Grant Thornton
An instinct for growth™

Tax

Regulation

Globe

Successes and setbacks

What the BEPS progress report tells us about the road ahead

As most of the Base Erosion and Profit Shifting (BEPS) Action Plan is made up of best practice recommendations rather than 'red line' requirements, it was always going to be applied selectively and in different ways from country to country.

Yet implementation has already confounded expectations in the extent to which many of the optional recommendations are being embraced and fast-tracked by major economies worldwide. These legislative changes are set to have a significant impact on financial and operational structures, as well as effective tax rates. At the same time, some of the BEPS actions that were meant to be universally and consistently implemented have stalled through lack of political momentum or international agreement on how they should be applied.

So, what aspects of BEPS have been most successful in winning government support, gaining an international consensus and delivering on their objectives? What aspects remain work in progress? What do these 'successes' and 'setbacks' for the implementation of BEPS say about the likely future shape of the international tax landscape, and the resulting challenges ahead for your business?

Successes – country by country (CbC) reporting

The adoption of CbC reporting in so many economies worldwide, including Canada, China, India, the United States (US) and the European Union (EU), means that BEPS – or at least one key area of it (Action 13) – is up and running. In all, more than 100 countries and jurisdictions have signed up for minimum standards that include CbC as part of the Inclusive Framework on adoption and implementation.[1]

The adoption of CbC is a major milestone for transparency and international co-operation on corporate taxation. The measures have been given additional force by the requirement to exchange information on rulings that could give rise to BEPS concerns.[2] Some economies including the EU are looking to go further by opening up the possibility of public disclosure of certain aspects of the CbC reports.[3]

A clear road ahead?

So does the roll-out of CbC mark the beginning of a bigger BEPS-orientated overhaul of how multinational enterprises (MNEs) are taxed? The G20 remains firmly committed to 'a timely, consistent and widespread implementation' of BEPS.[4] Yet progress to date is mixed as implementation of many of the BEPS articles comes up against a combination of difficulties in application and the headwinds of protectionism, local politics and economic priorities. There's even a possibility that BEPS could end up being little more than 'CbC plus' or is implemented so selectively and inconsistently as to undermine the international consensus and collaboration it was intended to foster. The analysis we've carried out for this article points to a more nuanced outcome as momentum builds behind certain aspects of BEPS, while others are set aside for a later date.

1 More information about the Inclusive Framework is available on the OECD website (http://www.oecd.org/tax/beps/beps-about.htm).

2 OECD media release, 11 July 2016 (http://www.oecd.org/tax/beps/oecd-releases-standardised-it-format-for-the-exchange-on-tax-rulings-under-beps-action-5.htm).

3 European Parliament Report, 12 January 2017 (http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595867/EPRS_BRI(2017)595867_EN.pdf).

4 Communiqué, G20 Finance Ministers and Central Bank Governors Meeting, Baden-Baden, Germany, 17-18 March 2017 (http://www.mof.go.jp/english/international_policy/convention/g20/170318.pdf).

Red lines and recommendations

So what marks out the priority actions from those at the back of the queue? The OECD's categorisation is clearly important, although not always the decisive factor. Some of the 15 actions are mandatory. In addition to CbC and reporting requirements for transfer pricing, examples include tackling harmful tax practices, preventing tax treaty abuse and improvements in cross-border tax dispute resolution. These red lines form the basis for the minimum standards for the Inclusive Framework.

Beyond these mandatory minimum requirements lie a series of desired but voluntary measures covering areas such as controlled foreign company (CFC) rules (moving profits to low tax jurisdictions) and disclosure of aggressive tax planning. In addition, there are common approach measures, which call for greater convergence between different jurisdictions in areas such as restrictions on interest rate deductions on intra-company debt and the treatment of hybrid mismatch arrangements.[5] Again these common approaches are non-mandatory.

Moving at different speeds

Apart from CbC, a lot of jurisdictions are only just beginning to make their assessments and formulate plans for implementing BEPS in their local markets. Inevitably there is greater urgency in implementing mandatory requirements. By contrast, many of the recommendations have yet to get beyond the drawing board, let alone move towards widespread adoption. The taxation of digital services is a case in point.

Yet some countries are moving ahead of the pack. Examples include India, which has introduced an equalisation levy, and South Africa, which has introduced VAT on electronic services independent to the BEPS process. Moreover, the EU's Anti-Tax Avoidance Directive (ATAD) demonstrates how quickly BEPS-orientated developments can be agreed and enacted if there is sufficient public pressure and political will. The launch of the Multilateral Convention and subsequent negotiations have added to the momentum for change by providing a mechanism for states to build agreed aspects of BEPS into their bilateral and multilateral tax treaties.[6]

What does experience so far tell us about the areas of BEPS that are going to be in the first wave of implementation and how they will be applied? What other areas are likely to remain under negotiation or on the backburner for longer?

[5] 'Hybrid mismatches' include double deductions for the same expense, deductions for an expense without the corresponding receipt being fully taxed or an entity that is look-through in one country but regarded as a separate entity in another such as the US 'check the box provision'.

[6] More information about the Multilateral Convention is available on the OECD website (http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm).

Progress, hold-ups and their implications

Where BEPS is moving ahead?

1 CbC reporting

Governments and tax authorities have embraced CbC reporting as an opportunity to enhance transparency and promote greater information sharing. Buy-in from the US is especially significant.

CbC reporting gives tax authorities useful new information about which businesses to target for investigation and audit by revealing the level of tax paid alongside the size of the workforce in each major operating territory. Australia[7] and the United Kingdom (UK)[8] have gone further by requiring large businesses to disclose their tax strategies and governance around this. The UK is notable in making this disclosure public.

Implications for BEPS implementation
Agreements on CbC could provide a model for extending consensus in other areas of international co-operation such as binding arbitration (Treaty Dispute Action 14).

Actions
In the wake of CbC, tax structures are now more visible, making aggressive planning harder to justify to wary boards and a hostile public.

It's important to think about what existing tax structures may need to be modified or eliminated.

It's also important to think about how your tax strategies and associated risks are likely to be viewed by tax authorities as they look at which businesses to target. The need to ensure that local operations understand the overall strategy and are following it demands more communication and collaboration between head office and subsidiary tax teams.

2 EU Anti-Tax Avoidance Directive (ATAD)

ATAD 1 is bringing key aspects of BEPS into EU and member state law including CbC reporting, restrictions on interest rate deduction, common patent box rules and actions to address hybrid mismatches.[9] Crucially, ATAD 2 takes this further by extending the reach of the curbs on hybrid mismatch to arrangements involving countries outside the EU.

Implications for BEPS implementation
EU finance ministers have come under pressure from the European Parliament and the public to enact and fast-track BEPS through ATAD. ATAD 2 was agreed just four months after the European Commission put forward the proposal, demonstrating how quickly progress can be made when there is public pressure and political momentum.

Significantly, ATAD builds some of the best practice recommendations (CFC rules) and common approaches (restrictions on interest rate reduction) into its minimum requirements. It also explores the possibility of a public CbC, where a MNE must publish a defined set of facts and figures that provides a global picture of their corporate income tax position. The company size thresholds being proposed are much lower than the OECD recommendations, raising the prospect that mid-sized businesses may be swept up along with the largest global companies.

Both CFC and restrictions on interest rate reduction would score quite highly in a tax authority cost-benefit analysis of BEPS implementation. And while non-mandatory, these are going to be high up the priority list within many states and regions, if not already in place. Most developed economies already have CFC rules, but restrictions on capitalisation and debt have been unevenly applied in the past. The new provisions on interest represent a major change for businesses, and perhaps starts a new era where corporate debt is regarded as inherently 'bad' compared to equity financing.

7 Australian Taxation Office (https://www.ato.gov.au/Business/Large-business/In-detail/Key-products-and-resources/Tax-risk-management-and-governance-review-guide/?page=2).
8 HM Revenue and Customs (https://www.gov.uk/guidance/large-businesses-publish-your-tax-strategy).
9 European Commission (https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en).

“ Although Brexit may allow flexibility from a rigid ‘one size fits all’ approach to BEPS in Europe, the UK is rightly seen as a leader in reforming international tax, and business should not expect a ‘soft touch’ from the UK Government.”

Wendy Nicholls
Partner
Grant Thornton, UK

ATAD provides a possible model for consensus building and flexible implementation in other regional areas such as the Association of Southeast Asian Nations (ASEAN). It allows considerable room for interpretation and adaptation locally – some of this is the result of modifications needed to secure political endorsement from the EU Economic and Financial Affairs Council (ECOFIN). It's set as a minimum standard, allowing member states to build further rules on top. Significant variations that are likely to remain include lower qualifying thresholds for the reporting requirements in some EU states.

Actions

As a result of ATAD 1 and ATAD 2, a big slice of BEPS is set to be an operating reality for EU organisations, both within their EU operations and, crucially, in their third-country dealings.

Curbs on hybrid mismatches and new interest rate deduction rules will require a review and possible rethink of operational and financial structures. While companies that make extensive use of debt finance will be especially affected by BEPS rules, some companies may have unintentional hybrids and you will need to check through structures to avoid penalties for abuse.

You should also make sure that the location of permanent establishments (PEs) and tax basis for innovation and intellectual property reflect the substance of your operations.

'Before implementing some of the BEPS actions, countries maybe waiting to see the impact of US tax reforms so that they do not harm the international competitiveness of their own MNEs.'

Where BEPS is stalling?

Some aspects of BEPS are still subject to international consultation on how they should be applied in practice.

Part of the delay lies in the technical intractability of some of the measures – hard-to-value intangibles being a case in point. There is still a lack of clear guidance in key areas of transfer pricing for PEs and how profits should be attributed to foreign branches. In our view, if the transfer pricing rules are applied correctly, there should be little to be gained from identifying a plethora of extra PEs, as the extra local profit would often be negligible. Unfortunately, however, this won't stop some countries arguing that limited local activity and work done by business travellers can trigger a local tax obligation.

Similarly, measures designed to provide tax rules that are more relevant to the digital economy have lacked both urgency and direction and have, for now, gone into the 'too hard' basket for most countries.

Implications for BEPS implementation
The cost-benefit driven prioritisation of certain aspects of BEPS is likely to preclude hard-to-agree and -implement measures in the first wave. But as the quick wins are exhausted, governments may revisit these trickier areas in search of fresh revenue opportunities.

Actions
Given the scale of BEPS, it's important to distinguish the big risk areas for your business that demand urgent attention from those that can be left on hold or dealt with later. At the same time, it's important to regularly revisit these evaluations. While certain aspects of the BEPS recommendations are at the back of the implementation queue at present, they could spring into life later on. The risk of being caught out is increased in circumstances where previous tax submissions could be challenged or are still open to review by the tax authority. The longer a risk is left unattended, the larger the potential assessment, penalties and interest could be.

Where BEPS is splintering?

While one of the main aims of the BEPS Action Plan is to bring greater consistency to the tax rules for MNEs, the architects of the plan recognised the need for flexibility in adapting the measures to local tax policy objectives. But we're already seeing much greater fragmentation than the OECD envisaged. Even in the area of transfer pricing documentation where the master file and local country file concepts are very clear and straightforward, some countries are adding their own tweaks and requirements, which could add unwelcome extra burdens on business. And the US has so far resisted making these changes, arguing that its own current documentation requirements are sufficient and well aligned with the OECD's BEPS recommendations.

While the pack has so far been slow and limited in implementing most aspects of the Action Plan apart from CbC, others have moved out ahead. And the resulting legislation often goes much further than the recommendations. Examples range from South Africa's transfer price documentation requirements[10] to the UK's and Australia's[11] diverted profit tax legislation to combat abuse of PE rules.

Implications for BEPS implementation
The slower the pack moves, the more countries will break ranks and come up with their own local interpretation of the recommendations. Instead of improved consistency, the actual result could be an even more complex patchwork of local rules. While in line with the BEPS rules, the results of the Multilateral Convention could heighten the divergence and complexity facing your business.

Actions
Fragmentation and different speeds of implementation make it necessary to keep a close eye on local developments and their implications. As with CbC, this demands more communication and collaboration between groups and subsidiary tax teams.

[10] Compulsory transfer pricing documentation, 16 November 2016 (www.grantthornton.co.za/insights/articles/transfer-pricing-documentation-now-compulsory.and-more).
[11] Increasing tax challenges for global organisations, 2016 (www.grantthornton.com.au/en/client-alerts/2016/increasing-tax-challenges-for-global-organisations).

Ready or not here it comes

Therefore, while BEPS implementation has a long way to go, patterns are beginning to emerge. The countries enacting the BEPS actions fastest are the ones feeling the most public pressure for tax reform. The BEPS actions at the front of queue are the ones that are likely to have the biggest impact from both a revenue generating and political perspective.

It's interesting that many countries have independently clamped down on hybrid mismatches, limited interest deductions and through updated CFC rules have curtailed the movement of profits to lower tax jurisdictions. Yet none of these were minimum requirements as set out in the BEPS Action Plan and for the measures to function effectively some level of international co-operation is required. The outcome of the Multilateral Instrument negotiations will give us a sense of the appetite for international co-operation.

The harmonisation achieved through the EU's ATAD 1 and 2 demonstrates that where there is political momentum, consensus can be achieved quite rapidly. However, whatever is agreed, it's likely that governments will continue to pick the BEPS actions that resonate more in their jurisdiction. For the time being at least it's likely that businesses will need to continue to monitor BEPS developments on a jurisdiction-by-jurisdiction basis.

Steering through the road ahead

Is your organisation up to speed? A survey we carried out last year revealed that more than three-quarters of participating businesses had not changed their approach to taxation to take account of BEPS.[12] Given the amount of strategic re-evaluation, financial restructuring and other heavy lifting that's likely to be needed, it's important to get into gear as soon as possible if you haven't already. Equally urgent is the bolstering of tax risk governance and management needed to steer through levels of scrutiny that are increasing in both intensity and in cross-jurisdictional co-ordination. Globally, BEPS implementation is fragmented, but that doesn't prevent tax authorities from hunting in packs.

With other sweeping changes on the horizon ranging from planned tax reforms in the US to Brexit-related restructuring, tax is now at the heart of the complexity and ambiguity facing all MNEs. It's therefore vital that your business has a clear and comprehensive view of the road ahead on tax and the best way to navigate it. We can help. If you would like to discuss any of the areas raised in this article, please contact your own Grant Thornton adviser or one of the contacts listed.

Canada
Tina Korovilas
E tina.korovilas@ca.gt.com

UK
Wendy Nicholls
E wendy.nicholls@uk.gt.com

India
Arun Chhabra
E arun.chhabra@in.gt.com

US
David Sites
E david.sites@us.gt.com

12 Grant Thornton media release, 20 September 2016 (https://www.grantthorntonglobal/en/press/press-releases-2016/beps-sept-16-release/).

Grant Thornton
An instinct for growth™

grantthornton.global