



International Tax

OECD Tax Alert

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Action plan on base erosion and profit shifting released

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The OECD has published its promised Action Plan on addressing Base Erosion and Profit Shifting (BEPS), after presenting the plan to the G20 Finance Ministers' meeting in Moscow on 19 July 2013.

The Action Plan sets out 15 areas for further work, including a summary of the key considerations to be addressed and the timetable for the work in each area. OECD working groups are being set up to focus on each of the issues, and interested non-OECD members of the G20 (Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia, South Africa and South Korea) will be invited to participate. In addition, the OECD will invite other countries on an ad hoc basis, and the UN's input is welcomed to provide insights in respect of the concerns of developing countries. The outcome of the actions will include changes to international tax rules and principles (such as those in the OECD's Model Tax Convention and Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations), as well as recommendations for domestic legislation that can be adopted by countries.

The Action Plan rules out fundamental change to the international tax architecture, such as the adoption of a global unitary tax system. It also notes that the current balance between source and residence countries remains unaltered by the BEPS proposals. Countries such as China and India have argued for change here; the OECD is clear that this report addresses base erosion alone.

Fifteen areas for further action

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.
 - The expected output is a report identifying the issues, together with possible actions to address them.

2. *Neutralize the effects of hybrid mismatch arrangements*
 - This work will have two coordinated 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.
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 is a familiar concept in many countries.
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 also will 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).
5. *Counter harmful tax practices more effectively, taking into account transparency and substance*
 - On the challenging issue of harmful tax practices, 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.
6. *Prevent tax treaty abuse*
 - The OECD will develop model tax convention provisions and provide recommendations for domestic rules to prevent 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 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.
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 model tax convention to prevent artificial avoidance of a taxable presence, including through commissionaire arrangements and the specific activity exemptions. This work also will address related profit attribution issues.
8. *Ensure that transfer pricing outcomes are in line with value creation: intangibles*
 - 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 model tax convention.

9. *Ensure that transfer pricing outcomes are in line with value creation: risks and capital*
 - 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 model tax convention.
10. *Ensure that transfer pricing outcomes are in line with value creation: other high risk transactions*
 - The OECD will develop rules to prevent profit shifting from transactions that would not, or only very rarely, occur between third parties. This will include clarification on the potentially contentious issue of recharacterization 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 model tax convention.
11. *Establish methodologies to collect and analyze data on BEPS and the actions to address it*
 - 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 2013 report on addressing BEPS 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 certain countries. One specific focus will be on international tax schemes, and a potentially wide definition of tax benefit.
13. *Re-examine transfer pricing documentation*
 - Following on from the G8 Declaration at Lough Erne in June 2013, 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.
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.

15. *Develop a multilateral instrument*

- 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'.

Timetable and next steps

The OECD has staggered deadlines for each action, beginning with September 2014 and ending with December 2015. This is an aggressive timetable, necessary to satisfy public and political scrutiny of the international tax system, while also providing some certainty for business by the end of that period. Some areas will progress faster as work has been underway for some time (such as the existing OECD work on the transfer pricing of intangibles). The OECD remains committed to consulting with business and interested stakeholders, and therefore it is expected that discussion drafts and documents will be released for comment over the coming months, either by individual organizations or through the OECD's business forum of BIAC.

Deloitte comments

This is a major initiative by the OECD. OECD Tax Director, Pascal Saint-Amans, has said he expects that multinational companies will end up paying more corporate tax as a result. The outcomes will depend on international agreement and will take effect in three ways:

- Recommendations to countries to change national rules;
- Changes to the model treaty and recommendations that countries adopt the new model; and
- Changes to the transfer pricing guidelines.

Countries will ultimately choose which measures they wish to adopt—especially in the areas put forward for national action. It is not clear, for example, whether countries would tighten their CFC rules in response to OECD recommendations.

Initial indications are that there will need to be more than one stage to the review of digital taxation. There is a perception that the US would be opposed to treating digital as a separate activity, with different tax rules from other areas. Imminent change thus looks unlikely.

Companies should prepare for the changes proposed to transfer pricing documentation. There appears to be a wide-ranging agreement amongst countries that a high-level map of profits and taxation would help with risk assessment. Businesses—and countries—are aware of the potential dangers, such as the possible misuse of confidential information, and finding safeguards will no doubt be part of the action plan.

Deloitte will be hosting two webcasts on the OECD BEPS action plan:

United States: Monday, 22 July 2013 at 2 pm EST, featuring Henry Louie, Deputy International Tax Counsel (Treaty Affairs), U.S. Treasury Department and Mike McDonald, Financial Economist, U.S. Treasury Department (register at <https://deloitte.zettaneer.com/Subscriptions/default.aspx?eventid=663103>)

Europe, Middle East and Africa: Wednesday 24 July at 1pm BST (register at www.deloitte.com/emea/dbriefs).

The webcasts also will be available in the archive for viewing at any time thereafter.

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