



BASE EROSION & PROFIT SHIFTING: FISCAL AND ECONOMIC IMPLICATIONS

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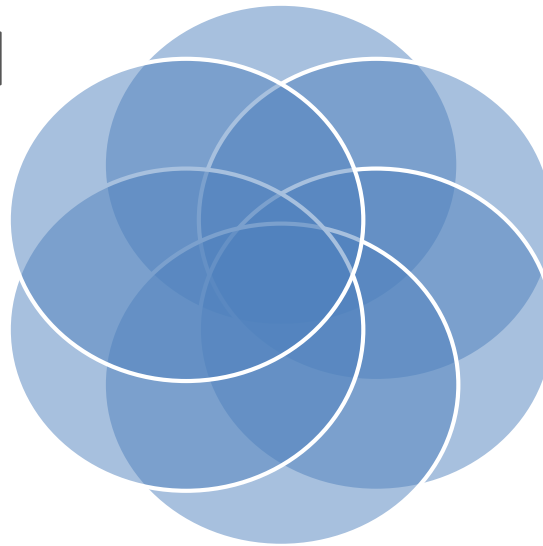
Pressures building for reform

Double non-taxation

**Need for global
action**

Stateless income

**Parliamentary
inquiries**



**Breakdown of
international
consensus**

Fiscal consolidation



Bold Action Required

September 2013: G20 Leaders endorsed ambitious and comprehensive BEPS Action Plan with 15 Actions

October 2015: 13 reports delivered just 2 years later

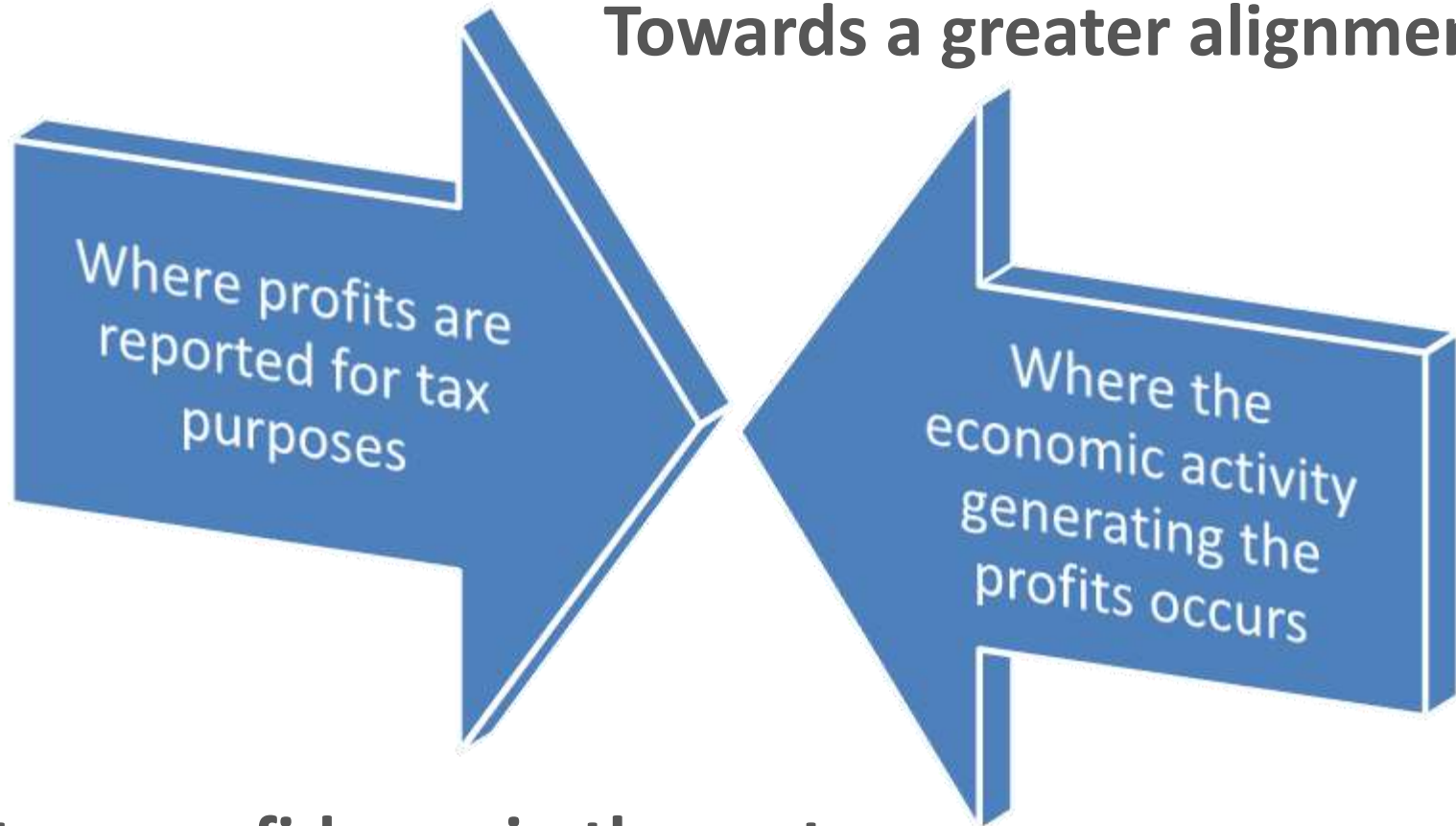
New or reinforced international standards and concrete measures to help countries tackle BEPS

Unparalleled effort - OECD/G20 countries working together on an equal footing with many developing countries



Objectives of the BEPS Project

Towards a greater alignment



Restore confidence in the system

Build a global consensus



Features of the BEPS Project

Fast-paced – two year time frame

- Urgent need to restore trust, level the playing field, and provide governments with efficient tools to ensure the fairness and effectiveness of sovereign tax policies
- Limit the risks of countries taking uncoordinated unilateral measures

Inclusive – OECD, G20 & Developing countries

- OECD and G20 countries working together on an equal footing
- 14 Developing Countries, ATAF, CREDAF & CIAT participating directly & more than 60 Developing Countries participating *via* Regional networks

Transparent process

- 23 Discussion Drafts published, 12,000 pages of comments received
- 11 public consultations with stakeholders and regular webcasts



15 Actions around 3 main pillars

Coherence

Hybrid Mismatch Arrangements (2)

CFC Rules (3)

Interest Deductions (4)

Harmful Tax Practices (5)

Substance

Preventing Tax Treaty Abuse (6)

Avoidance of PE Status (7)

Transfer Pricing Aspects of Intangibles (8)

Transfer Pricing Risk and Capital (9)

Transfer Pricing High Risk Transactions (10)

Transparency & Certainty

Measuring and Monitoring BEPS (11)

Disclosure Rules (12)

Transfer Pricing Documentation (13)

Dispute Resolution (14)

Digital Economy (1)

Multilateral Instrument (15)



What's in the BEPS Package?

- Detailed report on measuring BEPS
- Minimum standards
- Reinforced international standards on tax treaties and transfer pricing
- Common approaches and best practices for domestic law measures
- Analytical reports with recommendations (digital economy and the multilateral instrument)



What do we know about the scale and impact of BEPS?

More than 100 empirical studies report evidence of BEPS

New OECD research finds that global net annual revenue loss of 4-10% of CIT (USD 100-240 billion) at 2014 levels

BEPS creates many economic distortions

- ETRs of large MNEs are 4-8½ pp lower than similar domestic firms
- Favours intangible investments, companies locating debt in high-tax countries and distorts the location of FDI
- Creates negative tax spillovers across countries

Anti-avoidance rules are effective in preventing BEPS in individual countries, but coordinated measures could be more effective



Global fiscal estimates of BEPS

Fiscal estimate approach	Scope	Range USD (billions)	Year (level)
OECD aggregate tax rate differential 2015	Global	100-240 (4-10% of CIT)	2014
IMF CIT efficiency 2014	Global	5% of CIT	
IMF staff working paper tax haven spillover 2015	Global	123 (6% of CIT)	2013 Short-term
UNCTAD offshore investment matrix 2015	Global	200 (8% of CIT)*	2012
Clausing excess income in low tax countries 2015	Global	280 (13% of CIT)	2012
IMF staff working paper tax haven spillover 2015	Global	647 (32% of CIT)	2013 Long-term

* Only includes investment-related BEPS: not trade mispricing.



Revenue lost from profit shifting

- *CIT revenues lost from profit shifting = A worldwide responsiveness of profit-to-asset ratio to tax rate differentials × average asset/profit ratio × average tax rate differential × MNEs' average share of total profits × estimated global CIT revenue*
- Key parameters:
 - the responsiveness of the profit-to-asset ratio to tax rate differentials estimated from the ORBIS database with a particular regression specification for profitable entities (-0.1);
 - the average profit-to-asset ratio (6.2%) from ORBIS data;
 - an average tax rate differential between affiliates (3.6%) from ORBIS data;
 - MNEs' share of profits (59%) with the ORBIS data and supplemented with aggregate tax return tabulations for several countries;
 - tax credits as percent of before-credit corporate tax collections (19%) from an OECD survey;
 - an estimate of USD 2.3 trillion of after-credit corporate tax collections in 2014, adjusted for expected growth from 2011;
 - 95% confidence interval around tax sensitivity estimates and upper bound assumes firms outside the sample have 50% higher tax planning intensity than those in the sample



Assumptions underlying fiscal effects

- The estimated semi-elasticities of reported profits to tax rate differentials of -1.0 for all MNE entities and -1.6 for profitable MNE entities is assumed to be the same for the MNEs outside the ORBIS sample as the MNEs in the sample;
- the tax variable is assumed to accurately capture profit shifting, based on the specification of the regression and the variables used; tax revenue changes are assumed to be proportional to the amount of profit shifting;
- non-corporate businesses are assumed not to be engaged in BEPS;
- ORBIS relationships for tax rate differentials and asset/profit ratio are assumed to be the same for MNEs outside the ORBIS sample as the MNEs in the sample;
- differences in any of these relationships across countries are assumed to not significantly affect the global estimate;
- the average profit shifting response to tax rate differentials between 2000 and 2010 is assumed to be the same for 2014;
- averages are weighted by share of corporate tax collections after tax credits in 2005-2010 among the countries included in the analysis;
- for the final profit shifting fiscal estimate, actual corporate tax collections after tax credits are adjusted upward by 23% to more accurately reflect the taxable income base affected by profit shifting, based on a CFA/WP2 survey of corporate tax credits, principally at 2011 levels.



Some considerations in analysing BEPS countermeasures

- Economic effects of unilateral changes different than internationally-coordinated multi-lateral changes
- BEPS countermeasures should be considered in budget-neutral context
- Effects of BEPS countermeasures different than general corporate tax reductions
- Lots of uncertainty in disentangling BEPS from MNE's real economic activity and non-BEPS tax preferences
- Account for both taxpayers' and governments' behaviours



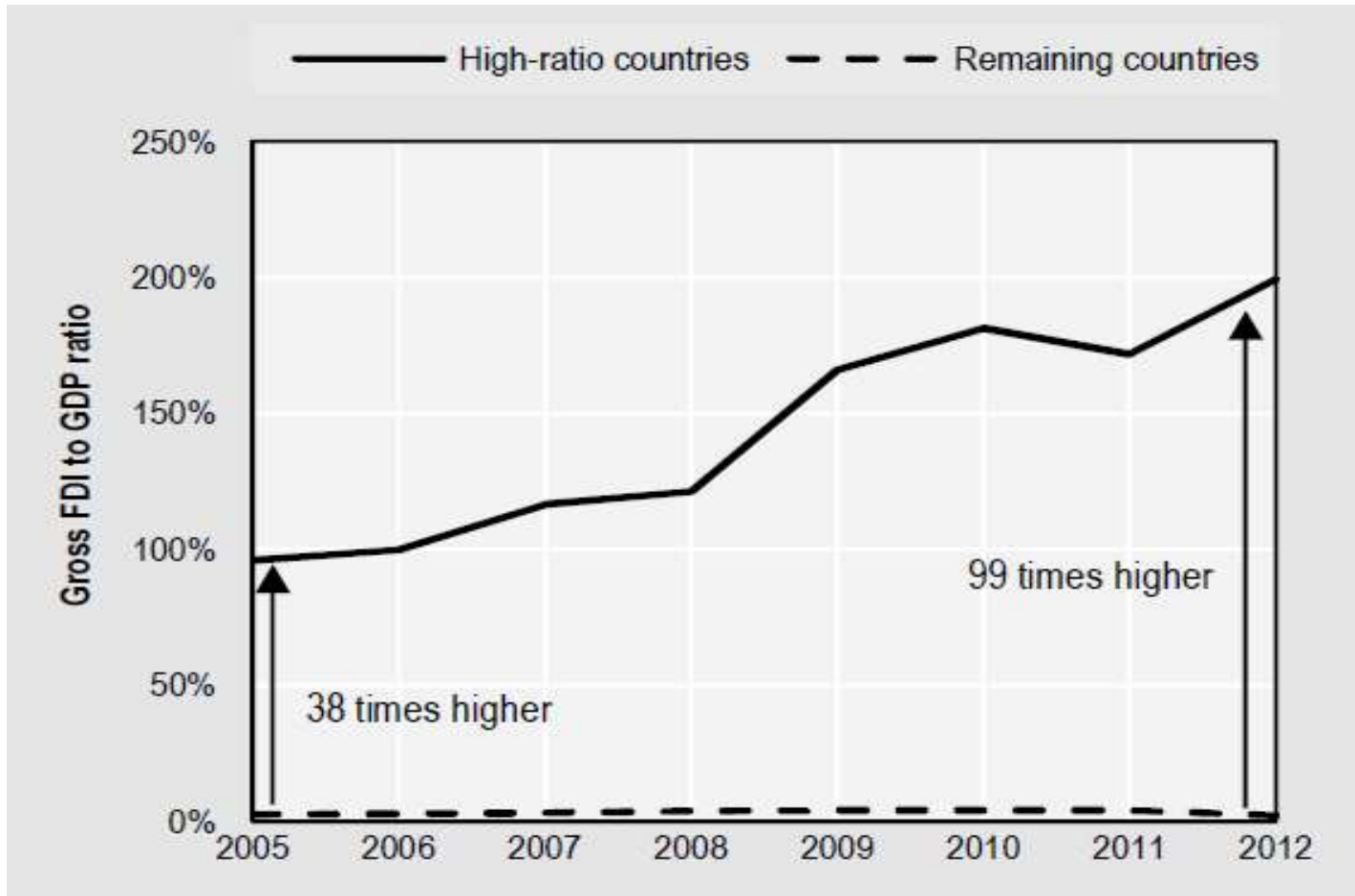
Economic (non-fiscal) effects of BEPS

- Differential tax rates across companies
- Distortions in the location of corporate debt
- Distortions in the location of patents
- The location of real economic activity
- Distortions in the types of investment
- Strategic spillover effects on governments' taxes and tax policies



Concentration of net FDI to GDP

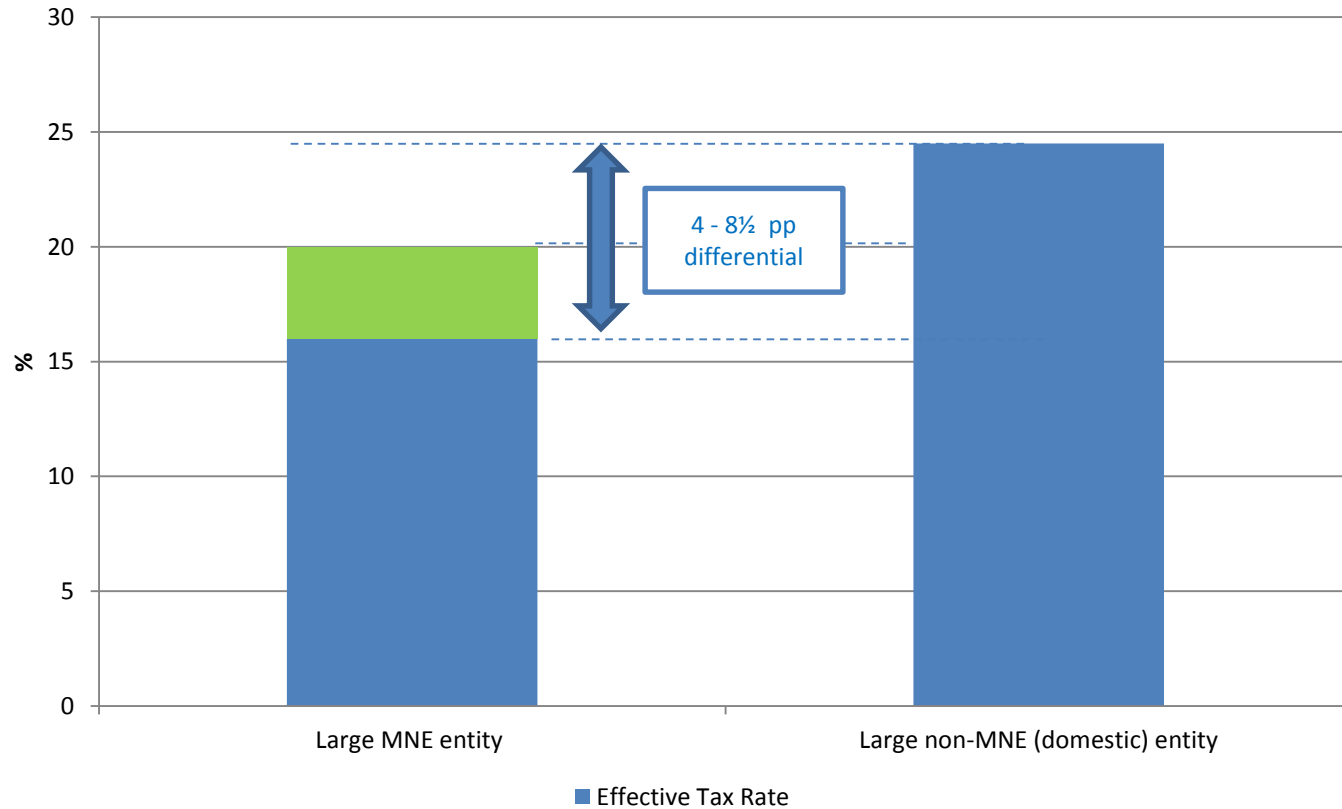
Foreign direct investment is increasingly concentrated





ETRs - large MNEs v large non-MNEs

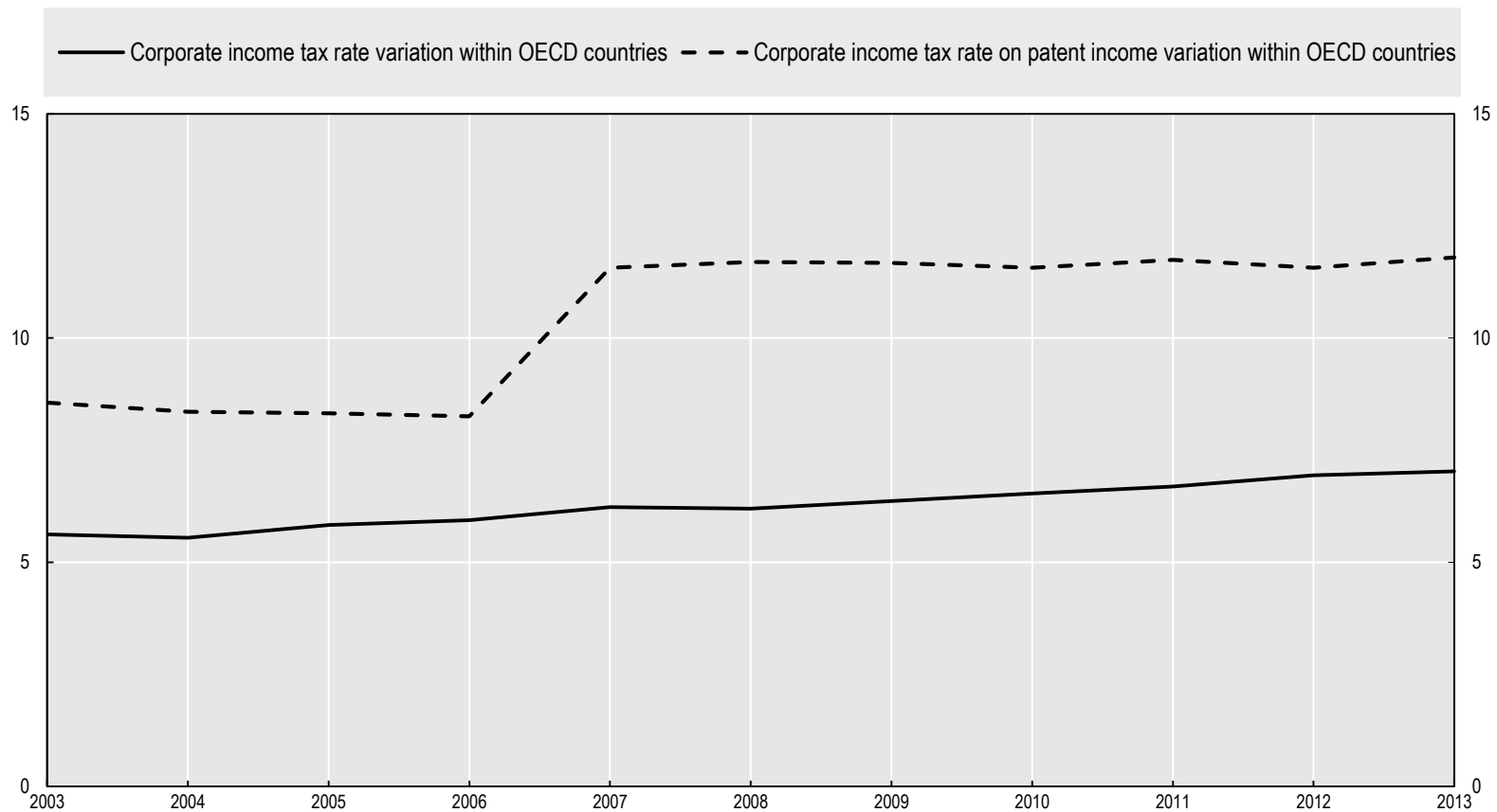
Effective Tax Rate Differentials





Incentives to engage in BEPS

While average statutory CIT rates have been declining in the OECD, tax rate differentials between countries have been increasing





Action 11: Measuring & Monitoring BEPS

Measuring & monitoring BEPS

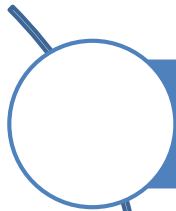
- Assessment of data
- A 'dashboard of indicators'
- Economic analysis
- Recommendations for new tools and data

Key recommendations

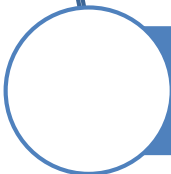
- The OECD to work with governments:
 - to publish a new regular Corporate Tax Statistics publication, including statistical analyses of Country-by-Country report data
 - to refine BEPS indicators and produce periodic reports on the estimated revenue impacts of proposed and enacted BEPS countermeasures
- More research is needed on MNEs, including by tax administrations in collaboration with academic researchers
- Better data and refined analyses will improve the measurement and monitoring of BEPS and countermeasures in the future



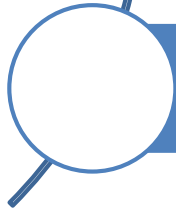
Developing an Inclusive Framework



Supporting implementation to ensure consistency



Monitoring implementation important to ensure a **level playing field & to assess impact of the measures**



Monitoring may take **different forms** depending on the item concerned, minimum standards, international standards, common approaches, relevant developments, etc.

G20 Finance Ministers: *“We will continue to work on an equal footing as we monitor the implementation of the BEPS project outcomes at the global level, in particular, [...] and we **call on the OECD to prepare a framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions, particularly developing economies, on an equal footing**”*

BEPS Inclusive Framework endorsed by G20 Finance Ministers, 28 February 2016



Companies are already preparing

- *Big companies are planning to overhaul their tax arrangements to comply with proposals for new global tax rules even before they become legally enforceable...* (source: Bergin, Reuters, 6 Oct. 2015)
- Based on a Thomson Reuters - Euromoney survey of 180 tax professionals across 35 countries

Of companies surveyed:

More than 59 percent	Are already implementing changes to their intercompany agreements
More than 55 percent	Are planning to change the way they price inter-group transactions
More than 66 percent	Are planning to review their business structures



Contact details



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Annex: Specific BEPS Actions



Action 1: Challenges of the Digital Economy

Impossible to ring-fence the digital economy for tax purposes

Digital economy has key features and fosters business models that raise related but different issues

No unique BEPS issues, but the **digital economy exacerbates BEPS concerns**

- Addressed across the BEPS Project, including within the work on permanent establishment, transfer pricing and CFC rules

Broader tax challenges

- Nexus and data challenges analysed with potential options, including Significant Economic Presence, WHT & Equalisation levy



Action 1: VAT challenges of the Digital Economy

Remote digital supplies to exempt businesses & multiple location entities

- Addressed by the OECD's Guidelines on place of taxation for B2B supplies of services and intangibles (completed in January 2014)

Collecting VAT on cross-border supplies from non-resident suppliers, especially in B2C trade: remote supplies to consumers and low value imports

Determining place of taxation of B2C supplies of services & intangibles

- Part of the OECD International VAT/GST Guidelines
- Level the playing field between domestic & foreign suppliers and facilitate the efficient collection of VAT due on these transactions
- VAT will apply based on where the consumer lives
- Simplified registration and compliance regime recommended to facilitate compliance by non-resident suppliers

Low value imports – report in Annex C



Action 2: Hybrid Mismatch Arrangements

Hybrid mismatch arrangements exploit differences in tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation

Common approach will facilitate convergence of national tax practices through domestic & treaty rules to neutralise such arrangements

The measures proposed take the form of:

- Recommendations for linking rules that align the tax treatment of an instrument or entity with the tax treatment in the counterparty jurisdiction but otherwise do not disturb the commercial outcomes. Apply automatically with a primary and secondary rule
- Changes to OECD MTC to help deal with hybrid entities



Action 3: Strengthen CFC Rules

Controlled Foreign Corporation (CFC) rules seek to ‘bring back’ the income received by a CFC that should be attributable to the domestic entity that exerts control over the CFC

To recognise varying policy objectives among jurisdictions, not a minimum standard, but are designed to ensure those jurisdictions that choose to implement have effective rules

Recommendations provide building blocks for effective CFC rules

- Definition of a CFC
- CFC exemptions & threshold requirements
- Definition of CFC income
- Rules for computing & attributing income
- Rules to prevent / eliminate double tax



Action 4: Interest deductibility

BEPS risks connected with interest deductibility

- Location of third party debt in high tax countries
- Using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense
- Use of interest debt to fund tax exempt income

The common approach aims at ensuring that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities

Fostering increased coordination of national rules

- Fixed ratio rule
- Group ratio rule
- Additional optional elements



Action 4: Interest deductibility (2)

Fixed ratio rule

- Allow net interest deductions up to a fixed net interest/EBITDA ratio
- Applies to interest paid to third parties and intragroup
- Fixed ratio corridor between 10-30%
- Factors provided to help countries set ratio

Group ratio rule

- Interest deductions up to net interest/EBITDA ratio of group
- Countries may instead apply a different group ratio (e.g. equity escape) or no group rule

Additional optional elements

- De minimis threshold
- Carry forward/back provisions
- Exclusion for third party interest funding certain public-benefit assets

Further work

- On detailed design and operation of group ratio rule
- Specific rules for banking and insurance sectors



Action 5: Harmful Tax Practices

Addresses preferential regimes and improve transparency in connection with certain rulings

Minimum standard based on agreed methodology to assess whether substantial activity in a preferential regime:

- “Nexus” approach: IP regimes, e.g. patent box
- Same principle for other preferential regimes

Improved transparency through mandatory spontaneous exchange on rulings related to:

- Preferential regimes
- Unilateral APAs and other transfer pricing rulings
- Where a unilateral downward adjustment
- Related party conduit rulings
- Other rulings subsequently agreed to give rise to BEPS concerns



Action 6: Preventing Treaty Abuse

Treaty abuse, in particular treaty shopping, is one of the most important sources of BEPS

Minimum standard on preventing abuse including through treaty shopping

New flexible rules that provide a minimum level of protection against treaty abuse, including treaty shopping:

- An express statement that common intention of the contracting states is to eliminate double taxation without creating opportunities for non-taxation will be included in tax treaties
- Specific anti-abuse rule, the limitation-on-benefits rule
- More general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test)



Action 7: Permanent Establishment

Business profits of a foreign enterprise are generally taxable in a State only to the extent that the enterprise has a Permanent Establishment in that State to which profits are attributable

Address techniques used to inappropriately avoid the tax nexus

- Replacement of a distributor with a “commissionnaire arrangement”
- Taking advantage of exceptions to prevent the taxation of mere preparatory or auxiliary activities – especially where MNE fragments its business activities
- Splitting up construction contracts in order to qualify for an exception based on time during which an enterprise is active on a construction site

Definition of Permanent Establishment in tax treaties

- Where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a taxable presence in that country unless intermediary performing activities in the course of an independent business
- Changes to this definition in Article 5 of the OECD Model Tax Convention ensure that this policy is better reflected



Actions 8-10: Transfer Pricing

Transfer pricing rules are used to determine the conditions, including the price, for transactions within an MNE group

Ensures that transfer pricing rules secure outcomes that better align operational profits with the economic activities that generate them

Existing standards in this area have been clarified and strengthened with

- guidance on the arm's length principle
- an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm's length principle
- guidance on transactions involving cross-border commodity transactions
- guidance on low value-adding intra-group services

The latter two areas were identified as critically important by developing countries

- Guidance will be supplemented with further work mandated by the G20 Development Working Group



Actions 8-10: Transfer Pricing (2)

Action	Issues addressed
Action 8 <i>Intangibles</i>	Considered transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and are often hard-to-value . Misallocation of the profits generated by valuable intangibles has heavily contributed to base erosion and profit shifting
Action 9 <i>Risks & capital</i>	Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks
Action 10 <i>Other high-risk transactions</i>	Focused on other high-risk areas, including the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation



Action 12: Mandatory Disclosure Rules

Tax authorities face a lack of timely, comprehensive and relevant information on aggressive tax planning which can be addressed by mandatory disclosure rules

MDR requires disclosure, often before returns are filed, of certain transactions, by promoters, taxpayers or both

Not a minimum standard, but 3 key outputs for countries wishing to adopt MDR:

- Framework for design of rules that are flexible to country specific risks and needs
- Special recommendations for rules that focus on international tax schemes
- Enhanced models of information sharing using the JITSIC network as a platform



Action 13: TP Documentation

Improved & better-coordinated TP documentation will increase quality of information provided to tax administrations & limit the compliance burden

Three-tiered approach, including a minimum standard on CBC reporting:

- **Master file:** MNEs will be required to provide tax administrations with high-level information on global business operations & TP policies to be available to all relevant tax administrations
- **Local file:** Detailed transactional TP documentation to be provided in a “**local file**” specific to each country, identifying material related-party transactions, amounts involved in those transactions, and analysis of TP determinations
- **Country-by-country reports:** Large MNEs are required to file annual **CbC Report** providing each tax jurisdiction in which they do business, their revenue, profit, income tax paid & accrued and other indicators of economic activity
- New CbC Reporting requirements are to be implemented for fiscal years beginning on or after 1 January 2016 and apply, subject to the 2020 review, to MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million (\pm 9000 groups)



Action 13: TP Documentation (2)

Model Template for Country-by-Country Report to be used as a risk assessment tool by tax administrations

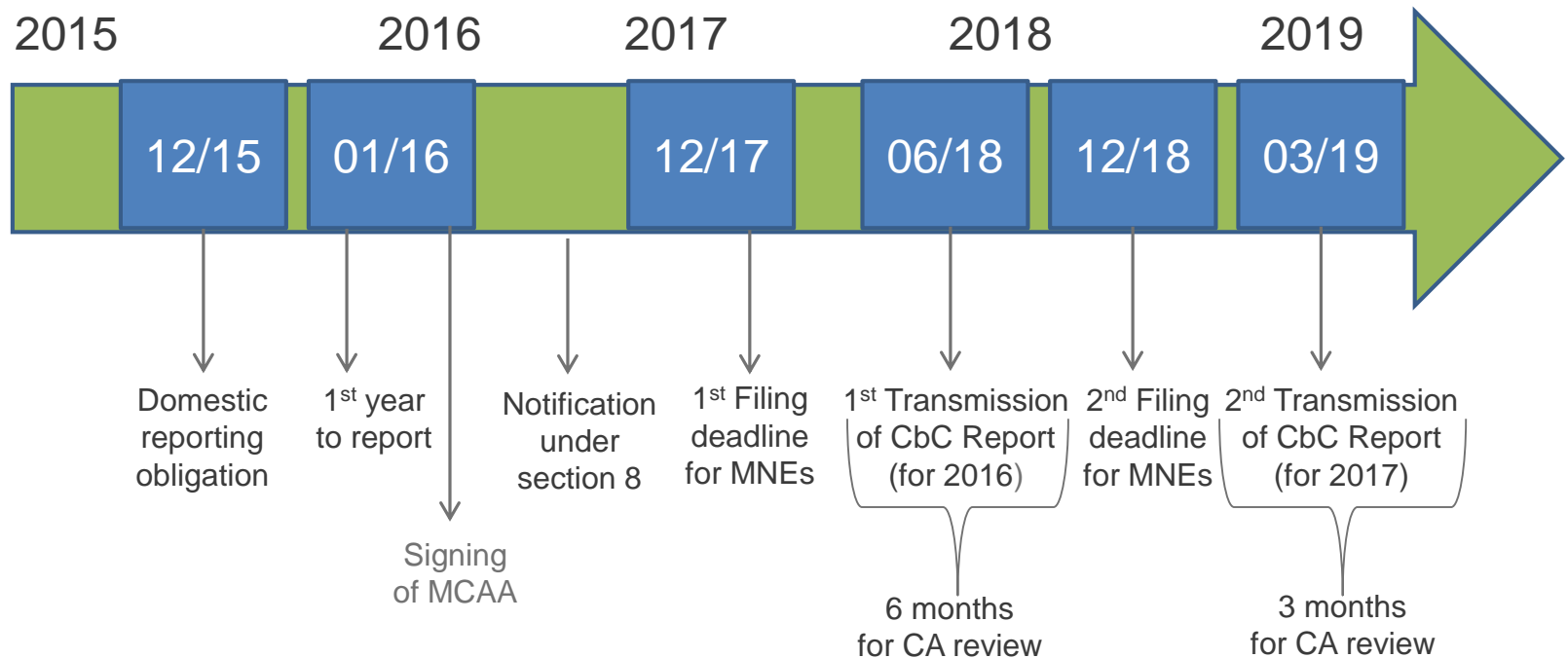
Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued – Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							



Action 13: TP Documentation (3)

Example of the timing of the exchange





Action 14: Dispute Resolution

Improving dispute mechanisms is an integral component of the work on BEPS so that unnecessary uncertainty for compliant taxpayers and unintended double taxation are avoided

Measures developed aim to strengthen the effectiveness and efficiency of the mutual agreement procedure process

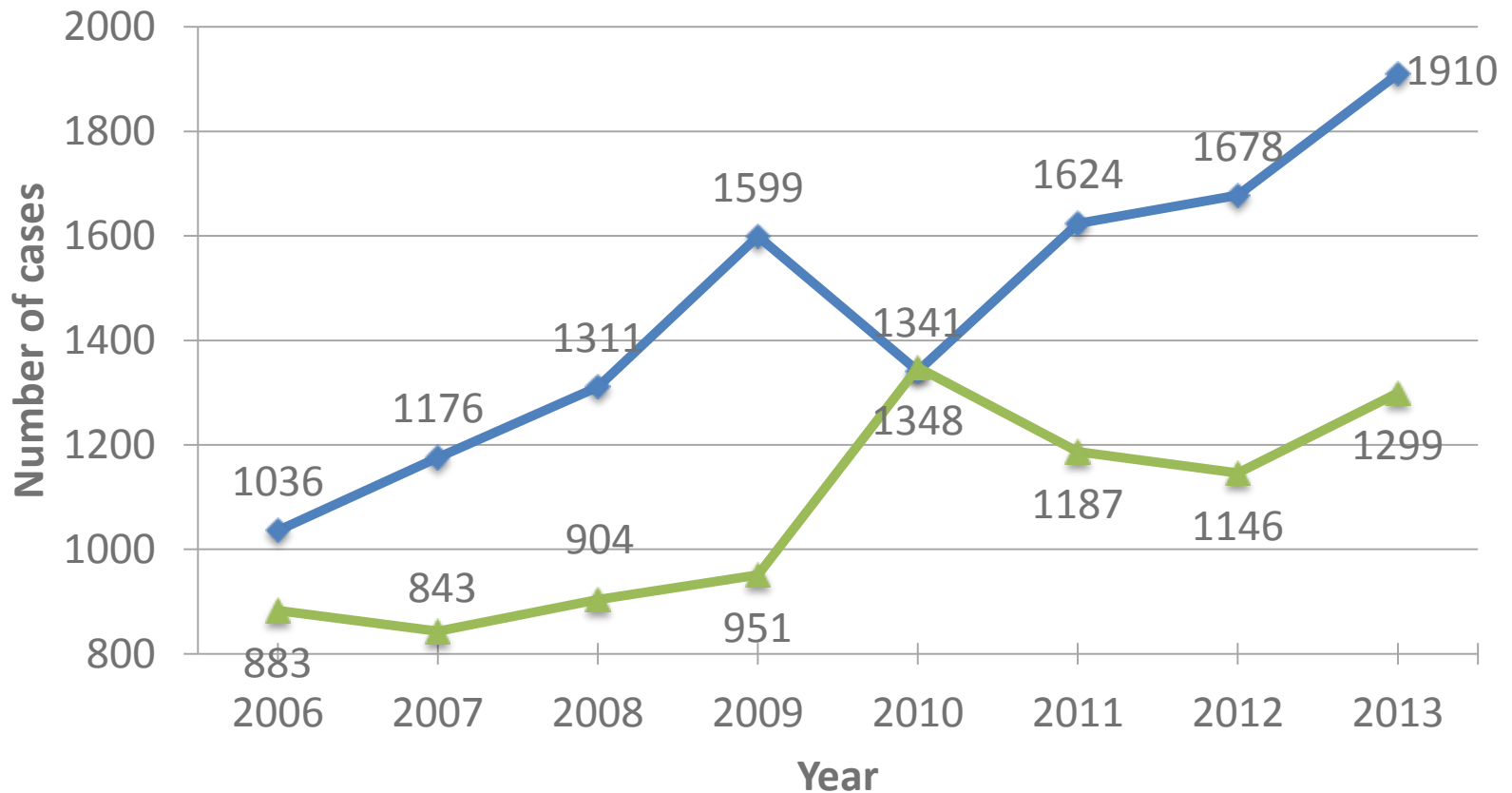
Minimum standard on the resolution of treaty-related disputes will:

- Ensure that treaty obligations related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner
- Ensure the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes
- Ensure that taxpayers can access the MAP when eligible



Action 14: Dispute Resolution (2)

MAP cases **initiated** and **completed** by year





Action 15: Multilateral Instrument

Analytical report concluded that MLI is feasible and desirable

Work launched and ongoing

- About 90 jurisdictions participating on equal footing to date
- First procedural meeting in May
- Inaugural meeting in November
- Consultations expected

Open for signature in 2016 by any interested jurisdiction