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Practice Group:

Tax

OECD/G20 Base Erosion and Profit Shifting Project

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On September 16, 2014, the Organisation for Economic Cooperation and Development ("OECD") released seven reports addressing certain aspects of the base erosion and profit shifting ("BEPS") project. The seven BEPS reports released by the OECD include tax challenges of the digital economy (Action 1), hybrid mismatch arrangements (Action 2), countering harmful tax practices (Action 5), abuse of tax treaties (Action 6), transfer pricing of intangibles (Action 8), country-by-country reporting (Action 13), and the feasibility of developing a multilateral instrument to amend bilateral tax treaties (Action 15). These reports have a global focus and global implications, and we have additionally provided our views on the potential impacts of the BEPS reports from an Australian perspective.

BEPS is not just a tax exercise; it is a political process. The effectiveness of BEPS ultimately relies on the will and ability of jurisdictions to agree to and adopt the BEPS recommendations. Demonstrating the extent of concern about base erosion and profit shifting, participants in the BEPS process include not only OECD countries, but several that do not belong to the OECD, including China, Brazil and India. There is a great diversity of economies and interests among these players, ranging from mature to emerging markets, manufacturing to high technology to natural resources, and from nonmobile to highly mobile income. While all have a common interest in leveling the playing field to eliminate tax arbitrage, the path to achieving that goal may vary depending on the particulars within each jurisdiction. The U.S. Treasury has been especially concerned that many BEPS action items could have a disproportionately negative effect on US businesses. These internal dynamics further complicate the considerable challenges BEPS participants face in reaching consensus on a multilateral, equitable approach to international tax policy.

The OECD is limited to making recommendations and has no authority to force any jurisdiction to adopt them. A European Union (EU) tax directive adopting some or all of the BEPS recommendations would then require their implementation by individual EU countries, but this requires unanimous consent by the European Council and approval by the European Parliament. The current nominee to be commissioner for economic and financial affairs, taxation and customs union in the new European Commission recently pledged his support for many of the BEPS policies during his nomination hearing. In the absence of unanimous consent, however, individual EU jurisdictions must take unilateral action, generally in the form of legislation, to adopt BEPS. Non-EU countries, including the U.S., also generally would require legislation to incorporate the policies of BEPS. In limited circumstances, some recommendations might be implemented through regulations or other procedures. The legislative process varies throughout the world, but in many cases, would substantially prolong the adoption of BEPS and could generate considerable debate over the merits of the BEPS policies within a country; in some circumstances, certain recommendations might never be adopted.

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In the U.S., it is difficult to gauge to what extent the BEPS project will influence US tax reform. Progress toward comprehensive tax reform has stalled in a contentious political environment, without a clear path forward. Yet, international tax policy, in particular, base erosion and profit-shifting issues, is front and center in the US tax policy debate. The recent surge in corporate inversions is just one symptom of the need to revamp the US tax code to make US-headquartered businesses more competitive in a global marketplace. If the BEPS timeline stays on track, and Congress and the Administration remain at loggerheads regarding reform, the influence of BEPS on US international tax policy going forward could be considerable.

The links and attachments hereto contain more digestible overviews of some of the important concepts discussed in the OECD BEPS reports. These overviews have been prepared by K&L Gates tax specialists and personnel from all corners of the world. In addition, the "Significant Items of Note" highlight items that to date may not have received sufficient attention or that will likely permeate future tax planning and compliance efforts and impact all stakeholders operating internationally.

Significant Items of Note

- The country-by-country reporting proposals will be expected to add material compliance costs and may be used by some countries as justification for the imposition of additional tax burden.
- Given the difficulty of compliance and enforcement in many B2C transactions, countries may look to financial and payment processing companies to act as withholding and compliance agents.
- Companies that are sufficiently "dematerialized" may face more liberalized nexus and/or doing business-type provisions that allow the market in which the consumer is located to more freely tax income generated by such companies.
- Treaty abuse would be curtailed by providing limitation on benefits clauses and/or adding general anti-abuse rules whereby, in the case of the latter, a treaty benefit would not be available where one of the principal purposes of the transaction or arrangement is to secure a benefit under a treaty and obtaining that benefit would be contrary to the object and purpose of the relevant provisions of the treaty.
- Heightened scrutiny of preferential effective rates for intangible income (patents or intellectual property boxes) and a requirement that substantial localized activities be a prerequisite for any such preferential effective rates.
- Although the OECD declined to specifically treat "location savings" as an intangible, certain low cost outsourcing jurisdictions (e.g. China and India) continue to insist otherwise.

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