



**OECD/G20 Base Erosion and Profit
Shifting Project**

Explanatory Statement

2014 Deliverables



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Introduction

Addressing base erosion and profit shifting (BEPS) is a key priority of governments around the globe. OECD and G20 countries, working together on an equal footing, adopted a 15-point Action Plan to address BEPS. Beyond securing revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers. A key focus of this work is to eliminate double non-taxation. However in doing so, new rules should not result in double taxation, unwarranted compliance burdens or restrictions to legitimate cross-border activity.

This document contains the first set of reports and recommendations to address seven of the actions in the BEPS Action Plan published in July 2013. Given the Action Plan's aim of providing comprehensive and coherent solutions to BEPS, the proposed measures, while agreed, are not yet formally finalised as they may be impacted by some of the decisions taken with respect to the 2015 deliverables with which they interact. They do reflect consensus on a number of solutions to put an end to BEPS.

With the adoption of this first set of deliverables and the implementation of the relevant measures by national governments, hybrid mismatches will be neutralised; treaty shopping and other forms of treaty abuse will be addressed; abuse of transfer pricing rules in the key area of intangibles will be greatly minimised; country-by-country reporting will provide governments with information on the global allocation of the profits, economic activity and taxes of multinational enterprises (MNEs).

Equally, OECD and G20 countries have agreed a report concluding it is feasible to implement BEPS measures through a multilateral instrument. They have also advanced the work to fight harmful tax practices, in particular in the area of IP regimes and tax rulings. Finally, they have reached a common understanding of the challenges raised by the digital economy, which will now allow them to deepen their work in this area where BEPS is exacerbated.

BEPS by its nature requires coordinated responses, particularly in the area of domestic law measures. This is why countries are investing time and resources on developing shared solutions to common problems. At the same time, countries retain their sovereignty over tax matters and measures may be implemented in different manners, as long as they do not conflict with their international legal commitments.

A. Background

In a context of severe fiscal consolidation, the G20 Leaders have identified the need to address BEPS as one of their priorities. At their meeting in Saint Petersburg in September 2013, they endorsed the ambitious and comprehensive Action Plan developed within the OECD, with all G20 countries. They have also called on countries to examine how their domestic tax laws contribute to BEPS and to ensure that international and domestic tax rules do not allow or encourage MNEs to reduce overall taxes by artificially shifting profits to low tax jurisdictions. The Action Plan aims to ensure that profits are taxed where economic activities generating the profits are performed and where value is created.

It was agreed that addressing BEPS is critical for countries and must be done in a timely manner, not least to prevent the existing consensus-based international tax framework from unravelling, which would increase uncertainty for businesses at a time when cross border investments are more necessary than ever. As a result, the Action Plan provides for 15 actions to be delivered by 2015, with a number of actions to be delivered already in 2014.

The OECD Committee on Fiscal Affairs (CFA), bringing together 44 countries on an equal footing (all OECD members, G20 and Accession countries), has adopted a first set of seven deliverables described in the Action Plan and due in 2014. Developing countries and other non-OECD/non-G20 economies have been extensively consulted through numerous regional and global fora meetings and their input has been fed into the work. It has also informed the development of a two-phase report for the G20 Development Working Group. Business representatives, trade unions, civil society organisations and academics have also been very involved in the process through opportunities to comment on discussion drafts which have generated more than 3 500 pages of comments discussed through five public consultation meetings and three webcasts which attracted over 10 000 viewers.

In accordance with the BEPS Action Plan, the 2014 deliverables focus on:

1. designing new international standards to ensure the coherence of corporate income taxation at the international level (through rules to neutralise hybrid mismatch arrangements – **Action 2**)
2. realigning taxation and relevant substance to restore the intended benefits of international standards both in the area of bilateral tax treaties (preventing treaty abuse – **Action 6**) and in the area of transfer pricing (assure that transfer pricing outcomes

are in line with value creation in the area of intangibles – **Action 8**);

3. ensuring better transparency for tax administrations and better consistency of requirements for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (**Action 13**).

Moreover, the CFA has agreed three important reports which address the cross cutting issue of addressing the tax challenges of the digital economy (**Action 1**), the feasibility of the development of a multilateral instrument as one means of enabling jurisdictions to implement measures developed in the course of the BEPS work and, as a result, modify the network of bilateral tax treaties (**Action 15**) and finally, a report on progress made to counter harmful tax practices more effectively, taking into account transparency and substance (**Action 5**).

B. Achievements – the seven 2014 deliverables

With this first set of deliverables, the OECD/G20 Project has gone a long way in achieving consensus on key measures to address BEPS. Implementation of the measures recommended in the different deliverables will address BEPS in some key pressure areas which were identified in the report *Addressing Base Erosion and Profit Shifting* endorsed by G20 Finance Ministers in February 2013. While agreeing on a set of new rules, countries have been mindful of the need to limit uncertainty and provide a sound and fair tax environment to business and investors. Fighting BEPS should not result in harming growth and the investment climate.

Jurisdictions can begin to implement recommendations for co-ordinated domestic tax legislation and tax treaty provisions to neutralise hybrid mismatch arrangements. These provisions, once translated into domestic law and tax treaties, will eliminate mismatches and put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another or the generation of multiple foreign tax credits for one amount of foreign tax paid. Further implementing guidance will be developed with input from stakeholders to ensure that the recommended rules are clear; operational for both taxpayers and tax administrations and that they strike a balance between compliance costs and neutralising a tax benefit from a mismatch. Also there is an interaction with other actions in the BEPS Action Plan, particularly Action 3 (strengthen controlled foreign company (CFC) rules) and Action 4 (limit base erosion via interest deductions and other financial payments), on which further guidance will be required. In addition, there are two pending issues relating to intra-group regulatory capital and the consequences of CFC inclusion

where no consensus has yet been reached. Work will continue on these issues and until such work has been completed and a consensus reached countries are free in their policy choices in these areas. The outcome from this further work, together with the implementing guidance will be published no later than September 2015.

The OECD/G20 BEPS Project has also reinvigorated the fight against harmful tax practices. This work focuses on reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby encouraging an environment in which free and fair tax competition can take place. This is essential in moving towards a “level playing field” and a continued expansion of global economic growth and countries agree that harmful tax practices should be tackled urgently. In this area, work has accelerated with **significant progress on improving transparency on rulings and of consideration of intellectual property (IP) preferential regimes and methodologies to assess substantial activity** in these regimes and others.

Treaty shopping and other treaty abuse strategies undermine tax sovereignty and deprive countries of revenue. Action 6 provided for developing model tax treaty provisions that would restore the bilateral nature of tax treaties and grant treaty benefits only in appropriate circumstances. All countries have agreed that anti-treaty abuse provisions should be included in tax treaties. It is recognised that different instruments can be used either alternatively or cumulatively. A minimum standard has been agreed upon and this will ensure that treaty shopping and other treaty abuses are no longer possible, while flexibility is provided for governments to include instruments that are fit for purpose to their specific situation. It is also recognised that the work on treaty abuse may impact existing business structures and may reveal a need for improvements of existing policies in order not to hamper investments, trade and economic growth. For example, policy considerations will be addressed to make sure that these rules do not unduly impact collective investment vehicles (CIVs) and non-CIVs funds in cases where countries do not intend to deprive them of treaty benefits. Finally, additional work is needed with respect to the contents of the model provisions and the relevant Commentary, in particular the limitation on benefits rule. Further work on these model treaty provisions and relevant Commentary and with respect to the policy considerations relevant to treaty entitlement of CIVs and non-CIVs funds will be finalised by September 2015.

The heavy and growing reliance of modern business on intangible property and the risk of BEPS through transfers of intangibles made it essential to clarify the transfer pricing rules in this area. Clarity will be good for both governments and investors in an area where rules were not

sufficiently developed. Action 8 called for such clarification, which is reflected in a revision of the Transfer Pricing Guidelines. At the same time, significant progress has been made in addressing the serious concern raised by the separation of the location of the return on intangible property and the location where economic activities take place and value is created. There is consensus that artificial shifting of profit to no or low tax environment jurisdictions (such as through “cash boxes”) can no longer be tolerated. Draft guidance has been developed for intangibles. However, it is also recognised that the 2015 work relating to the transfer pricing treatment of risk and capital and relating to the special measures that may be considered in this area, will influence the final outcomes of the work on intangibles. For that reason the full outcomes of the BEPS Action Plan on issues relating to intangibles will not be finalised until completion of the guidance relating to work on Actions 8, 9 and 10. Due consideration will be paid to make sure that the revised rules reconcile the location where profits are reported for tax purposes with economic activities and value creation, without increasing uncertainty.

In a major step forward in transparency, improved and better coordinated transfer pricing documentation has been agreed, which will increase the quality of information provided to tax administrations and limit the compliance burden on businesses. In addition to a master file and local files to be provided by multinational companies, a template for country-by-country reporting to tax administrations has been agreed. The country-by-country reporting will provide a clear overview of where profits, sales, employees, and assets are located and where taxes are paid and accrued. The country-by-country reporting template provides enough flexibility to limit compliance costs, while ensuring that tax administrations will have a very useful tool for risk assessment. The CFA has also agreed to review the adequacy of the scope of the information required no later than the end of 2020. This major achievement will require careful implementation, in particular as regards the way to transmit sensitive information, and guidance in this respect will be developed by February 2015.

In order to implement BEPS measures in a fast and effective manner, the BEPS Action Plan provides for the development of a multilateral instrument. **After consultation with public international law and international taxation experts, the CFA has concluded that a multilateral legally binding instrument to achieve this is feasible and could be developed soon to at least incorporate tax treaty related BEPS measures.** It is recommended that a mandate be drafted for countries to further consider negotiating such an instrument. This instrument has the potential to be cost efficient to governments, while providing more certainty to business.

Last and not least, common understanding has been reached on the key features of the digital economy. It has been agreed that because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. However, it is also recognised that the business models and key features of the digital economy exacerbate BEPS risks and therefore must be addressed. It is expected that the other actions will address these risks but at the same time a number of specific issues have been identified which must be taken into account when doing the work (permanent establishment issues, importance of intangibles and use of data and possible need to adapt CFC rules and transfer pricing rules to the digital economy). A number of broader direct tax challenges have also been analysed, such as the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus and further work will be carried out to evaluate their scope and urgency and potential options to address them. Finally, challenges in the area of indirect taxes in relation to business to consumer transactions have also been identified and will be addressed by 2015.

C. 2015 Actions and follow up

As reflected in the previous section, the 2014 deliverables are closely connected to 2015 deliverables. Indeed, the Action Plan was conceived to provide solutions in a holistic and comprehensive manner. Sequencing the actions should not hamper the comprehensiveness of the solutions to BEPS. The first set of deliverables must be seen in that context. **As a result the recommendations will remain in draft form so that the potential impact of the 2015 deliverables can be incorporated before finalising them.** For instance, the work on the transfer pricing aspects of intangibles includes sections still bracketed as they cannot be finalised before Actions 9 and 10 are delivered.

Moreover, the highly technical nature of the actions requires careful implementation, and guidance will have to be developed in 2015. This is for instance the case in the area of hybrid mismatch arrangements where a commentary on the recommended domestic provisions will have to be developed and the area of treaty abuse where improvements will have to be made to make the model treaty provisions and related commentary fit for purpose for economies with different characteristics. Equally, the implementation aspects of the country-by-country reporting template, in particular the modalities for filing and disseminating the information to tax administrations, will require detailed work later this year and in 2015.

While there is a clear commitment to the fight against BEPS practices, the changes that will be proposed should not create legal uncertainty, nor increase the risk of double taxation. Work is underway to ensure that dispute resolution mechanisms are made more effective.

Finally, some policy issues have emerged which will require careful consideration to make sure that no collateral damage emerges from the exercise. Namely, the scope of the report on hybrid mismatch arrangements may need further consideration so that there is no conflict with policy considerations or undue impact on ordinary capital market transactions while tax treaty anti-abuse provisions need to ensure that they do not hamper legitimate transactions, in particular in the case of the fund industry. Other policy issues might also arise when developing the 2015 deliverables.

The CFA has started the work on the 2015 deliverables and intends to complete them on time. Their completion will allow the consolidation of the different deliverables and the adoption of the different legal instruments in a way which addresses the diverse participation in the BEPS Project and beyond.

D. Next steps

The 2014 BEPS package consists of this Explanatory Statement and the seven 2014 deliverables: two final reports (Action 1 and Action 15), one interim report (Action 5) and four reports containing draft recommendations (Actions 2, 6, 8 and 13) which are agreed and will be finalised with further work on implementation and interaction with the 2015 deliverables.

In the short term, **this first set of deliverables will be presented to G20 Finance Ministers in September 2014 and Leaders in November 2014.** The CFA will deliver the 2015 outputs together with the resolution of pending technical issues and the completion of the implementation measures for the 2014 deliverables. Also, the adoption of the Report on the Digital Economy will result in extending the mandate of the Task Force on the Digital Economy to complete its work based on the outcomes of other actions to be finalised by 2015 which have a strong impact on it. A mandate would be drafted to be considered by the CFA in January 2015 for the negotiation of a multilateral convention to streamline the implementation of the BEPS Action Plan.

The 15 BEPS Action Plan deliverables span three different areas: best practices and model domestic rules with respect to domestic law measures, changes to the OECD Model Tax Convention and internationally agreed guidance on implementation (such as the Commentary to the OECD Model Tax Convention and the Transfer Pricing Guidelines), and other reports.

Once finalised, these measures are expected to become applicable via changes to bilateral tax treaties or through the multilateral instrument, through changes in domestic laws and with support from internationally agreed guidance.

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