



International Tax

## United States Tax Alert

October 6, 2015

### OECD Releases Final BEPS Reports

On Monday, October 5, 2015 the Organization for Economic Cooperation and Development (OECD) released the 2015 Final Reports on the G20/OECD Base Erosion and Profit Shifting (BEPS) project.<sup>1</sup> These reports cover the seven topics that were the subjects of the “2014 Deliverables” approved last fall, and finalize subsequent discussion drafts on the remaining eight “actions.”<sup>2</sup> The 2015 Final Reports recommend changes to domestic laws, the OECD Model Tax Convention (the “OECD Model”), and the OECD Transfer Pricing Guidelines (TPG). In addition, they propose to accelerate the incorporation of recommended treaty changes into existing bilateral treaties through a multilateral convention to be entered into by interested countries.

The 2015 Final Reports are to be presented to the G20 Leaders in Lima on Thursday, October 8.

#### Overview of the BEPS Package

Putting aside Actions 8, 9, and 10 (recommending changes to the TPG), many of the recommendations in the 2015 Final Reports are consistent with the 2014 Deliverables, subsequent discussion drafts, and public statements by the BEPS negotiators. The recommendations include additional examples and resolve some open issues, leaving others for subsequent development.

The table below contains an overview of several key non-transfer pricing reports and highlights some of the significant changes from prior deliverables and discussion drafts.

#### Implementation

##### In General

The practical realities of achieving consensus among the countries that participated in the BEPS project are reflected in the fact that almost every recommendation generally reflects only one of three possible levels of endorsement; they are indicated by, in descending order, the terms “minimum standards,” “common approaches,” and “best practices.” (One of the 2015 Final Reports (Action 7, regarding changes to the OECD Model definition of a

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permanent establishment (“PE”)) lacks even one of these levels of consensus.) “Minimum standards” reflect commitments to consistent implementation of standards laid out in final reports, and agreements to be subject to monitoring by the OECD during and after implementation. “Common approaches” reflect agreement as to “general tax policy direction,” with the aspiration that they will become “minimum standards” over time. “Best practices” are offered where the negotiators failed to reach a consensus that countries must adopt legislation on the particular topic in question.

## European Union

The European Council may intend to implement these minimum standards and best practices across all of the EU’s 28 member states in conjunction with the implementation plan outlined in the 2015 Final Reports.

## United States

The U.S. Congress has not been directly involved in the BEPS project, and to this point has shown little interest in implementing it. However, the 2015 Final Reports, and subsequent actions by other nations, may motivate Congressional action of some sort on international tax issues in the future.<sup>3</sup> Earlier this year, the chairmen of the House and Senate taxwriting committees<sup>4</sup> sent two letters to Treasury Secretary Jack Lew, asking to be kept informed on the details of the BEPS project and voicing concerns about country-by-country reporting (agreed to by the BEPS negotiators in Action 13), including whether the Treasury has the authority to implement it without legislation. In addition, the BEPS negotiators’ endorsement of the “substance” approach to preferential tax regimes (agreed to in Action 5) may have increased Congress’s appetite for enacting an “innovation box” that would be intended to preserve U.S. R&D jobs.<sup>5</sup>

## Highlights of Final Reports

The following table provides a brief outline of some of the 2015 Final Reports, including an overview of significant changes from prior deliverables and discussion drafts as well as notes concerning agreement implementation of each final report:

Action	Overview	Significant Developments	Implementation
<b><i>Financing</i></b>			
Neutralize effects of hybrid mismatch arrangements (Action 2)	<ul style="list-style-type: none"> <li>Domestic law and treaty provisions that deny a deduction or require an income inclusion with respect to arrangements involving hybrid instruments or entities</li> </ul>	<ul style="list-style-type: none"> <li>Favorable treatment for income inclusions under CFC regimes</li> <li>Treatment of stock loans and repos</li> <li>Further detail and explanatory examples</li> </ul>	<ul style="list-style-type: none"> <li>Common Approach</li> </ul>
Limit base erosion via interest deductions (Action 4)	<ul style="list-style-type: none"> <li>Limits on deductions for related and unrelated party</li> </ul>	<ul style="list-style-type: none"> <li>Net interest deductions limited to a fixed ratio of EBITDA</li> </ul>	<ul style="list-style-type: none"> <li>Common Approach</li> <li>Additional work in 2016 on groups that are highly</li> </ul>

	interest deductions	<ul style="list-style-type: none"> <li>• Fixed ratio between 10-30%</li> <li>• Exception from fixed ratio test for individual members of more highly leveraged consolidated groups</li> </ul>	<ul style="list-style-type: none"> <li>• leveraged or in banking or insurance</li> <li>• Additional work in 2016 and 2017 on transfer pricing aspects of financial transactions</li> </ul>
<b>Supply chain</b>			
Strengthen CFC rules (Action 3)	<ul style="list-style-type: none"> <li>• Outlines “building blocks” for design of a CFC regime</li> </ul>	<ul style="list-style-type: none"> <li>• Largely unchanged</li> </ul>	<ul style="list-style-type: none"> <li>• Best Practices</li> </ul>
Prevent treaty abuse (Action 6)	<ul style="list-style-type: none"> <li>• Recommends changes to OECD Model to prevent treaty shopping</li> </ul>	<ul style="list-style-type: none"> <li>• Largely unchanged</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum Standard</li> <li>• Insert into the Multilateral Instrument</li> <li>• The LOB will be updated to reflect the U.S. Model Treaty revisions due to be finalized this fall.</li> <li>• Non-collective investment vehicles to be addressed in early 2016</li> </ul>
Prevent artificial avoidance of PE status (Action 7)	<ul style="list-style-type: none"> <li>• Recommends following changes to PE definition in OECD Model: <ul style="list-style-type: none"> <li>○ Expand types of sales agent activity that can give rise to a PE</li> <li>○ Replace bright-line exceptions with subjective preparatory and auxiliary activity test</li> <li>○ No longer test for PE status on a separate company basis.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Adds the words “habitually plays the <i>principal</i> role leading to the conclusion of contracts that are <i>routinely</i> concluded <i>without material modification by the enterprise</i>” to the description of a “dependent agent PE”</li> </ul>	<ul style="list-style-type: none"> <li>• Insert into the Multilateral Instrument</li> <li>• Follow-up work on attribution of profits; additional guidance planned before end of 2016</li> </ul>
<b>Intellectual Property</b>			
Counter harmful tax practices (Action 5)	<ul style="list-style-type: none"> <li>• Define substantial activity requirement for preferential IP regimes</li> <li>• Compulsory spontaneous exchange of rulings and APAs</li> </ul>	<ul style="list-style-type: none"> <li>• Agreed approach to tracking and tracing front-end R&amp;D activities to back-end IP exploitation</li> <li>• Limit qualifying IP assets to include 3 categories: patents (broadly defined), copyrighted</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum Standard</li> <li>• Disclosure of existing post-2009 rulings by end of 2015</li> <li>• Disclosure of future rulings within 3 months, beginning April 2016</li> </ul>

		<p>software, and other similar IP assets that meet specific conditions on company size and amount of benefited income</p> <ul style="list-style-type: none"> <li>• Rules to prevent IP assets (not already in a regime) from being shifted from one related party to another</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring of preferential regimes</li> </ul>
Tax challenges of digital economy (Action 1)	<ul style="list-style-type: none"> <li>• Digital economy cannot be ring-fenced; BEPS risks addressed in other Actions are exacerbated by the digital economy</li> </ul>	<ul style="list-style-type: none"> <li>• Generally concludes that other parts of the BEPS Package addressing mobile income effectively address BEPS concerns in the digital economy</li> <li>• Does not adopt proposals discussed in 2014 Deliverable regarding Significant Economic Presence Test, Withholding Taxes, and Equalizing Levies</li> </ul>	<ul style="list-style-type: none"> <li>• Post-project monitoring process to be developed in 2016</li> </ul>
<b><i>Dispute Resolution and Multilateral Instrument</i></b>			
Make dispute resolution mechanisms more effective (Action 14)	<ul style="list-style-type: none"> <li>• Recommendations for the effective and timely resolution of disputes through MAP</li> </ul>	<ul style="list-style-type: none"> <li>• General agreement on taxpayer access, timely resolution, and peer review of MAP process</li> <li>• Agreement by 20 countries (representing 90% of all MAP cases at end of 2013) to adopt mandatory binding arbitration in their bilateral tax treaties<sup>6</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Minimum Standard</li> </ul>
Develop multilateral instrument (Action 15)	<ul style="list-style-type: none"> <li>• Ad hoc group, open to all interested countries, began in May 2015 to develop multilateral instrument to implement the BEPS treaty-related measures</li> </ul>	<ul style="list-style-type: none"> <li>• See discussion of OECD Model changes above</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiations underway with over 90 countries</li> <li>• Speculation that the United States may join</li> <li>• To be open for signature by end of 2016</li> </ul>

	and amend bilateral tax treaties		
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<sup>1</sup> The final reports are on the OECD website at <http://www.oecd.org/tax/beps-2015-final-reports.htm>.

<sup>2</sup> The BEPS Package also includes an Explanatory Statement that provides a useful, and very brief, introduction to the 1000-plus pages of the final reports.

<sup>3</sup> The most recent effort by key taxwriters, including Ways and Means Committee Chairman Paul Ryan, R-Wis., and Senate Finance Committee member Charles Schumer, D-NY, to pair a rewrite of the U.S. international tax rules with legislation to provide additional funding for highway construction and repair, appears to have stalled, at least temporarily. But in a statement released October 5, Ryan said that the 2015 BEPS Final Reports “will only increase the pressure for American businesses to move overseas [and the solution] is to bring our tax code into the 21st century, allowing companies to bring back their earnings without penalty and making our tax rates more competitive with the rest of the world. There is never going to be a perfect time to fix the tax code, but stalling for so long got us into this problem. We can’t afford to wait any longer.”

<sup>4</sup> Paul Ryan and Senator Orrin Hatch, R-Utah.

<sup>5</sup> House Ways and Means Committee members Charles Boustany, R-La., and Richard Neal, D-Mass., released a discussion draft proposal for a so-called “innovation box” in July that, among other things, could theoretically reduce the corporate income tax rate to as low as roughly 10 percent on certain income associated with intellectual property such as patents, inventions, know-how, software and films. The Boustany-Neal proposal was expected to be part of broader legislation being developed by Chairman Ryan that would overhaul U.S. international tax rules and generate certain one-time revenue from the reform provisions to pay for a long-term extension of the Highway Trust Fund.

<sup>6</sup> Countries reported as agreeing to mandatory binding MAP arbitration include the following: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.

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