Deloitte.

Ireland

BEPS Actions: An overall perspective

On 5 October 2015, ahead of the G20 Finance Ministers' meeting in Lima on 8 October, the OECD Secretariat published thirteen papers and an Explanatory Statement outlining consensus Actions under the Base Erosion and Profit Shifting ('BEPS') Project. These papers include and consolidate the first seven reports presented to and welcomed by the G20 Leaders at the Brisbane Summit in 2014.

Sixty-two countries have collaborated in the G20/OECD-led BEPS project and they have agreed to continue working together at least until 2020. Many more participated in shaping the outcomes through regional structured dialogues. Regional tax organisations such as the African Tax Administration Forum, Centre de Rencontre des Administrations Fiscales and the Centro Interamericano de Administraciones Tributarias joined international organisations like the International Monetary Fund, the World Bank and the United Nations in contributing to the work.

There will be some more policy developments in 2016 and 2017 but the main activity will be in monitoring each country's adoption of the BEPS measures. The monitoring group could be extended even more widely as other countries outside the project are invited to join. There's a precedent here, in the form of the *Global Forum on Transparency and Exchange of Information for Tax Purposes* which now includes 127 countries and jurisdictions.

The G20/OECD working group notes that "although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, today we know that the fiscal effects of BEPS are significant. The group estimates that **BEPS has cost some 4-10 per cent of annual corporate tax revenues**.

There are two big questions on the BEPS Actions: **when will they be implemented and which countries** will implement the Actions. **The Explanatory Statement sets out the various levels of agreement**:

"All OECD and G20 countries commit to **consistent implementation in the areas of preventing treaty shopping, Country-by-Country Reporting, fighting harmful tax practices and improving dispute resolution.** Existing standards have been updated and will be implemented, noting however that not all BEPS participants have endorsed the underlying standards on tax treaties or transfer pricing (understood to be only Brazil). In this regard, it is expected that the Irish government will include details on Country-by-Country Reporting and Knowledge Development Box in the upcoming Budget and Finance Bill. With regard to Actions being implemented by the Multilateral Agreement and given that this is scheduled to be finalised by the end of 2016, there is an additional period of time before any heavy lifting needs to be done on the implementation of these Actions.

"In other areas, such as **recommendations on hybrid mismatch arrangements and best practices on interest deductibility**, countries have agreed a **general tax policy direction**. In these areas, they are expected to converge over time through the implementation of the agreed common approaches, thus enabling further consideration of whether such measures should become minimum standards in the future. Given the proposed common approaches, there could be mixed reactions from different countries, with some jurisdictions making domestic amendments and others not. As such, there is a possibility that these common approaches may be revisited in a number of years.

"Guidance based on **best practices** will also support countries intending to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation.

"There is agreement for countries to be subject to **targeted monitoring**, in particular for the implementation of the minimum standards. Moreover, it is expected that countries beyond the OECD and G20 will join them to protect their own tax bases and level the playing field."

The **European Union may well decide to implement BEPS Actions** across the 28 member states. The European Commission published in June a Communication on a *Fair and Efficient Corporate Tax System in the European Union*, which aims to set out how the BEPS measures can be implemented within the EU. The Council of Finance Ministers may choose to adopt BEPS measures across the EU. However, any BEPS related EU directive would require unanimity among all member states, which historically has not been easy to achieve. The Irish Times have said that Minister for Finance Michael Noonan "warned new EU corporate tax moves must not go beyond the proposals agreed at OECD level, amid expectations the EU may introduce its own directive on combating aggressive corporate tax planning". The same article goes on to quote Minister Noonan as saying "We would be very interested in ensuring that what has been decided at the OECD is the policy, and that there aren't bells and whistles which will work against our interest, added on by the commission,"[1],

This is not to say that Ireland is not in support of the BEPS project, with the Minister saying "Ireland is committed to the BEPS project and we will play a full part in its implementation. As a first step we will legislate for Country-by-Country reporting and introduce a Knowledge Development Box, which will be the first and only such box in the world that complies with the OECD's new standards."[2]

Initial Actions to take effect

The **first Actions to take effect will be the new Transfer Pricing approach (Actions 8-10)**. Both the OECD and United Nations Model Tax Treaties require the use of arm's length pricing and the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* provide the main guidance on application globally. The new consolidated version of the Guidelines will not be published until 2017, but tax authorities are already starting to use material released in the public consultation in their approaches to open cases. The new approach will require that multinationals start afresh with their functional analysis. The aim is to ensure that "transfer pricing rules secure outcomes that see operational profits allocated to the economic activities which generate them." This will mean that entities must be able to control the risks that give rise to potential rewards and additionally that mere legal ownership of an intangible asset is not sufficient to generate a significant return. The paper adds that "capital-rich entities without any other relevant economic activities ('cash boxes') will not be entitled to any excess profits", which includes interest. Historically, Ireland has followed OECD guidelines with regard to transfer pricing. As such, it is expected that Ireland will adopt the OECD transfer pricing guidelines once they become available.

The **next Action to take effect is the country-by-country reporting to tax authorities**, set out in Action 13. There is a fixed template with very clear guidance on its use. All the main parent company countries have committed to this – so other countries will receive the benefit of additional information for risk assessment, provided they have a Double Tax Treaty or a Tax Information Exchange Agreement with the parent company country – or provided that both have signed the multilateral *Convention on Mutual Administrative Assistance in Tax Matters*. Some NGOs may complain that not all developing countries will get the information, but we must remember that there are 127 countries in the *Global Forum on Transparency and Exchange of Information for Tax Purposes* and the 80 or so that have signed the *Administrative Assistance Convention*. The first data (for December year-end groups with global sales of £586 million; €750 million; US$840 million) must be delivered to tax authorities by 31 December 2017, which will in turn distribute it by 30 June 2018. Multinationals are busy with their systems work on gathering the necessary data. Ireland is already in the process of drafting the legislation for Country-by-Country reporting and information in respect of the implementation of same into Irish law is expected to be provided in the upcoming Budget and Finance Bill. Companies located in Ireland impacted by Country-by-Country reporting will need to ensure their financial systems can capture the data required, as well as critically assessing how the information presented may look to tax authorities.

---

[1] "Government warns EU against tougher tax rules", Irish Times, Tuesday 6 October 2015

[2] http://www.finance.gov.ie/news-centre/press-releases/minister-noonan-welcomes-publication-oecd-beps-reports

The **final Action to take early effect covers those countries with Patent Box or other intellectual property regimes**. As has been flagged, Patent Box incentives may in future be given only where the related R&D is conducted in the same country. It is expected that Ireland will quickly introduce the new Knowledge Development Box regime. A public consultation process closed on 8 April 2015 and further information on the Knowledge Development Box is expected to be included in the Irish Budget 2016, which is to be announced on 13 October 2015, and the more detailed Finance Bill that is likely to follow on 22 October 2015. As outlined above, the Minister for Finance has said that this "will be the first and only such box in the world that complies with the OECD's new standards." There are indications that Germany, the United Kingdom and the United States may also introduce their own BEPS-compliant intellectual property regimes.

Actions likely to take effect from 2017 or later

Two important Actions – **Hybrid Mismatches** and **Interest Restrictions – will require national legislation**. The Working Party looking at these issues has provided over 400 pages of guidance to help countries to legislate to counter hybrids (an instrument or entity which, through different treatment in two countries achieves two deductions for the same economic expense or one deduction without equivalent income recognition). **The approach to hybrids will mean that they will no longer be effective** even if only one country enacts the anti-hybrid rules. The basic approach is to disallow the expense, with a secondary rule to tax the income, where the payor country does not counter the deduction. One of the challenges is that of getting enough information to establish that there is a hybrid effect. The UK has indicated it will consider legislation from 1 January 2017; few other countries have yet offered public support, although some (e.g. France) consider that hybrids are already ineffective under their current law. As this is a "common approach" Action item, we anticipate that some countries will legislate whereas for others it may not be a priority area of focus and no action will be taken.

The recommendations for **Interest Restrictions** provide that countries should limit interest deductions to a fixed percentage of earnings before interest, tax and depreciation (EBITDA). The cap should be in the range 10-30 per cent. Countries may optionally offer a fall-back to a group-wide ratio of third party net interest expense, should this be higher. There are other options put forward, including a *de minimis* limit to exclude low levels of debt and the ability to carry forward and back excess interest. Additionally, third-party debt to finance public-benefit projects may be excluded, subject to conditions. Australia has already said that it will not implement this Action and it seems that Germany and other European countries consider that their existing rules broadly satisfy the Action. The United States Congress and the Treasury Department both would like to limit interest deductions, but Congress is not expected to legislate except as part of a wider corporate tax reform. It is thought likely that the UK will issue a consultation later this autumn on how this Action might be implemented in that country.

It is understood that the Actions on **Hybrid Mismatches** and **Interest Restrictions** are not considered high priorities for Ireland in light of the extensive anti-avoidance tax law that is already in place in Irish tax law to counter hybrid mismatches and to restrict base erosion through interest deductions. It is, therefore, not expected that Ireland will introduce new legislation in the near term to implement these Actions, given the adequacy of our existing rules.

Actions requiring amendments to Double Tax Treaties

The **Multilateral Instrument** is intended to allow the effective modification of many treaties and will be negotiated during 2016. The initial conference to negotiate the convention starts on 5 November 2015, under the chairmanship of the UK, supported by vice-chairs from China and The Philippines. Over 90 countries and jurisdictions have indicated they will participate in the negotiation. The Multilateral Instrument must be completed by the end of 2016 and will then be available for countries to ratify. It is expected that there will be significant optionality within the Instrument, such that participating countries may make different choices.

The **areas to be covered by tax treaty changes are: Permanent Establishment (taxable presence); Treaty Abuse; and Dispute Resolution**. There is also a small change to cover part of Hybrid Mismatches.

The wide-ranging **Permanent Establishment** changes are intended to lower the threshold for recognising a taxable presence. The first area is reducing the importance of the place where a contract is legally entered into. The Action notes, *"As a matter of policy, where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes to Art 5(5) and 5(6) and the detailed Commentary thereon address commissionnaire arrangements and similar strategies by ensuring that the wording of these provisions better reflect this underlying policy."*

The second area for change limits the use of exemptions, *"…to ensure that profits derived from core activities performed in a country can be taxed in that country"*. The exemptions in Article 5(4) will be modified to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a "preparatory or auxiliary" character. However, some States consider that there is no need to modify Article 5(4) and that some of the exceptions included in Article 5(4) should not be subject to the condition that the activities referred to be of a preparatory or auxiliary character. Where countries are of this view, they may adopt a different version of Article 5(4) provided that they also include an anti-fragmentation rule to limit multinationals from splitting activities so as to avoid a taxable presence.

Additionally, so as to provide greater certainty about the determination of profits to be attributed to the permanent establishments that will result from the changes and to take account of the need for additional guidance on the issue of attribution of profits to permanent establishments, follow-up work on attribution of profits issues will be carried out with a view to providing the necessary guidance before the end of 2016, which is the deadline for the negotiation of the Multilateral Instrument.

The **Treaty Abuse** Action springs from concern that double tax treaties could be used to make available treaty benefits in circumstances not intended by a treaty's signatories. Countries have agreed to include anti-abuse provisions in their tax treaties, including a minimum standard to counter treaty shopping (routing payments via a treaty country to reduce taxes). They also agree that some flexibility in the implementation of the minimum standard is required as these provisions need to be adapted to each country's specificities and to the circumstances of the negotiation of bilateral conventions. The approaches put forward are limitation on benefits rules (used by the United States and Japan) and principal purpose tests (used by many other countries, including the UK). Collective investment vehicles (widely-held funds) will be able to qualify for treaty benefits in some circumstances. There will also be optional specific measures.

The **Dispute Resolution** Action is most important. The G20/OECD notes, *"Double taxation would harm multinationals which have contributed to boosting trade and investment around the world, supporting growth, creating jobs, fostering innovation and providing pathways out of poverty. Double taxation would also increase the cost of capital and could deter investment in the economies concerned."*

The measures developed under Action 14 aim to strengthen the effectiveness and efficiency of the Mutual Agreement Procedure (MAP) – where cases are settled between countries. The OECD's statistics on MAP show that there were over 4,600 cases at the end of 2013 between OECD members and four partner countries – including 1,900 new cases in the year.

The new minimum standard will ensure that treaty obligations related to the Mutual Agreement Procedure are fully implemented in good faith, that MAP cases are resolved in a timely manner, and that taxpayers can access the MAP when eligible.

Additionally, there will be a *"robust peer-based monitoring mechanism that will report regularly through the Committee on Fiscal Affairs to the G20."* This type of mechanism has worked well in the *Global Forum on Transparency and Exchange of Information for Tax Purposes* and it is intended that this will help ensure consistent application of the MAP in future.

Twenty countries (including Ireland), covering 90 per cent of reported open MAP cases, have said that they will add mandatory binding arbitration to their double tax treaties, using the 'last best offer' approach. This requires the independent arbitrator to choose between one of the proposals put forward by the countries, rather than making his/her own decision. The mechanism for adding arbitration would presumably be the

Multilateral Instrument, although the United States (one of the 20) has not yet decided to participate in the negotiations.

Further work

The G20/OECD will undertake more work in 2016 on several Actions:

- Harmful Tax Practices: revision of criteria; expanding participation of non-OECD countries
- Treaty Abuse: treaty entitlement of certain funds
- Interest: finalise design of group ratio carve-out, special rules for banking, insurance
- Permanent Establishments: profit attribution rules
- Transfer Pricing: financial transactions, use of the profit split method.

Deloitte bulletins and EMEA Dbriefs webcasts

Deloitte's Dbriefs webcast programme for Europe, the Middle East and Africa will include a roundup of the G20/OECD Deliverables on 20 October 2015 at 13.00pm (BST), with further detailed webcasts from 21 October. For full details and to register for the webcasts please go to **www.emeadbriefs.com**. Deloitte will publish detailed bulletins on all the main actions.

Contacts

Lorraine Griffin
Tel: 01 417 2992
Email: **lorgriffin@deloitte.ie**

Pádraig Cronin
Tel: 01 417 2417
Email: **pcronin@deloitte.ie**

Tom Maguire
Tel: 01 417 2469
Email: **tmaguire@deloitte.ie**

Pieter Burger
Tel: 01 417 2446
Email: **piburger@deloitte.ie**

Joan O'Connor
Tel: 01 417 2476
Email: **joconnor@deloitte.ie**

Declan Butler
Tel: 01 417 2822
Email: **debutler@deloitte.ie**

Conor Hynes
Tel: 01 417 2205
Email: **chynes@deloitte.ie**

Deirdre Power
Tel: 01 417 2448
Email: **depower@deloitte.ie**

Louise Kelly
Tel: 01 417 2407
Email: **lokelly@deloitte.ie**

Daryl Hanberry
Tel: 01 417 2435
Email: **dhanberry@deloitte.ie**

Karen Frawley
Tel: 01 417 2613
Email: **kfrawley@deloitte.ie**