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OECD Releases First Base Erosion and Profit Shifting Report

By John Henshall (London)

The Organization for Economic Cooperation and Development on February 12 released its first report on base erosion and profit shifting. The 91-page report will be presented at the February 15-16 meeting of G-20 finance ministers and central bank governors in Moscow.

The goal of this first 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 very 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 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 working group are:

- International mismatches (double nontaxation)
- OECD Model Treaty concepts in the field of digital delivery for 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 would rarely take place with third parties
- The effectiveness of domestic anti-avoidance measures (GAARs, CFC regimes, thin capitalization) to prevent treaty abuse
- 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
- To improve or clarify transfer pricing rules to address specific areas where the current rules produce undesirable results from a policy perspective. The current Working Party 6 intangibles work is only a part of this.
- To update solutions to the question of tax jurisdiction, particularly in relation to digital goods and services. This might require revision to the model treaty.
- More effective anti-avoidance measures to be included in domestic law or international guidance
- Rules on the treatment of intragroup finance transactions, including deductibility and withholding taxes
- 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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