and relevant OECD guidelines in dealing with such issues as transfer pricing and establishing taxable presence, and should engage constructively in international dialogue on the review of global tax rules and the need for any changes.

Transparency and reporting principles

Relationships between UK businesses and HMRC should be transparent, constructive and based on mutual trust with the result that HMRC should treat business fairly and with respect, and with an appropriate focus on areas of risk.

5. UK businesses should be open and transparent with HMRC about their tax affairs and provide all relevant information that is necessary for HMRC to review possible tax risks.

6. They should work collaboratively with HMRC to achieve early agreement on disputed issues and certainty on a real-time basis, wherever possible.

7. UK businesses should seek to increase public understanding in the tax system in order to build public trust in that system, and, to that end:
   • They should consider how best to explain more fully to the public their economic contribution and taxes paid in the UK.
   • This could include an explanation of their policy for tax management, and the governance process which applies to tax decisions, together with some details of the amount and type of taxes paid.
Transparency in the extractive industry

Project by project reporting

The Extractive Industry Transparency Initiative (EITI) was established a decade ago to promote transparency by extractive companies in relation to payments by such companies to governments – and transparency by governments in relation to payments received. Complying with EITI principles is voluntary.

Campaigners have encouraged the United States and the EU to introduce mandatory disclosure rules. The Dodd-Frank Act in the US required disclosure and the SEC finally produced detailed rules in 2013. The G8 at Lough Erne Summit endorsed disclosure and Canada announced shortly before the Summit that it too would introduce rules for Canadian companies. The US, France, the UK and Germany have all announced that they will sign up to the EITI.

After debate over several years, a new EU Accounting Directive (2013/34/EU) includes provisions requiring companies engaged in the extraction of oil and gas, mining and logging of primary forests to disclose payments made to governments in the countries in which they operate. The Transparency Directive applies similar rules to non-EU companies listed on EU stock exchanges.

The EU Directive must be put into national law by 2015 and reporting takes effect in 2016. Companies complying with broadly equivalent laws of third countries may be exempted from complying additionally with this Directive. The Commission will review progress in 2018 and may recommend extending the provisions to other sectors, perhaps to the construction industry due to the huge infrastructure programmes in Africa.

Neither EU nor US rules address the need for disclosure of this type of income by governments; however, this is addressed by the EITI.

The Directive requires disclosure of payments made to each governmental department (at a national, regional and local level), identified on a project-by-project basis (e.g. relating to a single contract, licence etc.) with a breakdown between the different types of payment (e.g. production entitlements, taxes, royalties, license fees etc.). Disclosure is limited to payments resulting from extractive operations with consumption taxes (VAT, sales tax etc.) and other taxes (e.g. payroll taxes) excluded.

A significant amount of information is already disclosed by some companies in voluntary sustainability reports. However the costs of compliance under both the new EU and US regimes will be significant given the level of detail required.

The new disclosures will be scrutinised by NGOs, the media and other interested parties to evaluate the contribution made to host countries and communities. Some companies may consider that additional, voluntary, disclosures may be needed to ensure that interested parties have sufficient context to form an informed view.

Groups will need to ensure financial systems are able to identify and report the vast amounts of required information promptly and accurately, and will need to begin work now in order to be ready for commencement.

More information about the EITI can be found at www.eiti.org
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Links


Extractive Industries Transparency Initiative: http://eiti.org/


Improving the transparency of Australia’s business tax system: //www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2013/Transparency%20of%20business%20tax/Key%20Documents/PDF/discussionpaper.ashx
Appendices

1. OECD Action Plan – Fifteen areas for further action: detailed comments

The Action Plan provides a background comment for each action. Some initial observations on the key actions are set out below.

1. Address the tax challenges of the digital economy

The focus will be to identify the main difficulties posed by the digital economy in relation to existing international tax rules, develop detailed options to address them, and consider indirect tax alongside direct tax issues.

This will include consideration of circumstances where, under current rules, a group has a significant digital presence in a country without a corresponding taxable presence, valuing and attributing marketable location-relevant data and ensuring effective collection of VAT/GST.

Digital falls into two main categories: online ordering for physical delivery and online ordering and online delivery. The first category may be capable of being dealt with through changing some of the permanent establishment rules (which can determine taxable presence). The taxation of digital services is a much more complex issue – and is of course a developing area of global trade.

Initial indications are that there will need to be more than one stage to the review of digital taxation. The first stage – by next September – may consider the scope of the issues and the interface with other Actions. The United States is thought to be against treating digital as a separate activity, with different tax rules from other areas. The Exchequer Secretary, David Gauke, has recently confirmed that the UK does not wish to introduce a special online retailer tax. France is keen to look at the question of marketable data, although Pascal Saint-Amans, director of the OECD’s Centre for Tax Policy, does not think that this is workable due to valuation and other issues. It is perhaps telling that indirect taxes are included, given the potential practicality of sales taxes in this area.

2. Neutralise the effects of hybrid mismatch arrangements

This work will have two co-ordinated strands – potential changes to the OECD’s model tax convention to prevent abuse and recommendations for the design of domestic tax rules to eliminate the tax advantages arising from hybrid instruments and entities.

Hybrid instruments and hybrid entities are legal forms which are treated in different ways in different countries. Typically they are used to generate tax deductions in the payor country without equivalent taxable income in the recipient country. One example might be a profit-participating loan, which can give tax deductible interest in some payor countries and tax exempt dividend income in some recipient countries. The UK has had rules to limit the effect of hybrids for some time (e.g. the anti-arbitrage rules). Germany has recently introduced anti-hybrid rules to levy tax on dividends received from countries that have allowed a deduction for them. It is likely that as this is one of the ‘easier’ areas to action, more countries will follow suit.

Amendments to the model treaty to restrict benefits where hybrids are involved are also contemplated, and the OECD recognises that there will need to be some kind of tie-breaker to prevent double taxation. Particularly challenging issues surround the US’s ‘check the box’ system and the creation of hybrid entities, not least because it has been entrenched in the overall US tax system for so many years.

3. Strengthen CFC rules

The OECD will develop recommendations on the design of domestic controlled foreign company rules. This is a new area for the OECD (being to date a matter only for national governments), but of course is a very familiar concept in many countries.

Some countries have argued that one reason for international tax planning is that other countries have ineffective ‘controlled foreign company’ rules, designed to tax in the parent company low-taxed profits earned in some foreign subsidiaries. It would be surprising if the UK were to agree to changes to the newly refocused UK CFC rules, not least because under EU law much tougher rules would be unlawful. The US CFC rules are likely to be reviewed as part of their wider tax reform proposals. The OECD observes that CFC rules also benefit source countries by reducing the incentive to relocate activities to low tax territories. Within the EEA, countries will have to take into account the decision in Cadbury Schweppes which exempts from CFC charges ‘genuine commercial activities’.
4. Limit base erosion via interest deductions and other financial payments

The OECD will evaluate the effectiveness of different types of interest limitations and develop recommendations for best practices for rules preventing base erosion through excessive interest deductions or to finance the production of exempt or deferred income. There will also be work on new guidance on the pricing of financial transactions including financial and performance guarantees (a known gap in the current OECD Transfer Pricing Guidelines).

The UK would need to assess whether or not to limit interest deductions, should the working group propose new limits. It is noteworthy that the OECD is looking at limiting interest deductions where they are related to the financing of exempt income – the UK government did not go this far when the dividend exemption was introduced, for example. The transfer pricing guidance on guarantees and other financial transactions will be helpful, as this is a known gap in the current Transfer Pricing Guidelines. The February BEPS report made a brief reference to captive insurance, but this now appears to be extended to other insurance arrangements. Changes in this area could prove difficult for EU and EEA Member States, due to the freedom of establishment and free movement of capital requirements in the EU Treaty.

5. Counter harmful tax practices more effectively, taking into account transparency

The OECD will focus on improving transparency, including of tax authority rulings where they relate to low-tax regimes, and also requiring substantial activity for any such preferential low-tax regime. Part of this work will evaluate different low-tax regimes.

The focus on transparency of tax rulings is new, and follows concern about some of the European rulings practices. The UK will no doubt support the ‘substantial activity’ test for preferential low-tax regimes to be classified as not harmful given the emphasis on activity in, for example, the UK Patent Box regime. The challenging part here will be achieving changes in non-OECD countries but the OECD has achieved considerable success with Tax Information Exchange Agreements with non-OECD countries.

6. Prevent treaty abuse

The OECD will develop model tax convention provisions and provide recommendations for domestic rules to prevent double tax treaties giving benefits in inappropriate circumstances. The treaty work may be similar in concept to the existing ‘limitation on benefits’ clauses that the US has agreed in its double tax treaties, or alternatively look at ‘subject to tax’ requirements for treaty benefits to apply.

The OECD is keen to clarify that tax treaties are not intended to be used to create situations of no taxation, and at the same time to develop guidance for countries on factors to consider before deciding to enter into a tax treaty.

This is a challenging area. The US version of ‘limitation on benefits’ is in practice seen as difficult to apply (and understand), and there are also difficulties with the preferred German option of ‘subject to tax’, including that paying companies often have difficulty in obtaining information. The Australian Treasury has been openly critical of countries agreeing tax treaties with countries that do not then exercise their right to tax. The UK has a small number of treaties with limitation on benefit clauses.

7. Prevent the artificial avoidance of PE status

This area will focus on making changes to the definition of a permanent establishment (‘PE’) in the OECD’s model tax convention to prevent artificial avoidance of a taxable presence, including through commissioner arrangements and the specific activity exemptions. This work will also address related profit attribution issues.

The review of commissioner arrangements is new but relates to disputes in this area over a number of years. The specific activity exemptions work is likely to focus on the holding stock exemptions (relevant for online retailers and other centralised principal models) and the artificial division of activities between companies so that they individually can obtain the ‘preparatory and auxiliary’ exemption. The OECD’s existing project on Article 5 (definition of PE) has been widely viewed as disappointing. It’s interesting that profit attribution will also be considered, as to date the OECD has refused to look at the definition and attribution questions together. More time limits for creation of a PE would be welcomed by business.
8, 9 and 10. Assure that transfer pricing outcomes are in line with value creation: intangibles, risks and capital, other high risk transactions

As widely anticipated, the OECD will undertake further work to prevent profit shifting by moving intangibles among group members, including ensuring that profits from intangibles are not divorced from value creation and special measures for hard-to-value intangibles. The output will be changes to the Transfer Pricing Guidelines, and, possibly, to the OECD’s model tax convention.

The OECD will develop rules to prevent high returns accruing to a company solely because risks have been contractually transferred to it or because it has been allocated excessive capital within a multinational group. The output will be changes to the Transfer Pricing Guidelines and, possibly, to the OECD’s model tax convention.

The OECD will develop rules to prevent profit shifting from transactions which would not, or only very rarely, occur between third parties. This will include clarification on the potentially contentious issue of recharacterisation and guidance on the use of profit split methodologies where appropriate, as well as protection against common base eroding payments. Again, the output will be changes to the Transfer Pricing Guidelines and, possibly, to the OECD’s model tax convention.

Work on the transfer pricing of intangibles has been underway for some time. The OECD’s latest draft, incorporating BEPS principles, was released on 31 July, which includes an anti-avoidance flavour.

These actions include specifically work on allocation of risks and capital for transfer pricing purposes, work on recharacterisation of transactions that might not occur between unrelated parties, work on hard to value intangibles and work on transfer pricing methods including profit splits.

The issue of excessive equity capital is a gap in the transfer pricing system, and it will be interesting to see how the OECD proposes to address this.

‘Recharacterisation’ is a challenging and potentially contentious area. The question always arises – recharacterise the actual transactions undertaken to what? In particular, recharacterisation opens the door for countries to claim taxing rights in any situation unless specifically restricted, and is likely to greatly increase the number of disputes requiring settlement through Mutual Agreement Procedures (if available). This uncertainty is one of the reasons why, to date, the OECD has been cautious, and the increased use of profit split methodologies is likely to be a much more practical outcome. It is a surprise to see management expenses and head office expenses listed as common base eroding payments, as often these reflect only commercial reality and are subject to long-standing transfer pricing rules such as assessing the benefit to the payor.

11. Establish methodologies to collect and analyse data on BEPS

The OECD will develop indicators of the scale and economic impact of BEPS, and tools to evaluate the effectiveness of measures taken under the Actions. One of the issues identified in the OECD’s February report on addressing base erosion and profit shifting was the limited data available to assess the scale of the problem. Taxpayer confidentiality will remain respected, and the OECD will take into account administrative costs of further data provision for both businesses and tax authorities.

12. Require taxpayers to disclose their aggressive tax planning arrangements

The OECD will develop recommendations on the design of domestic rules for early disclosure to tax authorities of aggressive tax planning schemes, drawing on the experiences of countries such as the UK. One specific focus will be on international tax schemes, and a potentially wide definition of tax benefit.

13. Re-examine transfer pricing documentation

The OECD will look at transfer pricing documentation to enhance transparency for tax administrations, including developing a common template for providing information on the global allocation of profits, economic activity and taxes paid.

This will result in changes to the Transfer Pricing Guidelines and recommendations for domestic rules on documentation.
This follows from the G8 Declaration and an early draft White Paper was issued on 31 July 2013. This proposes a new common template, whereby companies would provide tax authorities with details of where their profits were earned and tax paid, so as to aid risk assessment. Additionally, there will be work in an effort to reduce the volume of non-standard documentation requested by tax authorities. Business may have concerns about providing information where its confidentiality or usage may not be respected. Business will also want to limit the volume of non-standard information.

14. Make dispute resolution mechanisms more effective
The OECD remains concerned that double taxation can hinder global trade and investment, and therefore will address issues with the practical and timely resolution of disputes under the mutual agreement procedures in tax treaties. This will include consideration of binding arbitration clauses to ensure resolution and the removal of blocks from accessing mutual agreement procedures in some cases.

Taxpayers may well have concerns that providing additional information to tax authorities globally could lead to an increase in transfer pricing enquiries and possibly tax assessments. The purpose of this action is to recognise that dispute resolution does not always work well and to seek improvements. Reducing the effective incidence of double taxation is an important goal – whether this arises due to poor dispute resolution mechanisms or procedural problems, such as time limits. Providing examples of practical problems should help improve processes.

15. Develop a multilateral instrument to facilitate the speedy introduction of changes to the OECD model tax convention into existing treaties
The final Action is, as already widely referred to by the OECD, the development of a multilateral instrument to facilitate the speedy introduction of changes to the OECD model tax convention into existing treaties. This will start with an analysis of the tax and legal issues that such an instrument may present, with a view to coming up with an ‘innovative approach’.

There are over 3,000 bilateral tax treaties. Clearly, negotiating individual changes will take significant time and resource. The idea of a multilateral convention would be for participating countries to change many treaties with a single convention. However, there are legal issues with multilateral instruments in several countries (notably the US). Nonetheless, there is political will to achieve changes quickly, particularly within the EU. Is an EU multilateral instrument a possibility?

There is political will to achieve changes quickly, particularly within the EU.
2. The G8 Lough Erne Summit

The G8 leaders met on 17-18 June 2013 at Lough Erne, in Northern Ireland. Their ten-point communiqué includes five points on taxation, which mainly revolved around actions to reduce corruption, money laundering and tax evasion and actions to improve support for developing countries. However, the G8 also declared support for the BEPS process and especially for additional transparency to tax authorities by multinationals (which has become Action 13 in the BEPS Action Plan).

1. Automatic Exchange of Information
The Lough Erne Communiqué states that the G8: “commit to establish the automatic exchange of information between tax authorities as the new global standard, and will work with the Organization for Economic Cooperation and Development (OECD) to develop rapidly a multilateral model which will make it easier for governments to find and punish tax evaders.”

Specifically, the communiqué commits to working towards the recommendations set out in the OECD’s report on tax transparency developed for the G8 summit. This report outlines the practical requirements for developing automatic information exchange systems, and provides recommendations on the breadth of information, income and institutions to be covered. Nevertheless, there remain some significant challenges for governments to introduce such a system, including agreeing a common reporting schema, appropriate confidentiality of information and the legal basis for the exchange.

It is likely that the US FATCA approach will be the basis of the automatic information exchange system. The US is negotiating intergovernmental agreements with about 70 countries – of which the UK was the first. The UK has agreed in principle that the Crown Dependencies and Overseas Territories will also supply information to the UK, using the FATCA model.

The EU appears to want to maintain some control over information exchange between EU Member States, despite its five largest members stating that they wanted Europe to standardise on the FATCA model.

2. Transparency around beneficial ownership of companies
The G8 declared that companies should know who owns them and that tax authorities and law enforcement agencies should be able to obtain that information easily.

The UK has released a consultation document: Trust and transparency which explores options for UK registered companies, including whether the information should be publicly available, or merely available to tax authorities and other governmental agencies. The UK has also requested that the Crown Dependencies and Overseas Territories develop their own action plans to collect and make available this information.

3. Developing countries
The G8 reconfirms its commitment to provide practical support to developing countries’ efforts to build capacity to collect the taxes and to engage in and benefit from changing global standards on exchange of information. They declare that developing countries should have the information and capacity to collect the taxes owed them and the other countries have a duty to help them.

The G8 is committed to take action on raising global standards on extractives’ transparency and accountability. The G8 supports also greater transparency in land transactions and increased capacity to develop good land governance systems in developing countries.
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To start a new section, hold down the apple+shift keys and click to release this object and type the section title in the box below.