OECD ACTION PLAN ON
BASE EROSION AND
PROFIT SHIFTING

Tax Justice Network, Dar Es Salaam
2-3 October 2013
OECD Work on Taxation

• Focus has historically been on the development of common standards to eliminate double taxation for cross border investments
  – Model Tax Convention, which serves as the basis for over 3,000 bilateral tax treaties
  – Transfer Pricing Guidelines, which provide common standards for allocating income among members of a multinational group

• Prevention of double taxation remains core work but there is now recognition that the issue of double non-taxation due to base erosion and profit shifting (BEPS) should also be tackled
Increased Attention on BEPS

• Increased attention of mainstream media on corporate tax affairs

• Spreading perception that MNEs dodge taxes all around the world and in particular in developing countries

• Debate on BEPS issues has reached a high political level
  – G20 Leaders in Los Cabos, 19 June 2012
  – G20 Finance Ministers in Mexico City, 5 November 2012
  – BRICS joint communiqué, 18 January 2013
Report: Addressing BEPS

- **Addressing Base Erosion and Profit Shifting** published on 12 February 2013
  - identifies main pressure areas leading to opportunities for BEPS
  - calls on governments to address these areas: in a nutshell, if governments are not happy with the results under the laws, they must change the laws

- Sent to and discussed at G20 Finance Ministers meeting in Moscow on 15-16 February 2013:
  
  “[W]e welcome the OECD report on addressing base erosion and profit shifting and acknowledge that an important part of fiscal sustainability is securing our revenue bases. We are determined to develop measures to address base erosion and profit shifting, take necessary collective actions and look forward to the comprehensive action plan the OECD will present to us in July”

- G8 Leaders Meeting, 13-14 June 2013, Lough Erne
The BEPS Action Plan

• The action plan calls for 15 actions organised around the following three main pillars:
  – The coherence of corporate tax at the international level.
  – A realignment of taxation and substance
  – Transparency, coupled with certainty and predictability

• It also calls for targeted work in the area of the digital economy, which cuts across all three of the main pillars but also presents a number of specific features.

• The action plan also calls for the development of a multilateral instrument to implement the measures developed under the action plan.

• G20 Finance Ministers Meeting, 18-19 July 2013, Moscow
• G20 Leaders Meeting, 5-6 September 2013, St. Petersburg
Key pressure areas

- Hybrid Mismatch Arrangements
- Availability of preferential regimes
- Digital economy
- Anti-avoidance measures
- Related party debt-financing
- Transfer pricing
The Digital Economy (Action 1)

• Spread of the digital economy poses challenges for international taxation.

• The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs.

• Fundamental questions as to how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and character of income for tax purposes.
Coherence (Actions 2 through 5)

The Action Plan calls for the development of international standards to ensure the coherence of corporate tax at the international level

• This relates to the need to complement existing rules to prevent double taxation with instruments that prevent double non-taxation.
  ➢ Neutralise the effects of hybrid mismatch arrangements (action 2)
  ➢ Strengthen controlled foreign companies (CFC) rules (action 3)
  ➢ Limit base erosion via interest deductions and other financial payments (action 4)
  ➢ Counter harmful tax practices more effectively (action 5)
Four actions to ensure coherence

• Neutralise the effects of hybrid mismatch arrangements (action 2)
  – Mismatches in the way countries’ tax laws treat entities and instruments can allow companies to claim multiple deductions for the same economic expense or cause taxable income to disappear. This action will result in treaty and domestic law provisions to neutralise these schemes.

• Strengthen controlled foreign companies (CFC) rules (action 3)
  – One of the sources of BEPS concerns is the possibility of creating offshore entities and routing income through them to escape taxation. Strong CFC rules can address this issue by including the income of these offshore entities in the parent entity’s income on a current basis.

• Limit base erosion via interest deductions and other financial payments (action 4)
  – Some companies use excessive interest deductions to erode their taxable profits, or use debt (which generates interest expense deductions) to finance the production of tax-exempt income. This action will result in recommendations regarding best practices in the design of rules to prevent BEPS through the use of interest expense and other financial payments.

• Counter harmful tax practices more effectively (action 5)
  – Countries have long recognised that a “race to the bottom” would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue. Agreeing to a set of common rules will help countries make their sovereign tax policy choices, and this action will result in revamping the work on harmful tax practices to that end.
The Action Plan calls for a realignment of taxation and substance:

- This is about treaty abuse and transfer pricing, where the current rules do not always produce appropriate results.

  - Prevent treaty abuse (action 6)
  - Prevent the artificial avoidance of PE status (action 7)
  - Assure that TP outcomes are in line with value creation (actions 8, 9, 10)
Five actions to align taxation and substance

• **Prevent treaty abuse** (action 6)
  
  – While tax treaties are designed to prevent double taxation, in some cases they are used to create double non-taxation, in particular through the use of conduit companies. This action will result in model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

• **Prevent the artificial avoidance of PE status** (action 7)
  
  – Under the international standard, a country may not tax the business profits of a foreign company unless the company has a PE in that country. If the company is not taxed on those profits in its jurisdiction of residence, double non-taxation results. This action will result in changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS.

• **Assure that TP outcomes are in line with value creation** (actions 8, 9, 10)
  
  – Transfer pricing rules serve to allocate income earned by an MNE among the countries in which the MNE does business. In some cases, MNE have been able to use and/or misapply the existing rules to separate income from the economic activities that produce that income. This most often involves transfers of intangibles or other mobile assets, over-capitalisation of group companies, and contractual allocations of risk. These actions will result in rules to prevent BEPS through transfers of intangibles, through transfers of risk or excessive allocations of capital, or through transactions which would not, or would only very rarely, occur between third parties.
Transparency and Certainty

BEPS requires greater transparency and certainty

- Establish methodologies to collect and analyse data on BEPS and the actions to address it (action 11)
- Require taxpayers to disclose their aggressive tax planning arrangements (action 12)
- Re-examine transfer pricing documentation (action 13)
- Make dispute resolution mechanisms more effective (action 14)
Four actions to ensure transparency, while improving certainty

- Establish methodologies to collect and analyse data on BEPS and the actions to address it (action 11)
  - Further work needs to be done to measure the scale and effects of BEPS, and to monitor the impact of the actions taken to address it. This action will identify tools to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS.

- Require taxpayers to disclose their aggressive tax planning arrangements (action 12)
  - Improved disclosure measures can help tax administrations and tax policy makers to identify emerging risk areas, and also serve as a deterrent to engage in aggressive planning. This action will result in mandatory disclosure rules targeting these kinds of arrangements.

- Re-examine transfer pricing documentation (action 13)
  - This action will result in rules regarding transfer pricing documentation that enhances transparency for tax administrations while taking into account compliance costs for business, and will include a requirement that MNEs provide all relevant governments with needed information on their global allocation of income, economic activity, and taxes paid among countries.

- Make dispute resolution mechanisms more effective (action 14)
  - The actions to counter BEPS must be complemented with actions to ensure the certainty and predictability needed to promote investment in today’s environment. This action will ensure such certainty by developing solutions to address obstacles that prevent countries from solving treaty-related disputes.
Developing a Multilateral Instrument (Action 15)

- Some actions will result in changes to the OECD Model Tax Convention and changes to the OECD Model Tax Convention are not directly effective without amendments to bilateral tax treaties.
- If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties in effect will make such a process very lengthy.
- There is a need to consider innovative ways to implement the measures resulting from the work on the BEPS Action Plan.
### Timeline and Output by September 2014

<table>
<thead>
<tr>
<th>Action</th>
<th>Expected Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>Address the Tax Challenges of the Digital Economy</td>
<td>Report identifying issues raised by the digital economy and possible actions to address them</td>
</tr>
<tr>
<td>Neutralise the Effects of Hybrid Mismatch Arrangements</td>
<td>Changes to the Model Tax Convention</td>
</tr>
<tr>
<td>Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – phase 1</td>
<td>Finalise review of member country regimes</td>
</tr>
<tr>
<td>Prevent Treaty Abuse</td>
<td>Changes to the Model Tax Convention</td>
</tr>
<tr>
<td>Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles - phase 1</td>
<td>Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention</td>
</tr>
<tr>
<td>Re-examine Transfer Pricing Documentation</td>
<td>Changes to Transfer Pricing Guidelines and Recommendations regarding the design of domestic rules</td>
</tr>
<tr>
<td>Develop a Multilateral Instrument –phase 1</td>
<td>Report identifying relevant public international law and tax issues</td>
</tr>
</tbody>
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## Timeline and Output by September 2015

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<tr>
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<tr>
<td>Strengthen CFC Rules</td>
<td>Recommendations regarding the design of domestic rules</td>
</tr>
<tr>
<td>Limit Base Erosion via Interest Deductions and Other Financial Payments</td>
<td>Recommendations regarding the design of domestic rules</td>
</tr>
<tr>
<td>Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – phase 2</td>
<td>Strategy to expand participation to non-OECD members</td>
</tr>
<tr>
<td>Prevent the Artificial Avoidance of PE Status</td>
<td>Changes to the Model Tax Convention</td>
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<tr>
<td>Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles – phase 2</td>
<td>Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention</td>
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<tr>
<td>Assure that Transfer Pricing Outcomes are in Line With Value Creation / Risks and Capital</td>
<td>Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention</td>
</tr>
<tr>
<td>Assure that Transfer Pricing Outcomes are in Line With Value Creation / Other High-Risk Transactions</td>
<td>Changes to the Transfer Pricing Guidelines and possibly to the Model Tax Convention</td>
</tr>
<tr>
<td>Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It</td>
<td>Recommendations regarding data to be collected and methodologies to analyse them</td>
</tr>
<tr>
<td>Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements</td>
<td>Recommendations regarding the design of domestic rules</td>
</tr>
<tr>
<td>Make Dispute Resolution Mechanisms More Effective</td>
<td>Changes to the Model Tax Convention</td>
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# Timeline and Output by December 2015

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</thead>
<tbody>
<tr>
<td>Limit Base Erosion via Interest Deductions – phase 2</td>
<td>Changes to the Transfer Pricing Guidelines</td>
</tr>
<tr>
<td>Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – phase 3</td>
<td>Revision of existing criteria to identify harmful tax practices</td>
</tr>
<tr>
<td>Develop a Multilateral Instrument – phase 2</td>
<td>Multilateral instrument</td>
</tr>
</tbody>
</table>
Developing countries also face issues related to BEPS, though the issues may manifest differently given the specificities of their legal and administrative frameworks.

- The UN participates in the tax work of the OECD and will certainly provide useful insights regarding the particular concerns of developing countries.
- Task Force on Tax and Development
- OECD Global Relations Programme
- Global Fora on Tax Treaties, on Transfer Pricing, on VAT and on Transparency and Exchange of Information for Tax Purposes

A high-level policy dialogue with all interested parties will be organised on an annual basis.

Consultation with non-governmental stakeholders is also key. Business and civil society representatives will be invited to comment on the different proposals developed in the course of the work.

- Business and Industry Advisory Committee (BIAC)
- Trade Union Advisory Committee (TUAC)
- Non-governmental organisations, think tanks, and academia.
An inclusive project

• Deadlines set to deliver actions needed to address BEPS
  ○ *Expected that the Action Plan will largely be completed in a two-year period*
• All G20 countries/non-members of the OECD will participate on an equal footing (“G20/BEPS Project”)
• Interests of developing countries – participation of UN in the tax work of the OECD; Task Force on Tax & Development and OECD Global Relations Programme; Global Fora
• Presented to G20 Finance Ministers on 19 July 2013, and at G20 Leaders' Summit in September 2013
Objective: To increase the capacity of developing countries to adopt, and effectively implement, transfer pricing rules in accordance with internationally agreed principles.

Operates through a partnership with EU and WB/IFC. Capacity development initiatives in Colombia, Ghana, Kenya, Peru, Rwanda, Vietnam and Zambia.

- Provides assistance to regional organisations (e.g. ATAF, EAC) and develops new guidance and tools.
- Tests the applicability and relevance of OECD guidance on transfer pricing to the developing country context.
- Well positioned to provide feedback loop into OECD Base Erosion and Profit Shifting (BEPS).
Transfer Pricing: Impact

**Colombia:** An increase of over 70% in the revenue collected from transfer pricing adjustments (from USD 3.3M in 2011 to USD 5.83M in 2012); new transfer pricing legislation passed, organizational restructuring and risk assessment procedures in place.

**Ghana:** New transfer pricing regulations passed into law, administrative redesign and a new Transfer Pricing Practice Note for the guidance of taxpayers and tax officers agreed.

**Kenya:** An increase in the number of audit cases completed, revenue collected, and number of cases going to dispute resolution. In a recent case the KRA negotiated a transfer pricing adjustment resulting in additional tax revenue of USD 12.9 Million. In another recent case the Kenyan Judiciary subsequently ruled in favour of the KRA resulting in additional revenue of USD 10.9m.

**Rwanda:** A full assessment of the risk of profit shifting, as the basis on which a new transfer pricing regime is being planned.

**Vietnam:** A significant increase in the tax administration’s capacity to enforce its transfer pricing rules. A recent audit of a large MNE resulted in increased tax paid of USD 3.9M.
Objective

– Enable the transfer of tax audit knowledge and skills to tax administrations in developing countries through a real time, “learning by doing” approach.

– Experts will be deployed to work directly with local tax officials on current audits and audit-related issues concerning international tax matters, and to share general audit practices.

Goals

– Improve quality and consistency of audits, and transfer knowledge and skills.

– Greater certainty for taxpayers, potential for increased revenues, and encouraging a culture of compliance through more effective enforcement.
**TIWB: Strong support**

**G8 Leaders, June 2013:**

We welcome the OECD’s feasibility study for its Tax Inspectors Without Borders proposal to assist tax administrations investigate specific and complex tax cases. We will take practical steps to support this initiative, including by making tax experts available.

**G20 Leaders, September 2013:**

Developing countries must reap the benefits of the G20 tax agenda. ... The OECD’s Tax Inspectors Without Borders initiative to assist tax administrations of developing countries plays a useful role in this regard.
TIWB: Where are we

• TIWB approved in June 2013 by two OECD Committees, under an initial 18-month mandate.

• In the coming six months:
  – Up to 6 pilot TIWB expert deployments will be launched.
  – TIWB database of experts will be developed.
  – Advisory Board to TIWB Secretariat will be formed.
  – TIWB Toolkit, to assist developing country tax administrations, experts and donor partners to establish TIWB deployments will be finalised.

• Official TIWB launch scheduled for early 2014, when TIWB will be open for all interested countries.
TIWB: How to get involved

• Latest news on TIWB available from [www.oecd.org/tax/taxinspectors.htm](http://www.oecd.org/tax/taxinspectors.htm)

• TIWB updates posted to twitter: [@Tax_Inspectors](https://twitter.com/Tax_Inspectors).

• TIWB Secretariat can be contacted by email: [tax.inspectors@oecd.org](mailto:tax.inspectors@oecd.org)

• Tax Administrations will be able to make requests for assistance using the form available on our website.

• Interested experts will be able to register their interest in deployments online.