

PART 1 OF A REPORT TO G20 DEVELOPMENT WORKING GROUP ON THE IMPACT OF BEPS IN LOW INCOME COUNTRIES

JULY 2014



TABLE OF CONTENTS

Executive Summary	3
Key findings.....	3
Interim conclusions	4
Next steps	4
Section 1: Introduction.....	6
Section 2: What is BEPS?.....	8
Section 3: BEPS as a domestic resource mobilisation concern	10
Section 4: BEPS in the developing country context	12
a) The nature of cross-border tax planning may differ between developing and developed countries	12
b) Developing countries may lack the necessary legislative measures needed to address BEPS.....	12
c) Accessing relevant information is often difficult.....	12
d) Building and maintaining capacity to implement highly complex international rules that leave room for discretion in their application.....	13
e) Need for political impetus and support for effective measures to counter BEPS highlighted in regional consultations.....	14
f) The acute pressures on developing countries to attract investment can trigger a competitive ‘race to the bottom’	14
Section 5: The high priority BEPS action items for developing countries	15
a) Excessive or unwarranted payments to MNE affiliates – eroding the tax base of developing countries	15
b) Developing countries face challenges due to new models for doing business, such as global value chains	16
c) Developing countries struggle to obtain the information they need to assess and address BEPS issues	17
d) Developing countries report that they lose out from treaty abuse.	18
Section 6: Other high priority BEPS issues for developing countries.....	20
a) Developing countries face challenges in obtaining the data needed to apply the arm’s length principle.....	20
b) Developing countries lose out from indirect transfer of assets	20
c) Base erosion through wasteful tax incentives designed to attract investment – a major cause for concern	21

Section 7: Perspectives of international organisations.....	24
Section 8: Interim conclusion and next steps	25
Interim conclusions	25
Next steps.....	25
Sources	26
References.....	27
Annex A: Action items in the OECD/G20 BEPS Action Plan of most relevance to developing countries.....	28
Annex B: Special meeting of the OECD Task Force on Tax and Development on base erosion and profit shifting (BEPS) and developing countries and summary of the BEPS consultations.....	32
Annex C: Glossary.....	35

EXECUTIVE SUMMARY

At the G20's request, the OECD is leading the development of a strategy to address base erosion and profit shifting (BEPS). The Development Working Group (DWG) has asked the OECD to draw together the experiences of developing countries and international organisations in a report (of which this is Part 1) on the main sources of BEPS in developing countries and how these relate to the OECD/G20 BEPS Action Plan ('the Action Plan') on this issue. Annex A of this report identifies the relative significance to developing countries of each of the 15 Actions contained in the Action Plan.

The findings of this report are derived from dialogue and consultation with developing countries, and the experiences of international organisations working with developing countries. Direct consultations with developing countries were held in February and March 2014 at events organised by the OECD (in Asia and Latin America), the African Tax Administration Forum (in South Africa) and the *Centre de rencontres et d'études des dirigeants des administrations fiscales* (in Paris). The report also draws on dialogue with developing countries at meetings of the Task Force on Tax and Development (in October 2013 and March 2014), the meeting of the OECD Global Forum on Tax Treaties (in September 2013) and the meeting of the OECD Global Forum on Transfer Pricing (in March 2014).

BEPS relates chiefly to instances where the interaction of different tax rules leads to some part of the profits of Multinational Enterprises (MNEs) not being taxed at all. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. The international nature of tax planning means that unilateral and uncoordinated actions by countries will not suffice and may actually make things worse. The Action Plan to address the issues that lead to BEPS is a collective international effort which stands to assist both developed and developing countries.

BEPS impacts on domestic resource mobilisation in developing countries. For some of the poorest countries, which rely very heavily on tax revenue from MNEs, BEPS has a particularly significant effect on vital tax revenues. The impact of BEPS on developing countries, however, extends beyond revenue. BEPS undermines the credibility of the tax system in the eyes of all taxpayers. If the largest and most high-profile taxpayers are seen to be avoiding their tax liabilities, confidence and effectiveness of the tax system is undermined.

It is important to recognise that the risks faced by developing countries from BEPS, and the challenges faced in addressing them, may be different both in nature and scale to those faced by developed countries. This means that BEPS actions for developing countries may need specific emphases or nuances compared to those most suitable for advanced economies.

Key findings

This report finds that **developing countries often face policy and other conditions that impact on their abilities to address base erosion and profit shifting**. In particular:

- Some developing countries lack the necessary legislative measures needed to address base erosion and profit shifting.

- Developing country measures to challenge BEPS is often hindered by lack of information.
- Developing countries face difficulties in building the capacity needed to implement highly complex rules and to challenge well-advised and experienced MNEs.
- The lack of effective legislation and gaps in capacity may leave the door open to simpler, but potentially more aggressive, tax avoidance than is typically encountered in developed economies.

Developing countries and international organisations identify **the following key BEPS issues as being of most relevance:**

- Base erosion caused by excessive payments to foreign affiliated companies in respect of interest, service charges, management and technical fees and royalties.
- Profit shifting through supply chain restructuring that contractually reallocates risks, and associated profit, to affiliated companies in low tax jurisdictions.
- Significant difficulties in obtaining the information needed to assess and address BEPS issues, and to apply their transfer pricing rules.
- The use of techniques to obtain treaty benefits in situations where such benefits were not intended.
- Tax loss caused by the techniques used to avoid tax paid when assets situated in developing countries are sold.
- In addition, developing countries often face acute pressure to attract investment through offering tax incentives, which may erode the country's tax base with little demonstrable benefit (included in this report, not as an integral part of BEPS, but of first order concern to developing countries that impacts on the tax base).

Interim conclusions

BEPS has the potential to considerably impact on domestic resource mobilisation in developing countries. The risks faced by many developing countries, however, may differ from those faced by more advanced economies. For these reasons, developing countries have highlighted some of the action items in the Action Plan are of more relevance than others. They have also identified a number of issues, such as tax incentives, that are of concern to them, but which are not addressed in the Action Plan.

Next steps

An expanded version of this report (Part 2 will be presented in September 2014) will set out how the DWG might assist developing countries meet the challenges of the most relevant BEPS issues they face. This report will:

- Confirm which of the 15 actions included in the Action Plan are of most relevance to developing countries and whose corresponding outcomes can be expected to benefit them.

- Discuss other BEPS-related issues not in the Action Plan, including wasteful tax incentives, the lack of comparability data in developing countries and tax avoidance through the indirect transfer of assets located in developing countries.
- Discuss capacity building initiatives that, in the developing country context, must go hand-in-hand with regulatory measures. This will include a discussion on actions needed to ensure that developing countries can fully benefit from the most relevant issues contained in the Action Plan and how specific BEPS actions may need to be adapted (for example simplified) or supplemented (for example with additional guidance) to ensure they are effective for developing countries.

SECTION 1: INTRODUCTION

At the 2013 St. Petersburg Summit, Group of Twenty (G20) leaders recognised that “developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity, as mobilizing domestic resources is critical to financing development”.

The G20 leaders endorsed the St. Petersburg Development Outlook, which committed the DWG to “review relevant work on base erosion and profit shifting (BEPS) during 2014 in order to identify issues relevant to low income countries (LICs) and consider actions to address them”.

The DWG has requested a report on the main sources of BEPS for LICs (and other low capacity countries, hereinafter ‘developing countries’), how these relate to the OECD/G20 BEPS Action Plan¹ (‘the Action Plan’) and how the DWG might assist them to meet those challenges. The DWG has invited the OECD², as the organisation responsible for the Action Plan, to lead the development of the report, working closely with the International Monetary Fund (IMF)³.

This is Part 1 of the report, which was discussed at the meeting of DWG in May 2014. It identifies the BEPS issues of most significance for developing countries. Part 2 of the report, which will be available for the DWG meeting in September 2014, will i) highlight the actions developing countries have taken, many with international support, that indicate there are opportunities to raise additional revenues from addressing BEPS issues and to create a more certain and stable investment climate for business and ii) set out how G20 can assist developing countries address the challenges posed by these BEPS issues.

Annex A describes each of the 15 actions identified in the Action Plan and sets out the relevance of each action to developing countries, based on the consultations and experiences described in the box below.

¹ At the request of the G20, the OECD developed an Action Plan to tackle BEPS in a comprehensive manner. The Action Plan was fully endorsed by the G20 Finance Ministers at their meeting of 19 July 2013 and by the G20 Leaders at their meeting on 5-6 September 2013, with a mechanism to enrich the Plan as appropriate.

² The report is prepared under the responsibility of the Secretariats and Staff of the mandated organisations. It should not necessarily be regarded as the officially-endorsed views of those organisations or their member states.

³ The DWG’s Terms of Reference states: “Tax and Development Secretariat will also work with other international and regional organisations to elicit the views of LICs, including the African Development Bank, African Tax Administration Forum, Asian Development Bank, Centre de Rencontre des Administrations Fiscales, Economic Commission for Latin America and the Caribbean, Inter-American Center of Tax Administration, UN Committee on Tax and World Bank Group”.

This report is based on:

- a) Direct consultations with developing countries at regional BEPS consultation events (involving Asian, Latin American and Caribbean, and Francophone countries) and the ATAF Consultative Conference on New Rules of the Global Tax Agenda (involving African countries).
- b) Consultations with developing countries at the Annual Meetings of the OECD Global Forum on Tax Treaties, the OECD Global Forum on Transfer Pricing, and the OECD Task Force on Tax and Development. The Co-Chairs' Statement of Outcomes of the Task Force on Tax and Development is contained in the Annex B below.
- c) The experiences of OECD, World Bank Group and EU from their Tax and Development Transfer Pricing Programmes. These are demand driven programmes so provide evidence from the developing countries of the issues they consider are highest priority and which they are currently trying to address. Assistance is being provided to Albania, Bangladesh, Burundi, Cambodia, Colombia, Ethiopia, Ghana, Honduras, Jamaica, Kenya, Nigeria, Peru, Rwanda, Seychelles, Tanzania, Thailand, Uganda, Ukraine, Vietnam and Zambia. Feedback from developing countries is also received at OECD Global Relations events.
- d) The findings of a questionnaire sent to the participants to the March 2014 Global Forum on Transfer Pricing and comments received on requests for public input in the context of the BEPS Project.
- e) Comments and information received from the IMF⁴.

Annex C contains a glossary of terms used in this report.

⁴ IMF (2014) provides an extensive account of current international tax issues for developing countries.

SECTION 2: WHAT IS BEPS?

BEPS refers chiefly to instances where the interaction of different tax rules leads to some part of the profits of MNEs not being taxed at all. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place.

It should be stressed that such planning by large MNEs is rarely illegal. In some cases, it is simply a matter of exploiting the unintended mismatches between the rules on the taxation of MNEs put in place by different tax jurisdictions. In other cases, avoidance is possible because internationally developed principles have not kept pace with the global integration of the economy. No, or low, taxation is not a cause for concern per se, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In these cases, what matters is when income from cross-border activities goes untaxed anywhere.

Approximately 25% of intercompany transactions entered into by Colombian taxpayers are with low rate tax jurisdictions.

Source: Task Force Presentation, 28 March 2014

BEPS is a global issue that requires global solutions. The international nature of tax planning means that unilateral and unco-ordinated actions by countries will not suffice and may make things worse. The current OECD/20 Project, designed to address the issues that lead to BEPS, is a collective international effort which stands to assist both developed and developing countries. It is important to recognise, however, that the risks faced by developing countries from BEPS, and the challenges of addressing them, may be different both in nature and scale to those faced by developed countries. For example, gaps in developing country tax legislation, together with low administrative capacity, are likely to mean that developing countries facing cruder or more aggressive tax avoidance than typically encountered in more advanced economies. BEPS solutions need to be developed and evaluated with such issues in mind and BEPS actions for developing countries may need specific emphases or nuances compared to those more suitable for advanced economies.

Crude tax avoidance in Nigeria:

...most often, the companies making the payments are unable to demonstrate that commensurate benefits were obtained for these payments.

Source: OECD Questionnaire, March 2014

In addition, there are issues that create significant base erosion and potential double non-taxation in developing countries but which are not identified in the Action Plan. For example, governments increasingly offer MNEs tax incentives (such as tax-free periods or 'tax holidays') and in the consultation process developing countries voiced some doubts about the benefits of these measures. This is a long standing concern for developing countries and an area where a considerable amount of work has been carried out by the IMF and the World Bank Group. As tax incentives have a direct impact on developing country tax bases, and can give rise to the non-taxation of profit or to taxation of profit at a low rate, it is important that this issue is considered alongside other developing country BEPS issues. Tax incentives are therefore included within the scope of this report.

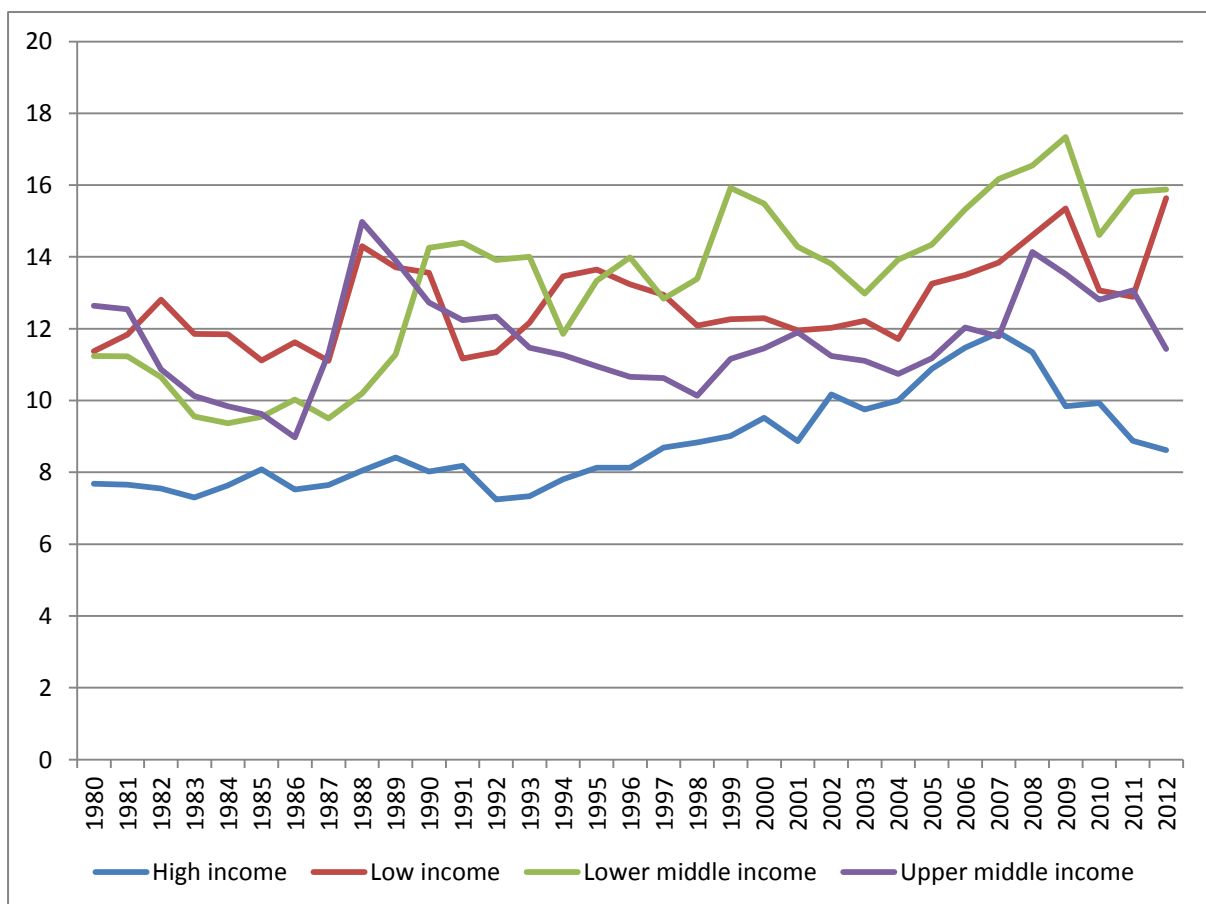
A further issue for developing countries, which was raised during the regional consultations, is the balance between source and residence taxation embodied in bilateral tax treaties modelled on the OECD and UN Model Tax Conventions. This is an issue of allocating taxing rights between two treaty partners. It is not a tax planning/avoidance issue and does not give rise to BEPS. It is thus outside the scope of the OECD/G20 BEPS Project and this report. However, it is recognised that this is an issue of significance for many developing countries, and that the OECD/G20 BEPS Project provides an opportunity to lay the ground for this legitimate debate. The BEPS consultations with developing countries have also highlighted the need to critically assess the costs and benefits of entering into tax treaties, and balance the policy objectives of revenue collection on the one hand and creating the right environment for foreign direct investment (FDI) on the other.

SECTION 3: BEPS AS A DOMESTIC RESOURCE MOBILISATION CONCERN

Moving towards a simpler, more equitable, transparent and broad based tax system has been a concern for developing countries for decades. Yet half of sub-Saharan African countries still mobilise less than 15% of their GDP in tax revenues, below the minimum level of 20% considered by the UN as necessary to achieve the Millennium Development Goals (UNDP, 2010) by 2015. Several Asian and Latin American countries fare little better. The urgency of domestic resource mobilisation, and the risk of BEPS, come together in sharp focus when developing countries' reliance on corporate income tax is considered.

As a share of all revenue, corporate income tax is more important in the poorest developing countries than in developed countries, as Graph 1 below shows.

Graph 1. Revenue from the corporate income tax as percentage of total revenue



Source: IMF (2014)

Extreme reliance on taxation of MNEs

- *Rwanda reports that 70% of its tax base comes from MNEs.*
- *In Burundi one company contributes nearly 20% of total tax collection. (Source: NSI, 2010)*
- *In Nigeria, MNEs represent 88% of the tax base. (Source: ATAF Conference, 18-19 March 2014)*
- *In Peru related party transactions account for 26% of GDP. (Source: Task Force Presentation, 28 March 2014)*

In some countries, reliance on MNE tax revenue is marked. This is not to downplay the importance of other pressing tax matters facing developing countries (such as the informal sector); rather, it is critical that developing countries are able to tax MNEs on the full profits that they earn in their jurisdictions according to clear rules.

Revenue loss from BEPS may be particularly important for resource rich developing countries. For these countries the taxation of natural resources is possibly the single biggest make or break fiscal concern in the next decade. MNEs dominate the extractive industries, and commonly export minerals to foreign related parties, making transfer

pricing a critical issue in the industry. BEPS risks in this sector therefore warrant particular attention.

The impact of BEPS on developing countries, however, extends beyond revenue from the taxation of MNEs. Companies operating only in domestic markets are at a competitive disadvantage if MNEs shift their profits across borders to avoid or reduce tax. More broadly, BEPS undermines the credibility of the tax system in the eyes of all taxpayers. If the largest and most high-profile taxpayers are seen to be avoiding their tax liabilities, confidence and effectiveness of the tax system is undermined. This is particularly important for developing countries as they face significant challenges with the taxing of “hard to tax” sectors, including small businesses (OECD, 2013).

The government of Zambia says that “it is losing as much as US\$2 billion annually to tax avoidance, and adds that the country’s mining industry is the biggest culprit”.

Source: Bloomberg, 25 November 2012

SECTION 4: BEPS IN THE DEVELOPING COUNTRY CONTEXT

The developing country experience of BEPS, and of countering BEPS, may be different from that of developed countries in six key areas.⁵

a) *The nature of cross-border tax planning may differ between developing and developed countries.*

Sophisticated tax planning structures may be less prevalent in, or of less pressing concern to, developing countries, where the lack of relevant and effective rules may leave the door open for much simpler tax planning strategies. Ineffective audit capacity may do little to discourage more aggressive and borderline tax planning practices. These differences in risks may need tailored approaches.

b) *Developing countries may lack the necessary legislative measures needed to address BEPS.*

A common issue for developing countries is incomplete legislation or legislation that is insufficiently targeted at the most important risks. Rwanda reports, for example, that its current transfer pricing rules are incomplete and are insufficiently effective to counter profit shifting. In many cases, rules can be easily circumvented. There is often more than one way in which profit can be shifted cross border, and legislation that closes one route will be ineffective if it leaves other routes open. For example, legislation that prevents profit shifting by means of transfer pricing will be of limited effectiveness if there is also no effective measure in place to prevent MNEs from introducing excessive interest-bearing debt into a country. Where such measures are in place, they may not be sufficiently robust.

“Delegates have to ask themselves whether they have all the legal instruments needed to adequately deal with base erosion”.
Ivan Pillay, ATAF Chair

Source: Moneyweb, 18 March 2014

c) *Accessing relevant information is often difficult.*

A common problem for developing countries is an inability to obtain the information they require from MNEs to adequately assess the risk of BEPS or to apply their rules to counter BEPS. This may be due to any or all of the following: i) lack of effective information-gathering rules, ii) poor compliance with such rules, or iii) limited capacity to implement and enforce them, iv) inadequate tools (such as e-filing systems) to capture information and then fully analyse it. Developing countries report that they face difficulties, for example, in obtaining information about the foreign operations of an MNE group often needed to fully assess the risk of tax loss. This is explored in more depth below.

⁵ On the importance and nature of international tax concerns for developing countries, see also IMF (2014).

d) Building and maintaining capacity to implement highly complex international rules that leave room for discretion in their application.

The number of tax and customs staff available for every 1000 citizens is 0.131 in Mozambique, 0.087 in Tanzania and 0.099 in Zambia in 2010. These 'tax staff per population ratios' are low compared to the world average of 0.82.

Source: CMI, 2011

Developing countries face specific challenges in applying a complex set of rules designed to counter cross-border international tax avoidance. First, tax administrations face competing priorities, often with woefully inadequate staffing. Second, many tax administrations are not competitive employers of skilled staff working on international tax avoidance issues, and there is a constant drain to the private sector, particularly the large accountancy firms. These constraints, combined with lack of experience, result in a well-known asymmetry when officials are confronted by well-advised large companies.

Finally, many developing countries may not have an established practice for settling disputes with large taxpayers conducting complex international transactions. The complex and fact-intensive nature of international tax rules means that disputes in developed countries are often settled by negotiation and compromise between the tax administration and taxpayer. This practice may not necessarily transfer well to the developing country context, where a culture of dealing with disputes in this way may be absent. In addition, the granting of wide discretion to tax auditors may open the door to corruption. Improving the effectiveness of dispute resolution while ensuring the integrity of the process needs to be explored in much further detail in the developing country context.

« Ils ont besoin d'être mieux armés pour répondre au rapport de force entre les multinationales et les administrations fiscales, souvent défavorable aux pays en développement ».

Source: CREDAF Event, 25 March 2014

Key messages from the Regional Consultations on BEPS concerning capacity issues

For developing countries, it is crucial that tax policy measures are capable of implementation, given the current constraints on capacity and access to information. Participants felt that implementation considerations should inform the development of the work on BEPS.

Source: Seoul Event, 20-21 February 2014

Africa must participate in the OECD/G20 BEPS Project and use the opportunity to shape the issues in the 15 Action points in this project. We should use the opportunity to ensure that sufficient attention is given to the different levels of readiness of African tax administrations and the resource and capacity limitations they have.

Source: ATAF Event, 18-19 March 2014

e) Need for political impetus and support for effective measures to counter BEPS highlighted in regional consultations.

The success of these measures will be determined not only by the technical accuracy of the solutions proposed, but also by the political consensus on the need for reforms.

Source: Bogota Event, 28 February 2014

An issue consistently raised by developing countries is the need to achieve political buy-in as a prerequisite to making the legislative changes and resource commitment required to counter base erosion and profit shifting. Lack of political awareness and commitment is cited by many developing countries as a major barrier to effectively introduce and apply rules to address BEPS issues.

f) The acute pressures on developing countries to attract investment can trigger a competitive 'race to the bottom'.

Although outside of the remit of the BEPS Action Plan, investment-targeted tax incentives granted to MNEs are eroding the tax base of developing countries, often with little demonstrable benefit. In 1980, 40% of sub-Saharan African countries offered tax holidays; in 2005, 80% did so (Keen and Mansour, 2009). This has been identified by developing countries as a key issue, and is discussed in more detail below.

Participants at the Regional Consultation on BEPS in Seoul agreed that, in the regional context, the OECD/G20 BEPS Project needs to reflect the balance between the encouragement of foreign investment and the need for domestic resource mobilisation for development.

Source: Seoul Event, 20-21 February 2014

Implications for developing countries

- Domestic rules to counter cross-border tax avoidance, and international standards and guidance, need to address the full range of potential risks.
- Rules also need to be implementable in the context of developing country resource and capacity limitations – this might mean they need to be simplified or more mechanical in nature, and allow for limited discretion.
- The development of international tax rules and guidance needs to take account of the limitations on access to information faced by developing countries.
- Improving the effectiveness of dispute resolution needs to be explored in the developing country context.
- BEPS issues for developing countries cannot be addressed in isolation from capacity issues and capacity building. It is critical that the BEPS actions take account of these capacity issues.
- Need for tax administrations, international and regional organisations, donors and NGOs to raise awareness of the significance of BEPS issues at developing country political levels.

SECTION 5: THE HIGH PRIORITY BEPS ACTION ITEMS FOR DEVELOPING COUNTRIES

Developing countries have identified the high priority BEPS Action Items, which are largely consistent across regions. This section of the report sets out the findings from consultations with developing countries (see Annex B) and from the experience of the IMF, OECD, World Bank Group and EU capacity development programmes with developing countries.

It should also be noted that although not specifically identified as a priority many developing countries recognise that the development of a multilateral instrument will be a useful mechanism for implementing the OECD/G20 BEPS Project measures particularly in the area of changes to double tax treaties.

The priority issues identified by developing countries are as follows:

a) Excessive or unwarranted payments to MNE affiliates – eroding the tax base of developing countries.

Developing countries regularly report that a variety of payments between companies in the same MNE group may unduly erode their tax base. They report that it is often difficult to assess whether such payments are for real value received, or whether they are excessive or unwarranted. These payments are typically for finance (e.g. interest payments), or for services, (e.g. management fees), or for intellectual property (e.g. royalty payments). Tax rules typically allow a deduction for such payments in arriving at the profit subject to tax, which means that excessive payments can inappropriately reduce the amount of profit on which tax is paid.

These types of payments arise in developed and developing countries but the risk of such payments eroding the tax base in developing countries may be greater as MNE affiliates in developing countries are generally recipients rather than providers of finance, services and intellectual property.

Developing countries have expressed specific concerns that their tax bases are eroded through payments of interest on loans. A company is usually financed (or capitalised) through a mixture of debt and equity. Excessive interest payments can arise if developing country taxpayers are burdened by excessive debt (known as “thinly capitalised”), or by an excessive price of debt. A deduction is normally made for interest in arriving at the tax measure of profit; so the higher the level of debt in a company, and thus amount of interest it pays, the lower the taxable profit.

Particularly common are payments to MNE affiliates for services provided by other members of the MNE group, such as for legal or IT services, or for management services or technical advice. For example, Mauritius reports that most of its transfer pricing issues arise where large management/technical fees are paid. Such payments are by no means always excessive, and may represent a fair return for valuable services provided. It is often difficult, however, for developing countries to obtain the full information needed to assess this.

58% of the developing country respondents to the questionnaire indicated that management fees and technical service fees regularly present transfer pricing enforcement issues in their country.

Source: OECD questionnaire, March 2014

Kenya reports that one of its key risks is transfers of locally developed intellectual property to low tax jurisdictions without compensation. A royalty is then charged for use by the Kenyan entity.

Source: Task Force Presentation, 28 March 2014

Royalty payments to MNE affiliates are also common. The ability to assess whether such payments are appropriate at all, or whether they are excessive in amount, again requires substantial information, and a high technical capacity.

A particular risk for resource-rich countries is the pricing of mineral export sales to MNE affiliates. Several countries have reported that they face challenges in ensuring that minerals are exported

at a fair price, again citing lack of data and information, and shortage of skilled capacity.

Implications for developing countries

- Need for effective and implementable rules to counter base erosion through the payment of excessive interest, including through excessive debt. (Addressed in Action 4 of the Action Plan, as described in Annex A below)
- Need for effective and implementable transfer pricing rules to counter base erosion through the payment of excessive royalties. (Addressed in Action 8 of the Action Plan, as described in Annex A below)
- Need for effective and implementable, and if necessary simplified, transfer pricing rules that enable developing countries to challenge excessive payments by MNEs in their countries to foreign related parties for management charges and service fees. (Addressed in Action 10 of the Action Plan, as described in Annex A below)

b) Developing countries face challenges due to new models for doing business, such as global value chains.

Globalisation has had an important impact on the way MNEs structure their business operations, bringing fresh challenges. The increasing mobility of capital and people, and the rapid adoption of technology to improve communications, has resulted in restructuring of MNE business models and operations. These changes are often based on centralised functions at a regional or global level rather than operations being managed within individual countries. Often referred to as “supply chain restructuring”, these practices are usually driven by business priorities, responding to efficiencies available from centralised planning, procurement and holding of intellectual property. However, they also make it easier to shift profits between tax jurisdictions giving rise to tax planning opportunities, and are often designed with tax minimisation in mind.

Kenya reports that some foreign companies operating in Kenya structure their business activities in a way to artificially avoid taxation.

Source: Task Force Presentation, 28 March 2014

Supply chain restructuring often involves the establishment of a central entrepreneurial company (the principal) in a low tax jurisdiction. Risks, such as bad debt, foreign exchange or inventory risks, are typically contractually transferred from, for example, a local distributor, to that principal, without moving the risk outside the MNE group as a whole. In such cases, the application of the arm’s length principle in transfer pricing rules can result in profits being shifted from the local

distributor to the principal. This ability to contractually shift risk between the members of an MNE (but not outside the MNE group as a whole) allows MNEs to plan where profits are reported, and thus tax paid.

Supply chain restructuring often goes hand in hand with the migration of valuable intellectual property to a centralised owner, often in a low tax jurisdiction, or where intellectual property is given favourable tax treatment. Where this happens, the income associated with that property also migrates, thus reducing the tax base.

Developing country tax administrations report that they are seeing many such restructurings, resulting in challenges arising from capacity shortfalls and information gaps. In some cases faced by developing countries, such restructurings are crude and abusive, with little or no substance behind them. In other cases, the complex nature of the restructuring means that testing the transfer pricing requires sophisticated analysis and comprehensive information in relation to both the resident taxpayer and the foreign principal. Successfully challenging such restructurings frequently involves the interaction of a number of tax rules – transfer pricing rules, tax treaties, the taxation of non-residents and rules concerning the transfer of intangible assets – all requiring strong technical capacity.

Implications for developing countries

- Need for effective and implementable transfer pricing rules that enable developing countries to address mismatches between where profit is recognised, and where it is truly earned. (Addressed in Actions 8, 9 and 10 of the Action Plan, as described in Annex A below)
- Need for effective rules that require MNEs to supply relevant information required to apply their transfer pricing rules. (Addressed in Action 13 of the Action Plan, as described in Annex A below)
- Need to update internationally developed principles to ensure developing countries can effectively tax foreign entities operating in their countries in line with the economic substance of their operations in those countries. (Addressed in Actions 1 and 7 of the Action Plan, as described in Annex A below)

c) Developing countries struggle to obtain the information they need to assess and address BEPS issues.

A major issue for developing countries is the ability to obtain information needed to assess the scale and impact of cross-border tax avoidance, and to take effective action to counter such avoidance.

Developing countries need data to adequately quantify tax loss from cross-border tax avoidance, and to pinpoint the sources and nature of such losses, as well as the effectiveness of measures introduced to counter them. The Action Plan recognises that this is an issue for developed and developing countries alike, and that work is needed to develop indicators of the scale and economic impact of BEPS. It is also acknowledged that tools are needed to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS.

Developing countries also need to be able to obtain the information they require to select the most appropriate taxpayers for audit, and then to effectively check or challenge their transfer pricing. Most developing countries have reported that they face significant challenges in obtaining the information they need to apply their rules. In particular, they express concerns over the difficulties in

obtaining relevant information from taxpayers about the foreign members and operations of MNE groups.

Several developing countries have expressed strong support for the introduction of some form of country-by-country reporting. Country-by-country reporting was originally a transparency initiative promoted by civil society calling for the public disclosure of taxes and other financial data from MNE's in each of the locations in which they operate. More recently, the debate has been taken up by the G8 which called on the OECD to develop a common template for country-by-country reporting to tax authorities by MNEs, but not publicly disclosed. Many developing countries see the value of this work in helping them to assess the risks of profit shifting.

Implications for developing countries

- Need for the development of indicators of the scale and economic impact of BEPS, and tools are needed to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS. (Addressed in Action 11 of the Action Plan, as described in Annex A below)
- Need for development of international standards and guidance on transfer pricing documentation and information reporting, including a common template for country by country reporting to tax administrations, that enable developing countries to obtain the information needed to assess the risk of transfer pricing abuse, and effectively address such risk. (Addressed in Action 13 of the Action Plan, as described in Annex A below)
- To expand the developments on transfer pricing documentation and information reporting to capture wider BEPS risks. (Addressed in Action 13 of the Action Plan, as described in Annex A below)

d) *Developing countries report that they lose out from treaty abuse.*

Around 3,000 bilateral tax treaties operate worldwide, and roughly 1,000 of these involve developing countries.

By way of background, most developing countries impose withholding tax on payments such as interest, management fees and royalties made by a resident taxpayer to a non-resident. These taxes are deducted from the payments by the payer, and then paid to the local tax authority. They are thus a tax on the foreign recipient of the payment. Withholding taxes in developing countries are usually between 10% and 20% of the payment amount. The effect of tax treaties, which usually override domestic legislation, is often to reduce that withholding tax to a lower rate or to zero.

Whilst developing countries generally agree that bilateral tax treaties have been effective in preventing double taxation, and support a predictable investment landscape, they are concerned about their misuse.

The concern is focused on the use of techniques (sometimes called "treaty shopping") to obtain treaty benefits (typically the reduction of withholding taxes) in situations in which such benefits were not intended.

Such techniques often involve the routing of payments of interest or royalties to an affiliate in a non-

Zambia sees transactions that are structured in a way to exploit the favourable terms found in a particular treaty. The effect is that Zambia loses out on withholding tax it would otherwise have been able to collect.

Source: OECD Questionnaire, March 2014

treaty country, through affiliates in a treaty country. Where this occurs, the country of the payer loses out on the withholding taxes that it would otherwise have been able to collect.

Estimates of lost withholding tax revenues for developing countries are hard to make. However, dissatisfaction among developing countries is possibly on the rise with Mongolia, for example, scrapping treaties with several jurisdictions because, according to the Mongolian Ministry of Finance, these arrangements are primarily used for tax avoidance by large extractive industry companies. The mining sector makes up more than 80% of Mongolia's exports and accounts for 30% of GDP.

Developed countries are beginning to take these concerns on board. The Netherlands, for example, is conducting a review of its tax treaties with developing countries, with a focus on anti-abuse measures. Mrs Lilianna Ploumen, Development Co-operation Minister, told the Financial Times: "By making use of loopholes in tax treaties in combination with differences between national tax rules, internationally operating companies can avoid paying tax. It means that poor countries miss out on tax revenues, funds they clearly need for matters such as infrastructure and education" (Houlder and Blas, 2013).

Implications for developing countries

- Need to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country including carrying out a cost/benefit analysis of the tax treaty. (Addressed in Action 6 of the Action Plan, as described in Annex A below)
- Need for development of domestic rules, and treaty provisions, that counter the unintended use of treaties to avoid withholding taxes. (Addressed in Action 6 of the Action Plan, as described in Annex A below)

SECTION 6: OTHER HIGH PRIORITY BEPS ISSUES FOR DEVELOPING COUNTRIES

a) Developing countries face challenges in obtaining the data needed to apply the arm's length principle.

The international standard in transfer pricing, which is routinely incorporated in domestic transfer pricing rules, requires MNEs to price their related-party transactions in line with the pricing they would have used if they were conducting the same transaction with an unrelated party. Financial data about transactions between unrelated parties that are similar to the related party transaction (known as “comparable transactions”) is thus a prerequisite for countries to be able to effectively enforce their transfer pricing rules.

In Vietnam, data on actual transacted prices between independent parties (which has been the main focus of the tax authorities) is difficult to obtain and apply.

Source: EuropeAid

Developing countries frequently express concerns about the availability and quality of financial data on comparable transactions. This is reflected in the statement in the United Nations Practical Transfer Pricing Manual for Developing Countries (2012): “It is often in practice extremely difficult, especially in some developing countries, to obtain adequate information to apply the arm's length principle”.

A recent International Finance Corporation (IFC)/World Bank Group survey of local tax practitioners in 25 countries in the Europe and Central Asia (ECA) region found that 76% of the responses stated they often, very often or always, encounter difficulties in obtaining domestic comparable information (Loeprick, Cooper, and Christ, forthcoming). The issue of comparability is discussed in detail in a recent OECD discussion paper, *Transfer Pricing Comparability Data and Developing Countries* (OECD, 2014).

Implications for developing countries

- Stakeholders need to find approaches that address the lack of comparability data in developing countries.

b) Developing countries lose out from indirect transfer of assets.

This is a complex issue, but one which may have significant impact on the tax revenues of developing countries, especially (but not only) those countries where income from extractive industries are important. At the heart of the issue is the taxation of the profit made by the owner of an asset when that owner sells it (for example, the sale of a mineral licence). In some circumstances the country in which the asset is situated has the right under its domestic rules, and its treaties, to tax such profit. However, the IMF reports that the asset owner is sometimes able to avoid this taxation by means of an ‘indirect transfer’; that is, the sale of the shares in the company that owns the asset rather than the sale of asset itself, or the sale of the shares of another company that owns the shares of the first company.

Although many developing countries have rules that allow the taxation of a profit on such indirect transfers, challenges arise both in discovering the transaction in the first place, and collecting the tax from the foreign company that sold the shares.

Implications for developing countries

- Developing countries at risk need to enact effective rules to tax capital gains where ‘indirect transfers’ are used.
- Developing countries need to have sufficient information to identify indirect transfers. (Addressed in Action 13 of the Action Plan, as described in Annex A below)
- Developing countries at risk need effective procedures to tax the foreign company that has recognised the capital gains. (For example through membership of the Multilateral Convention on Mutual Administrative Assistance⁶)

c) Base erosion through wasteful tax incentives designed to attract investment – a major cause for concern.

In 2011, the OECD and other international organisations reported to the G20 DWG that tax incentives, including corporate income tax exemptions in free trade zones, continue to undermine revenue; where governance is poor, they may do little to attract investment – and when they do attract foreign direct investment (FDI), this may well be at the expense of domestic investment or FDI into some other country. Since then, the situation is likely to have deteriorated as more evidence has emerged of the proliferation of tax incentives designed to attract investors. Forgone tax revenues as a result of tax incentives ranged between 9.5% and 16% of GDP per year in the Eastern Caribbean Currency Union over a three year period, while the effect of tax incentive regimes on FDI appeared to be very modest (Chai and Goyal, 2008).

These figures need to be set alongside the most recent Investor Motivation Surveys, for example in Guinea, Rwanda, Tanzania and Uganda, which show that over 90 % of investors would have invested even if incentives were not provided (James, 2013).

Investor Motivation Surveys	
Countries Surveyed	Would have invested even if Incentives were <i>not</i> provided
Rwanda (2011)	98%
Uganda (2011)	93%
Guinea (2012)	92%
Tanzania (2011)	91%
Vietnam (2004)	85%
Thailand (1999)	81%
Mozambique (2009)	78%
Burundi (2011)	77%
Serbia (2009)	71%
Jordan (2009)	70%
Kenya (2012)	61%
Tunisia (2012)	58%

⁶ See: www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm

A study of 12 Western and Central African countries over the period 1994-2006 showed no relationship between tax holidays and investment (James and Van Parys, 2010).

Tax incentives ranked 11th out of 12 location factors in a survey of 7,000 firms in 19 African countries.

Source: UNIDO, 2011

The damage to the revenue base that erodes the resources for the real drivers of investment decisions — infrastructure, education and security — is compounded by the lack of transparency and clarity in the provision, administration, and governance of tax incentives in developing countries. The granting of tax incentives for investment in developing countries is often done outside of a country's tax laws and administration, sometimes under multiple pieces of legislation. The design and administration of tax incentives may be the responsibility of several different ministries (e.g., finance, trade, investment). Where various Ministries are involved, they may not co-ordinate their incentive measures (tax and non-tax) with each other or the national revenue authority, with the result that incentives may overlap, be inconsistent, or even work at cross-purposes. Administrative discretion in the management of incentives can seriously increase the risk of corruption and rent seeking.

The long-term costs of tax incentives include the economic burden that arises from international tax competition as competing countries put in place matching measures. This is of particular concern in developing countries where new measures are introduced or the existing measures are significantly augmented without properly assessing the likely reactions of other countries. This wasteful practice leads to the “race to the bottom”, as countries make themselves collectively worse off.

There is a need to assess the cost-benefit aspects of tax incentives, evaluate their effectiveness and convey the results to policymakers.

Source: ATAF Conference, 18-19 March 2014

Finally, tax incentives can create unintended tax-planning opportunities leading to revenue leakages. For example, existing firms can reconstitute themselves as “new” ones towards the end of their tax holiday periods so that they can continue to be tax-exempt. Likewise, companies can attempt to re-characterise certain activities so that they fall within the boundaries of qualifying business activities, such as R&D tax incentives. Similarly, tax incentives enable opportunities for profits and deductions to be artificially shifted across MNEs with different tax treatments either domestically or internationally. These tax planning opportunities are commonly exploited in both developed and developing countries; however, their ill effects are especially pronounced in developing countries that have limited capacity to detect and counter detrimental tax avoidance techniques.

Implications for developing countries

Tax incentives are not covered specifically in the Action Plan. However, action is required to:

- Develop better guidance on assessing the costs and benefits of tax incentives to inform policy formulation.
- Calculate the amount of revenue forgone which is attributable to tax incentives for investment, including revenue leakages due to unintended tax planning opportunities.
- Conduct periodic reviews of the impact of tax incentives by assessing the extent to which the incentives have the desired effects on investment and if these effects are achieved at a reasonable price.
- Improve transparency and governance of tax incentives for investment by i) providing tax incentives through tax laws only and by ii) consolidating them under the authority of one government body.
- Enhance regional co-operation to avoid harmful tax competition.

SECTION 7: PERSPECTIVES OF INTERNATIONAL ORGANISATIONS

The findings set out above are primarily derived from consultations with developing countries. They also reflect the experiences of the IMF, OECD and World Bank Group capacity development programmes with developing countries. A broadly consistent picture emerges from these various sources.

In particular, a direct source of evidence on the specific areas of international taxation that concern developing countries can be found in the requests for assistance received by the IMF. The Fund has provided assistance in these areas for many years, typically as part of wider advice in tax policy and administration. The box below provides a partial listing of international tax topics and (non-OECD) countries in which the Fund has provided demand-driven assistance in the last few years. In its recent paper focused largely on international tax concerns for developing countries (IMF, 2014), the Fund highlights four areas of special, though by no means exclusive, concern: interest deductions, treaty abuse, arms-length pricing and (not in the BEPS Action Plan) indirect transfers of interest – all of which are noted above.

Areas of recent IMF Technical Assistance in International Taxation

This has covered a wide range of topics and countries including:

- *Transfer pricing issues:*
Bangladesh; Burkina Faso; Cambodia; Colombia; Dominican Republic; Egypt; El Salvador; Ethiopia; Guatemala; Malawi; Mauritania; Mongolia; Nicaragua; Panama; Ukraine.
- *Issues related to provisions of double taxation treaties:*
Burkina Faso; Costa Rica; Dominican Republic; Egypt; El Salvador; Georgia; Honduras; Indonesia; Malawi; Mauritania; Mongolia; Nepal; Panama; Uganda.
- *Capital gains across borders:*
Mongolia; various AFR natural resource intensive countries.
- *Holding companies, related party debt, thin capitalization, others:*
Bangladesh; Cambodia; Colombia; Egypt; Malawi; Portugal; Romania; Uganda; Ukraine.

Source: IMF (2013)

SECTION 8: INTERIM CONCLUSION AND NEXT STEPS

Interim conclusions

This report finds that BEPS has the potential to considerably impact on domestic resource mobilisation in developing countries. The risks faced by many developing countries, however, may differ from those faced by more advanced economies. For example, the granting of wasteful tax incentives may be far more significant to developing countries than to developed countries. Developing countries may also face less sophisticated and more abusive tax planning structures. In addition, developing countries often have limited capacity, experience and skills to implement measures designed to counter BEPS, and face challenges in obtaining the information they require.

For these reasons, developing countries have highlighted that at the present time some of the action items in the Action Plan are of more relevance than others. Section 5 of this report highlights the main BEPS issues that developing countries have reported – focusing on base-eroding payments, treaty issues, new business models and transfer pricing documentation. Although outside of the OECD/G20 BEPS Project remit, tax incentives are a major cause of concern for developing countries. As developing countries start to address these issues, it is likely that some of the other issues identified in the Action Plan will assume greater significance and risk to their tax base and will need to be addressed.

Annex A below identifies which of the action items in the Action Plan are considered most relevant by developing countries in the light of these core concerns. It is clear from consultations with developing countries, however, that addressing BEPS needs to go beyond tax technical considerations: implementation is equally important.

Next steps

Part 2 of this report will be presented in September 2014 and will set out how the DWG might assist developing countries meet the challenges of the most relevant BEPS issues they face. This Report will:

- Confirm which of the 15 actions included in the Action Plan are of most relevance to developing countries and whose corresponding outcomes can be expected to benefit them.
- Discuss other BEPS issues not in the Action Plan but which have a direct impact on developing country tax bases, and can give rise to the non-taxation of profit or to taxation of profit at a low rate, and consider actions needed to ensure these issues are effectively addressed. These include the granting of wasteful tax incentives, addressing the lack of comparability data in developing countries and tax avoidance through the indirect transfer of assets located in developing countries.
- Discuss capacity building initiatives that, in the developing country context, must go hand-in-hand with regulatory measures. This will take account of the capacity building initiatives already underway between developing countries, international and regional organisations and other development partners to address BEPS related issues. It will include a discussion on actions needed to ensure that developing countries can fully benefit from the most relevant issues contained in the Action Plan and how specific BEPS actions may need to be adapted (for example simplified) or supplemented (for example with additional guidance) to ensure they are effective for developing countries.

SOURCES

- ATAF Conference:** *ATAF Consultative Conference on New Rules of the Global Tax Agenda: Outcomes Document*, Johannesburg, South Africa, 18-19 March 2014.
www.ataftax.org/images/ATAF_documents/OUTCOMES_ATAF%20Consultative%20Conference%20on%20New%20Rules%20of%20the%20Global%20Tax%20Agenda.pdf
- Bloomberg:** Matthew Hill, *Zambia tax avoidance costs US\$2 billion a year*, Bloomberg News, 25 November 2012.
www.bloomberg.com/news/2012-11-25/zambia-says-tax-avoidance-led-by-miners-costs-2-billion-a-year.html
- Bogotá Event:** *Regional Consultation on BEPS: Co-Chairs summary*, Bogotá, Colombia, 27-28 February 2014.
www.oecd.org/ctp/co-chair-summary-LAC-regional-consultation-BEPS.pdf
- CMI:** Odd-Helge Fjeldstad and Kari K. Heggstad, *The tax systems in Mozambique, Tanzania and Zambia: Capacity and constraints*, Chr. Michelsen Institute (CMI) and NORAD, R 2011:3.
www.cmi.no/publications/file/4045-taxation-mozambique-tanzania-zambia.pdf
- CREDAF Event:** *Consultation des pays francophones sur BEPS (Base Erosion and Profit Shifting), resume des discussions*, Paris, France, 25 March 2014.
www.credaf.org/tl_files/International/OCDE/BEPS/Consultation%20pays%20francophones_CR_EDAF.pdf
- EuropeAid:** *Transfer Pricing and Developing Countries*.
ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/transfer_pricing_dev_countries.pdf
- Moneyweb:** Ingé Lamprecht, *Where will the tax revenue come from?* Moneyweb.co.za, 18 March 2014.
www.moneyweb.co.za/moneyweb-tax/where-will-the-tax-revenue-come-from
- NSI:** The North-South Institute, *Domestic Resource Mobilization in Africa: An Overview*, Winter 2010.
www.nsi-ins.ca/wp-content/uploads/2012/10/2010-Domestic-Resource-Mobilization-in-Africa-An-Overview.pdf
- OECD Questionnaire:** *OECD Questionnaire on transfer pricing aspects of BEPS Global Forum on Transfer Pricing*, March 2014.
- Seoul Event:** *Regional Consultation on BEPS: Co-Chairs summary of discussions*, Seoul, Korea, 20-21 February 2014.
www.oecd.org/ctp/Co-chairs-summary-Seoul-2014.pdf
- Task Force Presentation:** Developing country presentations at Task Force on Tax and Development meeting, Paris, France, 28 March 2014.
- UNIDO:** *Africa Investor Report 2011: Towards Evidence-Based Investment Promotion Strategies*, United Nations Industrial Development Organisation (UNIDO), 2011.
www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

REFERENCES

- Chai, J. and Goyal, R.** (2008), *Tax Concessions and Foreign Direct Investment in the Eastern Caribbean Currency Union*. IMF Working Paper, IMF WP/08/257, IMF Western Hemisphere Department, Washington, DC, www.imf.org/external/pubs/ft/wp/2008/wp08257.pdf.
- Houlder, V. and Blas, J.** (5 September 2013), "G20 to back moves to expose tax evaders", *Financial Times*.
- International Monetary Fund** (2014), *IMF Policy Paper: Spillovers in International Corporate Taxation*, Washington, DC, www.imf.org/external/np/pp/eng/2014/050914.pdf.
- James, S.** (2013), *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*, World Bank Group, available at SSRN: <http://ssrn.com/abstract=2401905>.
- James, S. and Van Parys, S.** (2010), *The effectiveness of tax incentives in attracting investment: panel data evidence from the CFA Franc zone*, *International Tax and Public Finance*, Vol. 17/4, pp 400-429.
- Keen, M. and Mansour, M.** (2009), *Revenue Mobilization in Sub-Saharan Africa: Challenges from Globalization*, IMF Working Paper, IMF WP/09/157, IMF Fiscal Affairs Department, Washington, DC, www.imf.org/external/pubs/ft/wp/2009/wp09157.pdf.
- Loeprick, Cooper, Christ**, "The Devil is in the detail": *Transfer Pricing, the Arm's Length Principle and the availability of Comparable Information in Emerging Economies*, World Bank Group (Forthcoming).
- OECD** (2014), *Transfer Pricing Comparability Data and Developing Countries*, Paris, www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.pdf.
- OECD** (2013), *What drives tax morale?* Paris, www.oecd.org/ctp/tax-global/TaxMorale_March13.pdf.
- United Nations Development Programme** (2010), *What Will It Take To Achieve the Millennium Development Goals? An International Assessment*, UNDP, New York, NY, pp. 26. Available at www.undp.org/content/undp/en/home/librarypage/mdg/international-assessment---english-full-version/.

ANNEX A
ACTION ITEMS IN THE OECD/G20 BEPS ACTION PLAN OF MOST RELEVANCE TO DEVELOPING COUNTRIES

	Actions	Relevance
Action 1	<p>Address the tax challenges of the digital economy</p> <p>Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, 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 under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.</p>	Medium
Action 2	<p>Neutralise the effects of hybrid mismatch arrangements</p> <p>Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.</p>	Low
Action 3	<p>Strengthen controlled foreign companies (CFC) rules</p>	Low

	Develop recommendations regarding the design of controlled foreign company rules.	
Action 4	<p>Limit base erosion via interest deductions and other financial payments</p> <p>Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.</p>	High
Action 5	<p>Counter harmful tax practices more effectively</p> <p>Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.</p>	Medium
Action 6	<p>Prevent treaty abuse</p> <p>Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.</p>	High
Action 7	<p>Prevent the artificial avoidance of PE status</p> <p>Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.</p>	High
Action 8	<p>Assure that transfer pricing outcomes are in line with value creation – Intangibles</p> <p>Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution</p>	Medium

	arrangements	
Action 9	<p>Assure that transfer pricing outcomes are in line with value creation – Risks and capital</p> <p>Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments</p>	Medium
Action 10	<p>Assure that transfer pricing outcomes are in line with value creation – Other high-risk transactions</p> <p>Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses</p>	High
Action 11	<p>Establish methodologies to collect and analyse data on BEPS and the actions to address it</p> <p>Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.</p>	High
Action 12	<p>Require taxpayers to disclose their aggressive tax planning arrangements</p> <p>Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax</p>	Medium

	administrations.	
Action 13	<p>Re-examine transfer pricing documentation</p> <p>Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template</p>	High
Action 14	<p>Make dispute resolution mechanisms more effective</p> <p>Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.</p>	Medium
Action 15	<p>Develop a multilateral instrument</p> <p>Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.</p>	Low

The above are the action items in the Action Plan that developing countries have identified as being most relevant to their country. However, it is important to note that the new rules that are developed under the Action Plan will not in isolation address all of the base erosion and profit shifting issues faced by developing countries. Improved rules and access to information will assist but developing countries will also need to build the capacity of their tax administrations to implement the new rules and effectively use the improved access to information.

Furthermore developing countries will need to address the significant loss of revenue through the granting of wasteful tax incentives.

ANNEX B
SPECIAL MEETING OF THE OECD TASK FORCE ON TAX AND DEVELOPMENT⁷ ON
BASE EROSION AND PROFIT SHIFTING (BEPS) AND DEVELOPING COUNTRIES
AND SUMMARY OF THE BEPS CONSULTATIONS

CO-CHAIRS STATEMENT
Paris, March 2014

The OECD's Task Force on Tax and Development met in Paris, France, on 28 March 2014, to take stock of the ongoing efforts to consult with developing countries and understand their perspectives on the **Base Erosion and Profit Shifting (BEPS)** issues they are faced with. Governments, international and regional organisations, civil society and business representatives welcomed the significant progress made in this consultation process since the previous meeting in Korea in October 2013 and explored how to ensure that developing countries have an ongoing voice in the development of the work on BEPS to reflect developing country needs to better mobilise their domestic resources. This meeting was the culmination of a first round of consultations with the developing world, which we summarise below, together with future actions to ensure there is an ongoing dialogue with developing countries.

BEPS consultations with developing countries

As mandated by the G20 Leaders and reflected in the BEPS Action Plan of July 2013, developing countries have been extensively consulted on their priorities and ways to address BEPS challenges. This consultation process involved a combination of regional and global high-level policy dialogues. Following the Annual Meeting of the Global Forum on Tax Treaties of September 2013 and the Plenary Meeting of the Task Force of October 2013, 4 Regional Consultations were held in February and March 2014 (hosted by or in conjunction with regional tax organisations – CIAT, ATAF and CREDAF) to discuss BEPS issues with countries in Asia, Latin America, Africa and for francophone countries and to explore how the current work in the context of the OECD/G20 Project on BEPS should take those into account, with a particular focus on developing countries.⁸ Representatives of the UN Committee of Experts and IMF officials actively contributed to these events.

This first round of regional consultations was concluded with global meetings, where the main outcomes of the regional meetings were presented. The Annual Meeting of the Global Forum on Transfer Pricing was held on 26-28 March 2014, gathered over 330 senior tax officials from more than 110 jurisdictions. On 28 March 2014, Government officials were joined by representatives from

⁷ Co-Chaired by South Africa and the Netherlands, the Task Force is a multi-stakeholder advisory group set up to help to improve the enabling environment for developing countries to collect taxes fairly and effectively. This statement reflects the views of the Co-Chairs and not necessarily those of all stakeholders.

⁸ In three of these Regional Consultations, the Global Forum on Transparency and Exchange of Information for Tax Purposes also gathered countries views on the benefits and challenges for countries in the region in implementing the global standards on automatic exchange of tax information (AEOI).

civil society and the business community at the Task Force's Special Meeting on BEPS and Developing Countries. The final plenary session brought together the lessons learned from the intensive regional and global dialogue that has taken place over the past 6-8 months and proposed a number of ways forward.

Lessons learned from the ongoing consultations

The Task Force welcomed international efforts to gather effective input from developing countries on the work on BEPS. These meetings concluded that BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from Multinational Enterprises (MNEs). The different meetings were consistent in emphasising the following key messages:

- *Some items of the Action Plan were considered of higher immediate priority by developing countries.* These include limiting base erosion via interest deductions and other financial payments (Action 4), preventing tax treaty abuse and the artificial avoidance of PE status (Actions 6 and 7), transfer pricing, in particular base eroding payments (Actions 8, 9 and 10), and transfer pricing documentation and Country-by-Country Reporting (Action 13).
- *A number of other issues that are linked to, but not specifically included in, the Action Plan have been considered as of key importance in developing countries.* These were the granting of wasteful tax incentives which may erode the country's tax base with little demonstrable benefit and the significant difficulties developing countries face in obtaining relevant data, particularly comparable data for transfer pricing purposes.
- *Capacity building is one of the biggest challenges faced by developing countries.* The lack of effective legislation and gaps in capacity may leave the door open to simpler, but potentially more aggressive, tax avoidance than is typically encountered in developed economies. BEPS solutions for developing countries may need to be tailored to this reality, and concrete technical support will be needed to enable developing countries increase their capacity to improve their domestic resource mobilization.
- *Political support is critical to drive policy change that balances the encouragement of foreign direct investment with the need for domestic resource mobilisation.* All stakeholders have a role to play in increasing awareness about the importance of BEPS for developing countries and in ensuring that the required support is obtained from political decision makers.
- *Further engagement with developing countries is crucial to ensure that BEPS solutions are achieved at the global level.* The first round of regional consultations was very effective and it is important to continue the global dialogue on BEPS issues.

Developing country input received so far will be fed into the report for the G20 Development Working Group (DWG). This report, which is being prepared by the Task Force Secretariat in close cooperation with the IMF and other international organisations, is focused on the main BEPS issues and challenges faced by developing countries, how these are related to the BEPS Action Plan, and how the DWG might assist developing countries to meet those challenges.

Next steps

As Co-Chairs, we encourage international and regional organisations and all stakeholders to take further steps to ensure that developing countries' voices are taken into account in the international efforts to counter BEPS and strengthen domestic resource mobilisation. These steps include:

- Organising a further round of regional consultations towards the end of 2014 to take stock of the impact of BEPS outputs due by September 2014, and to input on the work under development with regard to the other outputs due later in 2015, ideally in conjunction with other planned BEPS meetings hosted by international and regional organisations.
- Make full use of existing mechanisms to channel input provided by developing countries into the OECD/G20 BEPS Project, e.g. through the comments to be provided by all interested parties on BEPS discussion drafts and public consultations; the direct participation of Government officials into the BEPS work at working group level; the publication of summaries reflecting discussions held during meetings on BEPS; and the use of questionnaires to inform the relevant working groups.

ANNEX C GLOSSARY

Arm's length principle

The international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where “conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”.

Commissionaire

A commissionaire is an arrangement recognised under the European civil law concept of agency. Under civil law, a commissionaire can enter into sales contracts in its own name, but on behalf of the principal, where the commissionaire does not usually bind the principal. In theory the customer cannot sue the principal – there is no contractual relationship between the principal and the customer.

OECD/G20 Action Plan on Base Erosion and Profit Shifting (BEPS)

The Action Plan, published by the OECD in 2013, setting out a plan to provide countries with domestic and international instruments that will better align rights to tax with economic activity. The Action Plan (i) identifies actions needed to address BEPS, (ii) sets deadlines to implement these actions and (iii) identifies the resources needed and the methodology to implement these actions.

Permanent establishment (PE)

For the purposes of the OECD Model Tax Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The term “permanent establishment” includes especially:

- a) a place of management;
- b) a branch;
- c) an office;
- d) a factory;
- e) a workshop, and
- f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources

In addition, the term includes a “dependent agent” of a person in a country.

Under most treaties, a “permanent establishment” of a non-resident person in a country is required in order for that country to establish a right to tax any business profit earned by the non-resident person through the “permanent establishment”.

Tax treaty

This is a bilateral agreement made by two countries to resolve issues involving double taxation of income and capital.

Thin capitalisation

A company is typically financed (or capitalised) through a mixture of debt and equity. Thin capitalisation refers to the situation in which a company is financed through a relatively high level of debt compared to equity. Thinly capitalised companies are sometimes referred to as highly leveraged or highly geared.

Transfer pricing

This is the price at which an enterprise transfers physical goods, intangible property, or services to a related enterprise.