BEPS Frequently Asked Questions

What is BEPS?

Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid.

Are BEPS strategies illegal?

In most cases they are not. Largely they just take advantage of current rules that are still grounded in a bricks and mortar economic environment rather than today's environment of global players which is characterised by the increasing importance of intangibles and risk management. That said, some of the schemes used are illegal and tax administrations are fighting them.

Why is this relevant if it is all legal?

It is relevant for a number of reasons. First, because it distorts competition: businesses that operate cross-border may profit from BEPS opportunities, giving them a competitive advantage over enterprises that operate at the domestic level. Second, it may lead to inefficient allocation of resources by distorting investment decisions towards activities that have lower pre-tax rates of return, but higher after-tax returns. Finally, it is an issue of fairness: when taxpayers (including ordinary individuals) see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

Why worry about BEPS now? Is public outcry about the tax affairs of corporate giants the driving force behind the OECD's work on BEPS?

The OECD has been providing solutions to tackle aggressive tax planning for years. The debate over BEPS has now reached the highest political levels in many OECD and non-OECD countries. The OECD does not see BEPS as a problem created by one or more specific companies. Apart from some cases of egregious abuses, the issue lies with the tax rules themselves. Business cannot be faulted for using the rules that governments have put in place. It is therefore governments' responsibility to revise the rules or introduce new rules.

What is the cause of BEPS?

BEPS strategies take advantage of a combination of features of home and host countries' tax systems. Corporation tax is levied at a domestic level. The interaction of domestic tax systems means that an item of income can be taxed by more than one jurisdiction, thus resulting in double taxation. The interaction can also leave gaps, which result in income not being taxed anywhere. Corporations have urged bilateral and multilateral co-operation among countries to address differences in tax rules that result in double taxation but at the same time have exploited them so that income goes untaxed everywhere. The report, Addressing Base Erosion and Profit Shifting, identifies a number of circumstances that, combined in different forms, give rise to opportunities for BEPS.

What is the OECD's role in addressing BEPS?

Many BEPS strategies take advantage of the interaction between the tax rules of different countries, making it difficult for any single country, acting alone, to fully address the issue. There is thus a need to provide an internationally coordinated approach which will facilitate and reinforce domestic actions to protect tax bases *and* provide comprehensive international solutions to respond to the issue. Unilateral and uncoordinated actions by governments responding in isolation could result in double – and possibly multiple – taxation for business. This would have a negative impact on investment, growth and employment globally. The BEPS Action Plan provides a consensus-based plan to address these issues and is part of the OECD's on-going efforts to ensure that the global tax architecture is equitable and fair.

What does the BEPS Action Plan say?

It sets forth 15 actions to address BEPS in a comprehensive and coordinated way. These actions will result in fundamental changes to the international tax standards and are based on three core principles: *coherence, substance, and transparency*. The Action Plan also calls for further work to address the challenges posed by the digital economy. Looking toward innovative approaches to deliver change quickly, the Action Plan calls for a multilateral instrument that countries can use to implement the measures developed in the course of the work. While the OECD steps up its efforts to address double non-taxation, it will also continue work to eliminate double taxation, including through increased efficiency of mutual agreement procedures and arbitration provisions.

What actions will be carried out in the context of BEPS?

Domestic tax systems are coherent – tax deductible payments by one person results in income inclusions by the recipient. We need international coherence in corporate income taxation to complement the standards that prevent double taxation with a new set of standards designed to avoid double non-taxation. Four actions in the BEPS Action Plan (Actions 2, 3, 4, and 5) focus on establishing this coherence.

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.

Current rules work well in many cases, but must be modified to prevent instances of BEPS. The involvement of third countries in the bilateral framework established by treaty partners puts a strain on the existing rules, in particular when done via shell companies that have little or no economic substance: e.g. office space, tangible assets and employees. In the area of transfer pricing, rather than replacing the current system, the best course is to fix the flaws in it, in particular with respect to returns related to over-capitalisation, risk and intangible assets. Nevertheless, special rules, either within or beyond the arm's length principle, may be required with respect to these flaws. Five actions in the BEPS Action Plan focus on aligning taxing rights with substance (Actions 6, 7, 8, 9, and 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 permanent establishment (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 transfer pricing outcomes are in line with value creation (actions 8, 9 and 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.

Because preventing BEPS requires greater transparency at many levels, the Action Plan calls for: improved data collection and analysis regarding the impact of BEPS; taxpayers' disclosure about their tax planning strategies; and less burdensome and more targeted transfer pricing documentation. Four actions in the BEPS Action Plan focus on improving transparency (actions 11, 12, 13, and 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) - While taxpayers often are required to produce voluminous documents regarding their transfer pricing arrangements, in many situations the information does not help tax administrators develop a "big picture" view of a taxpayer's global arrangements. 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.

Can BEPS be tackled without replacing the arm's length principle with formulary apportionment?

The current transfer pricing rules do not always properly address the way modern businesses operate in a globalised environment, and taxpayers have thus been able to use/misuse the rules to artificially shift profits. In particular, the arm's length principle faces challenges in addressing transfers of intangibles, risks, and capital, and other high-risk transactions. The Action plan includes three major actions to address these cases, which may include special measures either within or beyond the arm's length principle. The Action Plan has been developed to fix the current system quickly and efficiently, without preconceptions regarding the precise nature of the changes that may be required to address these critical transfer pricing issues. However, adoption of alternative transfer pricing methods like formulary apportionment would require development of a consensus on a number of key issues (which countries do not believe to be attainable in the short or medium term) and could also raise systemic problems which could result in even more damaging problems for countries' revenues. Accordingly, it is believed that it will be most productive to focus on addressing specific issues arising under the current arm's length system at the present time.

How will the actions be implemented? How long will it take?

The BEPS Action Plan calls for the development of tools that countries can use to shape fair, effective and efficient tax systems. Because BEPS strategies often rely on the interaction of countries' different systems, these tools will have to address the gaps and frictions that arise from the interface of these systems. Some actions, for example work on the OECD Transfer Pricing Guidelines and the Commentary to the OECD Model Tax Convention, will result in changes that are directly effective. Others will be implemented by countries through their domestic law, bilateral treaties, or a multilateral instrument.

Addressing BEPS is critical for most countries and must be done in a timely manner so that concrete actions can be delivered quickly before the existing consensus-based framework unravels. . At the same time, governments need time to complete the necessary technical work and achieve widespread consensus. Against this background, it is expected that the Action Plan will largely be completed in 2 years.

How will G20 countries that are not members of the OECD be involved?

The work on BEPS, launched by the OECD, is now strongly supported by the G20 where it is a key item on the Finance Ministers' and of the Leaders' agenda. Non-OECD G20 countries were involved in the work and all (Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia and South Africa) participated in the meeting of the Committee on Fiscal Affairs where the Action Plan was adopted. The continued participation and endorsement of all G20 countries will be critical to guarantee a level playing field and prevent inconsistent standards. To this end, and in order to facilitate greater involvement of major non-OECD economies, the "BEPS Project" has been launched, and interested G20 countries that are not OECD Members will participate in the project on an equal footing. Other non-members could be invited to participate on an ad hoc basis.

Will developing countries be involved? How will their concerns be addressed?

Developing countries also face issues related to BEPS and the work will take into account the specificities of their national legal and administrative frameworks. In this respect, the Global Fora on Tax Treaties, on Transfer Pricing, on VAT and on Transparency and Exchange of Information for Tax Purposes will be useful platforms for developing countries to provide relevant input as will the Task Force on Tax and

Development. In addition, the CFA will benefit from the input of the UN, which has been an observer to the CFA since January 2012.

What are the next steps?

Work on the 15 actions outlined in the Plan has already started and will continue the technical work to develop concrete measures that countries can put in place to end double non-taxation and the artificial shifting of profits.

Will the BEPS Action Plan put an end to offshore tax evasion?

The work on BEPS focusses largely on legal tax planning techniques rather than offshore tax evasion, which is illegal. However, other work being carried out by the OECD and the OECD Global Forum on Transparency and the Exchange of Information is focused on combatting offshore tax evasion.

Based on this work, many jurisdictions have taken concrete actions to improve their legal framework and practices to ensure transparency and effective exchange of information to combat offshore tax evasion. Though there is still room for improvement, the current results are impressive.

How will the BEPS Action Plan affect "tax havens"?

The BEPS Action Plan aims to end the use of shell companies used to stash profits offshore or unduly claim tax treaty protection and neutralise all schemes that artificially shift profits offshore. Though the BEPS Action Plan is not about dictating whether countries should have a specific corporate income tax rate, it will have an impact on regimes that seek to attract foreign investors without requiring any economic substance.

Is the OECD against tax competition?

The OECD is against <u>harmful</u> tax competition. Countries have long recognised that a "race to the bottom" would ultimately drive applicable tax rates on certain sources of income to zero for all countries, harming nations and their citizens. Agreeing to a set of common rules will help countries make their sovereign tax policy choices.

Is the BEPS project against business?

No, it is not. In most cases, business is just using the rules that governments themselves have put in place. It is therefore governments' responsibility to revise the rules or introduce new ones. To ensure the fairness of the corporate tax system, the BEPS project will provide a co-ordinated, comprehensive approach that prevents double taxation *and* double non-taxation, creating a level playing field for all taxpayers.

How can business and civil society get involved in the work?

The work on the Action Plan will continue to involve a transparent and inclusive consultation process, including through an annual high-level policy dialogue with all interested parties.

The BEPS Project will depend on business and civil society input to develop effective, practical solutions that provide a certain and predictable environment for all stakeholders. The OECD's core relationship with civil society is through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD. Non-governmental organisations, think tanks, and academia will also be consulted.

How much tax revenue is lost to BEPS?

Existing studies provide abundant circumstantial evidence that BEPS is widespread. Several studies and data show that profits are reported for tax purposes in locations different from where the actual business activities and investment takes place.

But the existing data and studies do not provide enough information to reach solid conclusions about how much BEPS actually occurs...

What is the appropriate level of corporate income tax?

Every jurisdiction is free to set up its own corporate tax system as it chooses. States have the sovereignty to implement tax measures that raise revenues to pay for the expenditures they deem necessary. No or low taxation is not *per se* a cause of concern unless it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, tax policy concerns arise when there are gaps in the interaction of different tax systems or when, the application of bilateral tax treaties allows income from cross-border activities to go untaxed.

Where can I get more information on BEPS?

More information is available in the BEPS Action Plan, as well as in the report Addressing Base Erosion and Profit Shifting. You can also visit the OECD website at www.oecd.org/tax/beps.htm or contact Pascal Saint-Amans (pascal.saint-amans@oecd.org) or Raffaele Russo (raffaele.russo@oecd.org).