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BUSINESSEUROPE comments on the OECD Action Plan on Base Erosion and Profit Shifting

Dear Mr Saint Amans,

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Action Plan on Base Erosion and Profit Shifting.

We welcome the Action Plan on Base Erosion Profit Shifting by the OECD and G20. The BEPS Action Plan must no doubt be considered one of the most challenging tax projects ever undertaken by the OECD. The 15 action points span over basically every aspect of international taxation that is perceived as not functioning properly in relation to BEPS.

It is essential for business investment, jobs and growth that tax rules are predictable and to the extent possible, not distorting economic decisions. The current overhaul of international taxation rules calls for an inclusive and transparent process. With the document presented, business is well placed to give constructive comments to governments and international organizations.

The lack of coordination between countries on tax rules, definitions of economic instruments and legal entities as well as administrative procedures may result in international double taxation or unintended so called double non-taxation. The global tax system was originally designed to prevent double taxation. The focus now is on double non-taxation. However, it is important to address both these aspects in the BEPS project.
Considering the political pressure behind the BEPS project, it is important to keep in mind and to make sure that any changes to the international tax system is made in a balanced and proportionate way. Governments need to agree on acceptable forms of

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tax competition and businesses must adhere to rules and principles agreed upon. Failure to come to such an agreement might result in unilateral actions by States, which in turn increases the risk of double taxation. Achieving consensus, beyond the G20 countries, towards uniformly agreed standards is thus critical in order to avoid unilateral actions by States. We commend the OECD for its timely action in reforming the international tax system.

We stress the need for universal rather than sector specific changes of the tax rules. The corporate income tax should continue to be levied according to where economic activity takes place and profit rendered. The prices of goods or services must reflect economic activity and we agree with the report that unintended double non-taxation in a situation with so called hybrid instruments should be addressed by governments. It is also important to review how the CFC rules affect the allocation of international taxation rights and their impact on competitiveness of individual countries.

In the BEPS report and other OECD publications a distinction is made between intended and unintended double non-taxation. This distinction is important because it gives meaning to differences between tax efficiency and aggressive tax planning on the side of business and normal tax policy and harmful tax practices on the side of governments. This distinction therefore needs to be further operationalized to be able to come to effective and proportional measures in tackling BEPS related issues. This also means that there should be consensus that universally accepted unintended results of either tax policy or tax planning should be the pivotal point of the work on BEPS. Defining these concepts would clearly be very helpful.

A broad overview of the action points shows that the OECD has made an effort to present the Action Plan in a balanced way so that both business and governments have a responsibility to act to address the BEPS related issues. It is important that BEPS does not turn into an exercise in assigning blame to either business or governments.

The aim of the BEPS project should be to identify parts of the international tax system that do not work well and/or do not work as intended. These issues should be addressed by formulating open norms based on well-established principles, not dealing with issues through ad-hoc anti-abuse measures. In addition, the information that is available to tax authorities could greatly be improved by automatic exchange of information between different tax authorities and when tax authorities and business actively engage in co-operative compliance.

In this way a global level playing field can be promoted and affirmed, designed to enhance global trade and prosperity. The Action Plan should play a vital role in realizing growth and prosperity. Any changes of international rules of how to allocate taxation rights between countries must be proportionate. Allowing any increased importance of sales as an indicator of economic activity when attributing the right of corporate profits, rather than the existing international taxation principles, must be carefully analysed before any changes are considered.

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Since many Member States are not members of the G20 and/or the OECD, we consider the active inclusion of the European Commission in the work on BEPS as crucial for an acceptable outcome to all Member States and Europe as a whole. Any change in international tax rules or principles must be EU law compliant to ensure application also in the EU. We are prepared to give constructive comments and input to the process.

You will find at annex specific comments on each point of the Action Plan. We would like to stress that comments presented here are only an initial reaction. I understand Krister Andersson will participate to the BIAC Consultation on the BEPS Action Plan on October 1st and I hope this will form part of an on-going dialogue through which we can constructively contribute to a successful outcome of the BEPS project.

Sincerely yours,

James Watson
Director

Economics Department

Specific comments on the Action Plan

Action points 2-5 deal mainly with coordinating national tax policy, 6-10 deal with issues concerning substance and transfer pricing and 11-14 focus mainly on legal certainty and transparency between governments amongst themselves and/or between business and governments. Action points 1 and 15 fall somewhat outside these clusters, dealing with the digital economy and the possibilities of a multilateral treaty.

Coordinating national tax policy (action points 2-5)

This cluster of action points should be examined in light of earlier OECD work on harmful tax practices, EU initiatives on harmful tax competition and work in the Code of Conduct group. We believe that as a rule tax competition in itself is beneficial for states. It will encourage states to innovate their tax system and prevents inefficiencies and the forming of 'cartels'.

Sound tax competition does not lead to a race to the bottom, but will result in a race to the optimum as long as there are oversight bodies such as the OECD to determine the playing field and to safeguard the rules. For that reason, a clear internationally agreed working definition on harmful tax practices would be very useful in addressing BEPS issues and in determining the boundaries for acceptable forms of tax competition.

The Action Plan also states that accomplishing the actions set forth requires an effective and comprehensive process that involves all relevant stakeholders. To this end, the OECD will also involve interested G20 countries that are not OECD members. Also other non-member will be invited. This is a laudable development from a point of view that a global level playing field should be achieved. At the same time, going by G20 statements, it seems that the OECD has deviated somewhat from the path of requiring consensus. This could lead to a situation where countries deal with the issues in their own way, creating more gaps and frictions between national tax systems. Consequently, consensus is required. We would like to stress the need for an inclusive process of small economies as well as larger economies.

ACTION 2 – ***Neutralize the Effects of Hybrid Mismatch Arrangements***

"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 payor; (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. "

We are generally supportive of this work stream. It is however important that any initiative in this area is internationally coordinated. In order to achieve a positive impact on hybrid mismatches, countries will have to be willing to share information regarding mismatches and also commit not to implement new legislation that would facilitate mismatches.

Furthermore, one has to acknowledge that there may be cases where double non-taxation is an intentional result of domestic policy initiatives, introduced to stimulate investment. Consequently, it is of utmost importance that any action to reduce the impact of mismatches is clearly defined.

How will an internationally coordinated approach interact with such domestic legislation and the tax sovereignty of different countries?

ACTION 3 – ***Strengthen CFC Rules***

"Develop recommendations regarding the design of controlled foreign corporation rules. This work will be coordinated with other work as necessary."

We would welcome a more coordinated approach regarding CFC rules. More uniformity in this area may increase predictability and thus be beneficial to business. However, the taxation of foreign income constitutes an important aspect of the tax policy of every national government to stimulate growth and investments. The taxation principles in this area vary from country to country and consequently, so does the current CFC regimes. Many countries do not have CFC rules. Considering that countries have chosen such different approaches to stimulate economic activity, we believe that it will be very difficult to coordinate and reach a common position on a standardized CFC regime.

ACTION 4 – ***Limit Base Erosion via Interest Deductions and Other Financial Payments***

"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. "

We believe that, as a principle, companies should be entitled to finance their business operations as they see fit, with equity or debt, as long as they comply with transfer pricing principles in relation to the level of debt and the interest payable. More coordination in the area of interest deductibility would be welcomed if it reduces the burden of compliance and improves certainty for business. It may be noted that the inherent economic double taxation of equity financed investments implies a distortion in the financing mix of companies. We welcome the efforts to present best practices in this area.

Disparities between States in nominal tax rates should fall inside the domain of acceptable tax competition. This should therefore be outside the scope of BEPS, or at least not being addressed as an interest deductibility issue, but rather as a question of acceptable tax competition.

ACTION 5 – ***Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance***

"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."

Since tax is a cost that every MNE tries to control, companies will consequently respond to legitimate incentives. It is of utmost importance for businesses to be able to understand the difference between what is perceived as a BEPS incentive and what is simply permissible planning to manage tax as a cost. Certain structures resulting in BEPS appear to be the result of domestic legislation rather than generic/global issues. Consequently, consideration needs to be given to differentiate between issues that can be addressed through domestic measures and those that will require international coordination.

We believe that Governments have to agree on acceptable forms of tax competition and avoid labeling businesses as aggressive tax planners or tax avoiders when using legislated tax incentives such as accelerated depreciation or patent box regimes. In return businesses must adhere to rules and principles agreed upon by and between countries. Governments need to find a common position on how to define "acceptable tax competition". Such a definition could be linked to full transparency as far as the rules are concerned and a sufficient level of economic activity required.

Substance and transfer pricing (action points 6-10)

It is important to maintain a principle-based approach rather than resort to a series of ad hoc measures. The Action Plan confirms that the at arm's length principle must be maintained. Additional measures to combat unintended double non-taxation should remain within the at arm's length standards. Where it is clear that a transaction is upheld by proper analysis of functions carried, risks taken and assets used and reasonable substance is present, it should be clear that there is no situation of artificially segregating taxable income from the activities that generate it.

ACTION 6 – ***Prevent Treaty Abuse***

"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 coordinated with the work on hybrids.

We are concerned about the first sentence in this action point. Is the intention to introduce domestic anti-abuse rules that would override tax treaties? If so, we would be strongly against it since it would effectively undermine the predictability and certainty of a tax treaty. When making an investment, a taxpayer should be able to rely on the text of a tax treaty. Although we understand the need for rules to counter treaty abuse, such rules should come in the form of treaty provision and not domestic legislation. A number of provisions to counter treaty abuse can already be found in the Commentary on Article 1 of the OECD Model Tax Convention. We therefore recommend that the work in this area is concentrated on designing effective treaty provisions to counter treaty abuse.

ACTION 7 – ***Prevent the Artificial Avoidance of PE Status***

"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.

We have no objections against targeting artificial business arrangements. However, considering the discussions in relation to the latest review of the commentary to Article 5 on the definition of permanent establishment, we feel somewhat concerned that this could turn into yet another clash on source versus resident taxation.

ACTION 8 ***– Intangibles***

"Develop rules to prevent profit shifting 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 rules measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements."

In order to avoid inconsistent interpretation and application, We believe that finding a clear and well accepted definition of the term intangible is of utmost importance. Anything else is likely to result in numerous dispute and double taxation. In our view, a definition of intangible assets that are to be recognized for TP-purposes ought to include three typical characteristics: *ownership*, *control*, and *transferability.* Although business attributes or notions such as goodwill, on-going concern value, synergies, location savings, workforce in place etc. may affect the valuation of a transaction and consequently affect the transfer price of an intangible asset, such attributes or notions are not themselves assets which can be owned, controlled or transferred. Consequently, they should not be included in the definition.

It is equally important to distinguish between allocation of ownership and the compensation for functions performed which may (or may not) contribute to the development and enhancement of the IP. The compensation for functions performed will naturally vary depending on the facts and circumstances in each case but nothing should prevent a highly qualified service provider performing important functions related to the development and/or enhancement of the IP from being entitled to a significant service fee, without acquiring any right or share in the potential IP resulting from his services. At arm's length, it is indeed reasonable to assume that a highly qualified service provider performing high value adding R&D or marketing functions should receive a higher compensation than a service provider only providing routine R&D or marketing activities. However, this does not mean that either of the service providers at arm's length is entitled to a share in the IP as such. We believe that this distinction is important in order not to dilute the IP ownership concept for transfer pricing purposes into something completely unpredictable. It is crucial to avoid a situation where it will in most cases be possible to argue for some sort of joint or shared ownership based on notions of how "important" various functions are considered to be.

For more detailed remarks on intangibles we refer to the BUSINESSEUROPE Tax Policy Group comments on the revised discussion draft on transfer pricing aspects of intangibles.

ACTION 9 ***– Risks and Capital***

"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."

We strongly believe that for normal transactions the arm's length principle works. It should not be modified or diluted to deal with abusive behavior. The principles laid out in Chapter IX of the Transfer Pricing Guidelines on risk allocation and capital is valid and reasonable. Abusive behavior should be countered with targeted measures.

ACTION 10 ***– Other High-Risk Transactions***

"Develop rules to prevent profit shifting 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."

As stated under Action point 9, we believe that the arm's length principle works and it does not require that comparables between unrelated parties exist for every transaction. In situations where there are no comparables, transactions can still be priced by the use of transfer pricing methods.

In order to make business decisions, legal certainty is required. A transaction should, in accordance with the Transfer Pricing Guidelines, only be recharacterised in exceptional cases. Increasing use of recharacterisation would create uncertainty for business and lead to double taxation.

Legal certainty and transparency (action points 11-14)

In relation to these action points, it is disconcerting to find that there is no reliable data available on the magnitude of BEPS, nor is there an agreed upon methodology to gather and analyse such data. This begs the question on how effective and proportionate measures can be expected if there is little or no real insight in the scope of the problem.

In addition, the proposed timing concerning the action points raises some question since the results on data collection and developing methodologies (action point 11) are not foreseen until September 2015. Despite this, it is stated that actions should be delivered by September 2014 in the area of hybrid mismatch arrangements (action point 2), treaty abuse (action point 6), transfer pricing aspects of intangibles (action point 8), transfer pricing documentation requirements (action point 13), identifying the problems of the digital economy (action point 1) and part of the work on harmful tax

practices (action point 5 - finalise review on member countries regimes).

In short, we believe that establishing methodologies to collect and analyse data should have far more priority than what is currently the case. As stated in the Action Plan: timely, targeted and comprehensive information is essential. Decisions need to be taken on the basis of the right policy considerations. Despite all political pressure, proper due diligence need to be performed to be able to come to effective and proportional measures.

As is the case with all action points, international coordination is a prerequisite.

ACTION 11 – ***Establish Methodologies to Collect and Analyze Data on BEPS and the Actions to Address It***

"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."

The OECD's February report on BEBS concluded that there basically was no reliable data available on the scale and impact of BEPS.

The importance of reliable data has been addressed above. A lot of relevant information is clearly already available for tax authorities by way of audits - as stated in the Action Plan - but also through yearly submitted tax returns. Additionally, co-operative compliance programmes could provide more up-to-date information without resorting to new disclosure initiatives and related administrative burdens. Furthermore, by engaging with business directly through co-operative compliance more reciprocal understanding for either position could be established. However, it is important to make sure that any new types of data to assess BEPS, and actions to address it, does not lead to significantly greater administrative burden on businesses.

Furthermore, any selected method should ensure certainty and reliability. Business should not be negatively affected by incorrect/non reliable data. In addition, and for obvious reasons, the question of confidentiality for taxpayers is a key issue.

ACTION 12 – ***Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements***

"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 coordinated 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 administrations."

This focus in this action point – as well as the previous one – is mainly about solving a perceived information deficit on the side of the tax authorities. If the claim is correct that in most countries the tax authorities have little capability to develop the 'big picture' of the value chain, there could be a warranted need for a targeted approach to improve this.

However, in order to ascertain the need for this approach it should first be established that the lack of capability in fact lies with the absence of information, insufficient means to access that information etc. In addition, it should be established that the information could not be made available to the relevant tax authorities through (automatic) international exchange of information, for instance through a government that is actively engaged in co-operative compliance.

Only in those cases would it be valid to resolve the absence of information, on for instance, the value chain by an internationally agreed and coordinated request to the tax payer to disclose the relevant information.

Mandatory disclosure rules on aggressive tax planning arrangements seem irrelevant when there is no consensus on what should be considered an aggressive tax planning arrangement. Also, disclosure rules should be redundant if the automatic information exchange between tax authorities is properly arranged as indicated above.

ACTION 13 – ***Re-examine Transfer Pricing Documentation***

"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 may 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."

Businesses spend a lot of time and incur a lot of costs to define and document their Transfer Pricing. Despite this, the documentation often seems to serve little practical purpose. With tougher tax administrations and environments changing ever more rapidly, it is hard to define rules that last more than 3 years and to document them with the details requested by tax administrations.

The current focus of TPD is local and not well suited to an increasingly global economy. It is important to identify what information would be most useful to tax authorities. The information requested in the action plan seems a bit rudimentary in order to provide useful indicators for risk assessment purposes. It may be more relevant to focus on information in relation to particular risk associated with certain activities. Consequently, the OECD work on TPD should be streamlined with the one on Transfer Pricing Risk Assessment (TPRA). Information required by tax authorities for Transfer Pricing Risk Assessment purposes will vary from business to business. In agreement with BIAC, we believe that businesses themselves are best placed to determine how this information can be usefully presented in relation to their activities. We also agree that it is in the interest of businesses to present the information in a manner that tax authorities can understand, as this is more likely to lead to a "low risk" assessment.

ACTION 14 – ***Make Dispute Resolution Mechanisms More Effective***

"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."

We very much welcome and appreciate that dispute resolution is addressed in the action plan. This topic is of great importance to businesses. It is also important for governments since the elimination of international double taxation increases investments, jobs and therefore tax revenues. Furthermore, legal certainty is of utmost importance for any business investment and the availability of effective dispute resolution mechanisms forms an inextricable part of this.

Considering the scope of the BEPS project, with new claims of taxing rights, it is likely to put additional strain on the disputes resolution mechanisms. Still, relatively few tax treaties include an arbitration clause and the number of MAP cases keeps increasing. Consequently, we fully support and encourage the OECD to work on improvements to the efficiency of MAP and the promotion of mandatory arbitration provisions in tax treaties.

Digital economy and multilateral treaties (action points 1 and 15)

ACTION 1 – ***Address the Tax Challenges of the Digital Economy***

"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."

We do not believe in widening the scope of the PE concept to include the digital economy. Considering the complexity of this topic and the speed with which business models evolve around the digital economy, a specific set of rules for the digital business does not seem achievable. This is an area where a more in-depth policy debate on the merits of direct/indirect tax solutions is needed. The EU's work on this topic for VAT and competition purposes should be explored.

The Action Plan states that actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income. However, several of the actions points calls for greater reliance on where economic activity takes place and in Action 1 the importance of actual sales for taxable profits is emphasized. For smaller open economies, attributing sales an increased importance when assessing where profits should be taxed, would result in substantial revenue losses from the corporate income tax. Is that acceptable, in particular since smaller countries are not members of the G20?

While we understand the concerns which governments and domestic business have, it is important that any proposal considers the wider taxing rights issue.

ACTION 15: ***Develop a Multilateral Instrument***

"Analyze 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."

A multilateral instrument could be an effective way to implement BEPS actions in the current extensive body of bilateral treaties. We would support a solution which would increase international tax coordination and improve the effectiveness of the current framework in this area.