



OECD/G20 Base Erosion and Profit Shifting Project

2015 Final Reports

Information Brief

Base Erosion and Profit Shifting

Gaps and mismatches in the current international tax rules can make profits “disappear” for tax purposes, or allow the shifting of profits to no or low-tax locations where the business has little or no economic activity. These activities are referred to as **base erosion and profit shifting (BEPS)**. Apart from some cases of blatant abuses, **the issues lie with the tax rules themselves**.

Instead of making investments for economic reasons, companies are often tempted to choose **investments purely for tax reasons**, leading to an inefficient allocation of resources. This also affects trust in the integrity of the tax system, an issue which is particularly important at a time of fiscal consolidation and social hardship in many countries. **The confidence that citizens have** as to the fairness of the tax system is also at stake when there is a perception that some can legally avoid tax liabilities.

BEPS results in a loss of revenue for governments that could otherwise be invested to support resilient and balanced growth. Research undertaken since 2013 confirms the potential magnitude of the BEPS problem, with estimates indicating annual losses of anywhere from **4-10% of global corporate income tax (CIT) revenues, i.e. USD 100 to 240 billion annually**. In developing countries, where reliance on corporate tax as a source of revenue is generally higher than in developed countries, the potential impacts are particularly stark.

From Inception to Action, and Delivery

In 2013, OECD and G20 governments **embarked on the most significant re-write of the international tax rules in a century**. The BEPS Project launched during the most severe financial and economic crisis of our lifetime, with an ambitious goal: revise the rules to align them to developments in the world economy, and ensure that profits are taxed where economic activities are carried out and value is created. Countries recognised the need to prevent the unravelling of the existing consensus-based framework and planned accordingly to ensure that globalisation did not lead to decreased international cooperation and uncoordinated unilateral actions in the tax sphere which would multiply uncertainty and unpredictability.

The initial OECD report *Addressing Base Erosion and Profit Shifting* (OECD, 2013)¹ showed that **no single rule or provision is the root cause of BEPS. It is the interplay among different rules that generates BEPS**: domestic laws and rules which are not coordinated across borders, international standards which have not always kept pace with the changing global business environment and an endemic and worrying lack of data and information. **The Action Plan on Base Erosion and Profit Shifting** (OECD, 2013)² **identified 15 actions**, along three fundamental pillars: introducing coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in the existing international standards and improving transparency, as well as certainty for businesses that do not take aggressive positions.

¹ See www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm.

² See www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm.

Working Together

In the context of the BEPS Project, and for the first time in history, all G20 and OECD countries worked on an equal footing to revise the fundamentals of the international tax rules. What looked a hazardous bet for many, has now proven to be a success story. G20 and OECD countries have achieved consensus on complex technical issues, respecting different countries' perspectives and striving to identify agreed solutions to the shared challenges caused by BEPS.

Developing countries were engaged³ extensively from the outset, via a number of different consultation mechanisms. Subsequently, they provided input directly, by participating to the meetings of the OECD Committee on Fiscal Affairs and its Working Parties, and also via regional networks meetings organised in Africa, in the Asia-Pacific region, in Latin America and the Caribbean, as well as in the Eastern Europe and Central Asia region. These consultations have been held jointly with regional tax organisations, with a key role played by African Tax Administration Forum (ATAF), *Centre de Rencontres et d'Etudes des Dirigeants des Administrations Fiscales* (CREDAF), Intra-European Organisation of Tax Administrations (IOTA), Inter-American Center of Tax Administrations (CIAT), and other international organisations such as the United Nations (UN), International Monetary Fund (IMF), World Bank Group (WBG). **Developing countries' input focused on areas of key relevance for them and helped shape the final outputs.**

The EU Commission was fully engaged and provided its views throughout the Project. The parallel work carried out by the EU Commission, and in particular the Action Plan on Corporate Taxation unveiled in June 2015, complements the BEPS Project by closing existing loopholes in EU rules. It also provides a swift mechanism for the implementation of domestic law measures at the EU level.

A Transparent Process

Stakeholders have been consulted widely. In total, **the BEPS Project received more than 1,400 submissions** from industry, advisers, NGOs and academics, totalling approximately **12,000 pages of comments**. **Eleven public consultations** were held, gathering a variety of stakeholders for open and frank discussions of their views and suggestions. To ensure full transparency, these public consultations were streamed live, as were a number of **webcasts** where the OECD Secretariat periodically updated the public and answered questions. Stakeholders' input has been of great relevance, given the fast pace and ambitious objectives of the BEPS Project. It helped ensure that the measures were well targeted and did not unduly burden business with compliance requirements, while at the same time addressed the underlying policy concerns.

Stakeholders' input was also useful to identify areas where “collateral damages” could have been generated. Examples of this include **the application of the rules on tax treaties to collective investment funds** and other funds. Importantly, a number of **rules have been tailored to carve out SMEs when they do not raise the same concerns** compared to large MNEs.

³ More information: www.oecd.org/tax/developing-countries-and-beps.htm.

Delivery

Following the release of seven preliminary reports in September 2014, all of which were endorsed by G20 Finance Ministers and Leaders, the final outputs have been consolidated into a comprehensive BEPS Package. **It comprises reports on each of the 15 items identified in the BEPS Action Plan and supersedes the September 2014 deliverables**, which were agreed but left in draft form so as to be able to take into account the interactions with other action items.

Once the new measures become applicable, the expectation is that **profits will be reported where the economic activities that generate them are carried out and where value is created**. BEPS structures that have become well-known to everyone and that relied on outdated rules or on the lack of coordination among domestic measures have been rendered ineffective. The full package of measures will be presented by the OECD Secretary General Angel Gurría to **G20 Finance Ministers at their 8 October meeting** in Lima and subsequently to G20 Leaders at their summit in Antalya on 15-16 November 2015.

BEPS Package in a nutshell

A. Data and economic analyses

Countries have worked collectively to provide a range of reasonable estimates of the magnitude of BEPS and its economic impact. The work shows that BEPS is significant and a serious source of concern in terms of lost government revenues. The new research looks at the existing data sources, describes their limitations and provides for new indicators of BEPS behaviours. It also addresses the methodological issues and the approach taken in carrying out economic analyses of BEPS and of the impact of BEPS countermeasures. Recommendations are formulated regarding new tools and data to monitor BEPS and the effects of BEPS countermeasures in the future. **Based on the available data, as indicated before, an estimate of the current overall tax loss due to BEPS ranges between 4% and 10% of global corporate income tax revenues, i.e. at least USD 100 to 240 billion annually** (Action 11). Given developing countries' greater reliance on corporate income tax revenues, estimates of the impact of BEPS on them as a percentage of tax revenues are higher than for more developed countries. In addition, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average; the effective tax rates paid by large MNE entities are estimated to be 4 to 8½ percentage points lower than similar enterprises with domestic-only operations. The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio. These and other indicators highlight the existence of BEPS behaviors.

B. Reinforced transfer pricing rules

In the area of transfer pricing, the guidance on the arm's length principle has been upgraded to ensure that **what dictates results is the economic rather than the paper reality** (Actions 8-10). The OECD Transfer Pricing Guidelines now contain a clear framework indicating that while contractual arrangements are important, and serve as the starting point of any transfer pricing analysis, the arm's length principle does not and can not rely on self-serving contracts which do not reflect the conduct of the parties on the ground. The revised guidance clarifies how risks and risk-related returns are to be allocated within a group of companies, how returns on intellectual property (IP) shall be allocated, with detailed guidance on the transfer pricing treatment of synergies, location-savings and local market features, as well as assembled workforce. **Recognising the difficulty in valuing IP, a special approach for hard-to-value intangibles has been devised.** Simplification mechanisms have been developed in the areas of commodity transactions and low-value adding services, two areas of particular relevance to developing countries, and for which their contribution was paramount to

understand the concerns and identify the best way to address them. The scope for **new and more detailed guidance on the application of profit-split methods** for global value chains has been agreed and such guidance will be finalised soon.

In a major step toward greater transparency on MNE operations, the requirements for transfer pricing documentation have been substantially revised (Action 13). MNEs will be required to submit information regarding their global business operations and transfer pricing policies in a “Master File,” as well as more detailed information regarding relevant related party transactions and the amounts involved in such operations in a “Local file.” **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.** Guidance and tools to ensure a swift and consistent implementation of country-by-country reporting across countries have been developed, to ensure the widest possible dissemination of information among tax administrations, while respecting the agreed safeguards on confidentiality, appropriate use and consistency. The first country-by-country reports are expected to be filed and exchanged in 2017, when the long-held transparency objectives demanded by civil society will become an international standard.

C. Strengthened tax treaty provisions

In the area of tax treaties, key changes to the Model Tax Convention have been agreed to ensure that treaties simply eliminate double taxation, rather than being an integral part of complex schemes aimed at shifting income into no-or low-tax locations, often free of tax at source. The **minimum standard in the area of treaty shopping** will ensure that treaty benefits are only granted to those entities that are entitled to them (Action 6). Further, a number of more targeted measures have been identified to address specific schemes aimed at benefitting from certain treaty provisions, such as in the case of dividend stripping schemes, dual resident or hybrid entities.

The definition of Permanent Establishment has been modified to better reflect today's business reality and avoid widespread circumvention of the principle that underlines it (Action 7). The amended provision will ensure that a business' core activities cannot inappropriately benefit from the exception for preparatory and auxiliary activities, and that the PE status will no longer be circumvented via the use of commissionaires or similar structures, or via the fragmentation of activities among different group entities. Profit attribution rules will need to be clarified in light of the changes agreed. This work will be completed in 2016.

With the strong political commitment to the effective and timely resolution of disputes through the Mutual Agreement Procedure (MAP), agreement on a **minimum standard to secure progress on dispute resolution** has been reached and an effective monitoring mechanism will be established (Action 14). Eleven best practices have also been identified to streamline MAP. These decisions will help ensure that cross-border tax disputes between countries over the interpretation or application of tax treaties are resolved in a more effective and timely manner. In parallel, **a large group of countries is committing to move quickly towards mandatory and binding arbitration.** It is expected that rapid implementation of this commitment will be achieved through the inclusion of arbitration as an optional provision in a planned Multilateral Instrument (Action 15) to be developed to implement the BEPS treaty-related measures.

D. Criteria and their application to ensure fair tax competition

BEPS measures will ensure that governments eliminate or modify preferential regimes that have the potential to attract paper income rather than substantial business activities (Action 5). Countries looked at their own rules to ensure that they do not encourage or facilitate BEPS. They have agreed on the “nexus” approach to evaluate whether preferential regimes on intellectual property are harmful or not. All OECD and G20 countries have endorsed an approach which requires a nexus, or concrete link, between the location of the activities generating the income eligible for the preferential tax treatment (e.g. where the R&D activities are actually carried out) and the location of the income

benefiting from a preferential regime. **Sixteen regimes have been found inconsistent in whole or in part with the nexus approach. Countries should now proceed with a review of possible amendments to their regimes.** Transparency among governments will also be a key element of the fight against BEPS, particularly as regards rulings that could have an impact on other countries' tax base. For this reason, a framework for compulsory and spontaneous exchange of information on certain categories of tax ruling has been put in place.

E. Bridging gaps among domestic laws

Model rules, best practices and convergent approaches have been identified in relation to a number of domestic law measures which relate to cross-border taxation. These include **model provisions to tackle hybrid mismatch arrangements**, which make taxable income disappear or allow taxpayers to claim multiple deductions for a single expense (Action 2). Effective CFC rules in the countries where the headquarters are located will reduce incentives to strip income out of other countries, as this income will in any case be subject to full taxation. For this reason, **the building blocks of effective CFC rules have been identified** (Action 3). In the area of interest deductibility (Action 4), the recommended approach is based on a fixed ratio which **limits an entity's net deductions** for interest and payments economically equivalent to interest to a percentage of its EBITDA (earnings before interest, taxes, depreciation and amortisation) This approach can be supplemented by a worldwide group ratio rule, which allows an entity to exceed this limit in certain circumstances.

F. The overarching themes of the digital economy

All the BEPS measures, and in particular the ones on PE, transfer pricing and CFC rules, will also address BEPS issues exacerbated by the digital economy (Action 1). Taxpayers will no longer be able to effectively establish structures that separate the income from the value-added activities of their business, a phenomenon that was particularly exacerbated by the key features and the business models of the digital economy. Importantly, **rules have been devised to ensure that VAT is collected in the country where the consumer is located.** This issue is particularly acute in the online business-to-consumer market, and greatly affects the level-playing field between domestic and cross-border suppliers. The experience of countries that have already introduced simplified registration systems has been extremely positive and has had a strong impact on VAT collection.

Possible technical options have been identified to deal with the **broader challenges raised by the digital economy**, i.e. those that go beyond BEPS. These challenges relate to the allocation of taxing rights among countries - principally to when a non-resident should be taxed in a country on its business profits and the value of data, and how to allocate it for tax purposes. The options include alternatives to the existing threshold for taxing non-residents (a "significant economic presence" test); the imposition of a withholding tax on certain types of digital transactions; and the introduction of an "equalisation levy." At this stage, none of the options were adopted as internationally agreed standards. These conclusions may evolve as the digital economy continues to develop - in particular regarding robotics, the Internet of Things, 3D printing and the Sharing Economy - and will depend on the actual impact of other measures on BEPS issues. Countries therefore decided to continue monitoring developments in the digital economy and to take related decisions over time.

Next challenge: Inclusiveness, consistent implementation and monitoring impact

Now that there is widespread agreement among countries on the measures to tackle BEPS, **implementation becomes key**. Work will be carried out to support interested countries, particularly those for which capacity building is an important issue, in implementing the rules and applying them in a consistent manner. Some of the measures may be immediately applicable, such as the revised guidance on transfer pricing, while others require changes in domestic laws and in bilateral tax treaties. Action 15 provides for the development of a multilateral instrument to enable jurisdictions to implement the treaty measures agreed upon in the course of the BEPS Project and amend their networks of bilateral tax treaties. To date, about 90 countries have joined the Group as members, and 5 regional tax organisations have joined as observers.

Monitoring implementation and the impact of the different BEPS measures is another key element of the BEPS implementation phase. **Following the G20 and OECD call for even increased inclusiveness, a new framework for monitoring BEPS will be conceived and put in place, with all interested countries participating on an equal footing.** Monitoring the impact of the BEPS measures will likely include assessing the implementation of the minimum standards agreed in the areas of treaty abuse, dispute resolution, country-by-country reporting and harmful tax practices, as well as of the other BEPS measures, together with the monitoring of their overall impact and effectiveness.

Further information

To find out more about the BEPS Project, please visit our website www.oecd.org/tax/beps.htm, or contact:

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Recommended reading

About BEPS

- *What the BEPS are we talking about?* (OECD, 2013)
www.oecd.org/tax/what-the-beps-are-we-talking-about.htm
- *Action Plan on Base Erosion and Profit Shifting* (OECD, 2013)
www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm
- *Addressing Base Erosion and Profit Shifting* (OECD, 2013)
www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm

www.oecd.org/tax/beps.htm

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