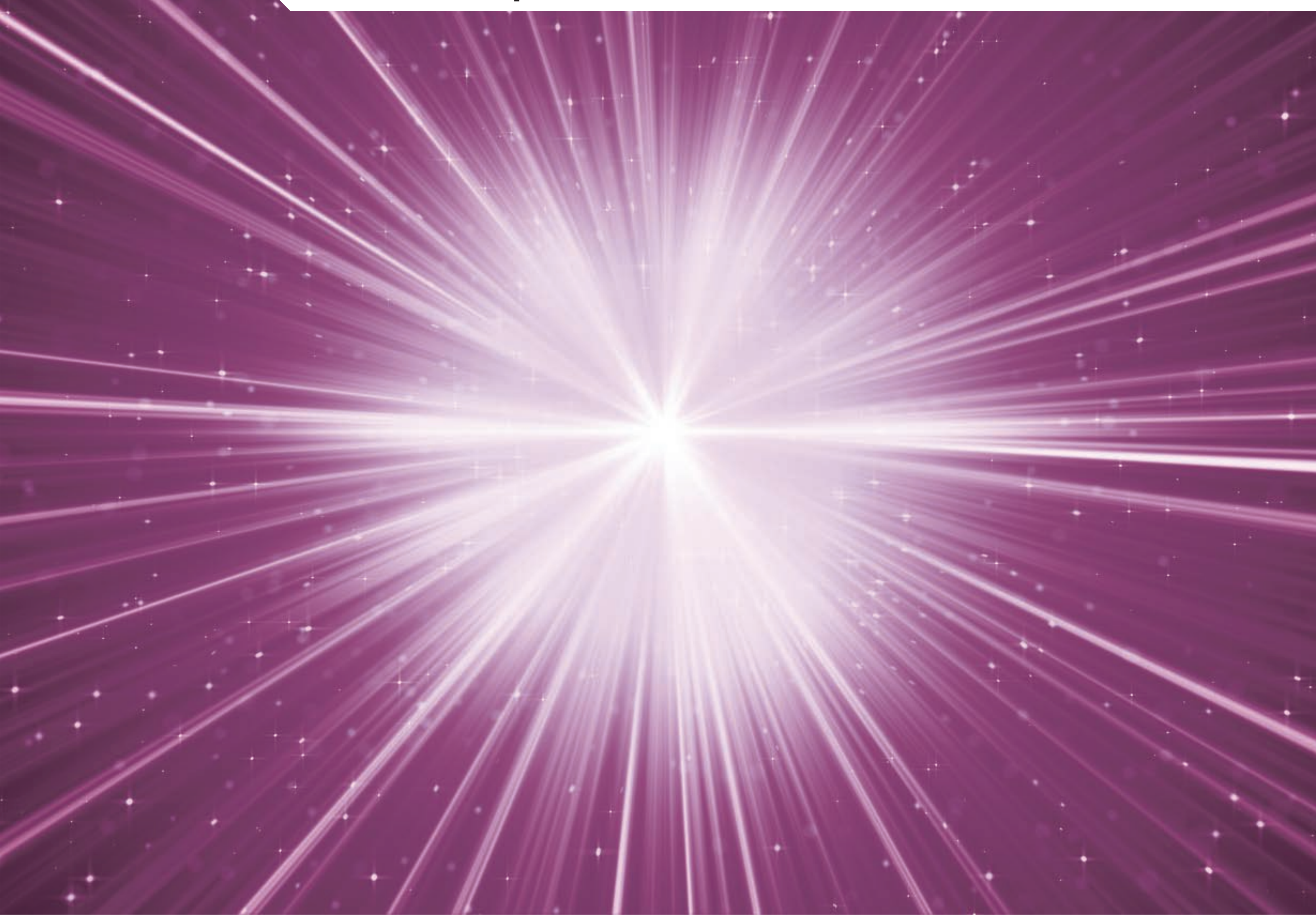
OECD/G20 Base Erosion and Profit Shifting Project

BEPS Project Explanatory Statement

2015 Final Reports



OECD

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2015 FINAL REPORTS

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Introduction

1. International tax issues have never been as high on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years. This has put a strain on the international tax framework, which was designed more than a century ago. The current rules have revealed weaknesses that create opportunities for Base Erosion and Profit Shifting (BEPS), thus requiring a bold move by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created. In September 2013, G20 Leaders endorsed the ambitious and comprehensive Action Plan on BEPS. This package of 13 reports, delivered just 2 years later, includes new or reinforced international standards as well as concrete measures to help countries tackle BEPS. It represents the results of a major and unparalleled effort by OECD and G20 countries[1] working together on an equal footing with the participation of an increasing number of developing countries.

2. The stakes are high. Although measuring the scope of BEPS proves challenging, the findings of the work performed since 2013 confirm the potential magnitude of the issue, with estimates indicating that the global corporate income tax (CIT) revenue losses could be between 4% to 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. The losses arise from a variety of causes, including aggressive tax planning by some multinational enterprises (MNEs), the interaction of domestic tax rules, lack of transparency and coordination between tax administrations, limited country enforcement resources and harmful tax practices. The affiliates of MNEs in low tax countries report almost twice the profit rate (relative to assets) of their global group, showing how BEPS can cause economic distortions. Estimates of the impact of BEPS on developing countries, as a percentage of tax revenues, are higher than in developed countries given developing countries' greater reliance on CIT revenues. In a globalised economy, governments need to cooperate and refrain from harmful tax practices, to address tax avoidance effectively, and provide a more certain international environment to attract and sustain investment. Failure to achieve such cooperation would reduce the effectiveness of CIT as a tool for resource mobilisation, which would have a disproportionately harmful impact on developing countries.

3. This BEPS package, which includes and consolidates the first seven reports presented to and welcomed by the G20 Leaders at the Brisbane Summit in 2014, has been developed and agreed in just two years. This is chiefly because there is an urgent need to restore the trust of ordinary people in the fairness of their tax systems, to level the playing field among businesses, and to provide governments with more efficient tools to ensure the effectiveness of their sovereign tax policies. It was also imperative to move quickly to try to limit the risks of countries taking uncoordinated unilateral measures which might weaken key international tax principles which form a stable framework for cross-border investments. BEPS can result in double non-taxation but addressing BEPS should not result in double taxation. Double taxation would harm MNEs which have contributed to boosting trade and investment around the world, supporting growth, creating jobs, fostering innovation and providing pathways out of poverty. Double taxation would also increase the cost of capital and could deter investment in the economies concerned.

4. The level of interest and participation in the work has been unprecedented with more than 60 countries[2] directly involved in the technical groups and many more participating in shaping the outcomes through regional structured dialogues. Regional tax

organisations such as the African Tax Administration Forum (ATAF), *Centre de rencontre des administrations fiscales* (CREDAF) and the *Centro Interamericano de Administraciones Tributarias* (CIAT) joined international organisations like the International Monetary Fund (IMF), the World Bank (WB) and the United Nations (UN), in contributing to the work. Stakeholder interest including invaluable interactions with business and civil society saw more than 12 000 pages of comments received on the 23 discussion drafts published and discussed at 11 public consultations, as well as more than 40 000 views of the OECD webcasts on BEPS.

5. The report *Addressing Base Erosion and Profit Shifting* (OECD, 2013) concluded that no single tax rule on its own enables BEPS; it is rather the interplay among different issues that makes it possible. Domestic laws and rules that are not co-ordinated across borders, international tax standards that have not always kept pace with the changing global business environment and a pervasive lack of relevant information at the level of tax administrations and policy makers combine to provide opportunities for taxpayers to undertake BEPS strategies. The availability of harmful tax practices was also identified as a key pressure area.

6. Out of a shared desire to address BEPS concerns, there is agreement on **a comprehensive package of measures** which are designed to be implemented domestically and through treaty provisions in a coordinated manner, supported by targeted monitoring and strengthened transparency. The goal is to tackle BEPS structures by comprehensively addressing their root causes rather than merely the symptoms.

7. Once the measures are implemented, many schemes facilitating double non-taxation will be curtailed. The implementation of the BEPS package will better align the location of taxable profits with the location of economic activities and value creation, and improve the information available to tax authorities to apply their tax laws effectively. In order to minimise the incidence of double taxation, improving dispute resolution as well as establishing mechanisms to support and monitor the implementation of the measures are also a key part of the BEPS reforms.

8. The BEPS package represents the first substantial – and overdue - renovation of the international tax standards in almost a century. This renovation is necessary not only to tackle BEPS, but also to ensure the sustainability of the current international framework for the taxation of cross-border activities and the elimination of double taxation. The G20 and the OECD have recognised that BEPS by its very nature requires coordinated responses, which is why countries have invested the resources to participate in the development of shared solutions. After summarising the achievements to date, this Explanatory Statement outlines the way forward to ensure an efficient implementation of the agreed measures and to follow up through an inclusive, targeted monitoring mechanism.

Achievements of the BEPS Project

9. For the first time all OECD and G20 countries have worked together on an equal footing to design common responses to international tax challenges. Further, there has been unprecedented participation by developing countries in the development of commonly-agreed international tax standards. The fact that so many countries have participated in the work and cooperated in the development of changes to the international tax environment is in itself **a significant achievement of the Project**.

10. Moreover, in addition to the work undertaken within the Project, parallel work has been undertaken that targets the priority BEPS challenges identified by low-income countries and spelled out in a two-part report to the G20 Development Working Group[3] in 2014. These include issues relating to the availability of transfer pricing comparables including challenges in the commodities sector, transparent and effective tax incentives, and indirect transfers of assets. The development of toolkits to help developing countries address these issues will continue through 2016 and 2017, working with countries in partnership with regional tax organisations and the IMF, World Bank, and UN.

11. **A comprehensive package of measures has been agreed upon.** Countries are committed to this comprehensive package and to its consistent implementation. These measures range from new minimum standards to revision of existing standards, common approaches which will facilitate the convergence of national practices and guidance drawing on best practices. **Minimum standards were agreed in particular to tackle issues in cases where no action by some countries would have created negative spill overs** (including adverse impacts of competitiveness) on other countries. Recognising the need to level the playing field, all OECD and G20 countries commit to consistent implementation in the areas of preventing treaty shopping, Country-by-Country Reporting, fighting harmful tax practices and improving dispute resolution. Existing standards have been updated and will be implemented, noting however that not all BEPS participants have endorsed the underlying standards on tax treaties or transfer pricing. In other areas, such as recommendations on hybrid mismatch arrangements and best practices on interest deductibility, countries have agreed a general tax policy direction. In these areas, they are expected to converge over time through the implementation of the agreed common approaches, thus enabling further consideration of whether such measures should become minimum standards in the future. Guidance based on best practices will also support countries intending to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation. There is agreement for countries to be subject to targeted monitoring, in particular for the implementation of the minimum standards. Moreover, it is expected that countries beyond the OECD and G20 will join them to protect their own tax bases and level the playing field.

12. Model provisions to **prevent treaty abuse, including through treaty shopping,** have been developed and will be included in the multilateral instrument that countries may use to implement the results of the work on tax treaty issues into bilateral tax treaties. This will impede the use of conduit companies in countries with favourable tax treaties to channel investments and obtain reduced rates of taxation**.** Some of these provisions require additional technical work, which will be finalised in 2016.

13. **Standardised Country-by-Country Reporting** and other documentation requirements will give tax administrations a global picture of where MNE profits, tax and economic activities are reported, and the ability to use this information to assess transfer pricing and other BEPS risks, so they can focus audit resources where they will be most effective. MNEs will report their revenues, pre-tax profits, income tax paid and accrued, number of employees, stated capital, retained earnings, and tangible assets in each jurisdiction where they operate. The implementation package provides guidance to ensure that information is provided to the tax administration in a timely manner, that confidentiality is preserved and that the information is used appropriately. It is recommended that the first Country-by-Country Reports be required to be filed for MNEs' fiscal years starting from 1 January 2016. It is acknowledged that some jurisdictions may need time to follow their particular domestic legislative process in order to make necessary adjustments to the law. The filing requirement will be on MNEs with

annual consolidated group revenue equal to or exceeding EUR 750 million (or a near equivalent in domestic currency). Anticipation of this reporting system has already begun to discourage aggressive tax planning.

14. **A revitalised peer review process will address harmful tax practices, including patent boxes where they include harmful features, as well as a commitment to transparency through the mandatory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of information exchange, could give rise to BEPS concerns**. Agreement on the nexus approach for preferential intellectual property (IP) regimes requires alignment of the benefits of these regimes with substantive research and development activity. The renewal of efforts to address harmful tax practices will reduce the distortionary influence of taxation on the location of profits from mobile financial and service activities, thereby encouraging an environment in which fair tax competition can take place.

15. With the strong political commitment to the effective and timely resolution of disputes through the mutual agreement procedure (MAP), agreement on a **minimum standard to secure progress on dispute resolution has been reached.** This will help ensure that cross-border tax disputes between countries over the interpretation or application of tax treaties are resolved in a more effective and timely manner. The Forum on Tax Administration (FTA), including all OECD and G20 countries along with other interested countries and jurisdictions on an equal footing, will continue its efforts to improve MAP through its recently established MAP Forum. This will require the development of an assessment methodology to ensure the new standard for timely resolution of disputes is expeditiously met. In parallel, a large group of countries is committing to move quickly towards mandatory and binding arbitration. It is expected that rapid implementation of this commitment will be achieved through the inclusion of arbitration as an optional provision in the multilateral instrument to be developed to implement the BEPS treaty-related measures. **An effective monitoring mechanism will be established to focus on the improvement of dispute resolutions.**

16. The BEPS Project has also revisited the existing **international tax standards to eliminate double taxation, in order to stop abuses and close BEPS opportunities**. This translates into a set of agreed guidance which reflects the common understanding and interpretation of provisions based on Article 9 of both the OECD and UN model tax conventions. Changes to the Transfer Pricing Guidelines will ensure that the transfer pricing of MNEs better aligns the taxation of profits with economic activity. Outcomes will be determined in accordance with the actual conduct of related parties in the context of the contractual terms of the transaction. These and other changes will reduce the incentive for MNEs to shift income to “cash boxes” – shell companies with few if any employees and little or no economic activity, which seek to take advantage of low or no-tax jurisdictions. Specifically, the revised guidelines on transfer pricing address the situation where a capital-rich member of a group, i.e. a cash box, simply provides assets such as funding for use by an operating company but performs only limited activities. If the capital-rich member does not in fact control the financial risks associated with its funding, then it will be entitled to no more than a risk-free return, or less if, for example, the transaction is not commercially rational and therefore the guidance on non-recognition applies. The **Transfer Pricing Guidelines are also being modernised in relation to intangibles**. Recognising the difficulty in valuing certain intangibles, an approach to assure the appropriate pricing of hard-to-value intangibles has been devised

to give countries an additional tool to address the use of information asymmetry between taxpayers and tax authorities to undervalue intra-group transfers of intangibles.

17. **Changes to the permanent establishment** definition have been agreed to address techniques used to inappropriately avoid the tax nexus, including via commissionaire arrangements and the artificial fragmentation of business activities. As indicated in the report on Action 7, follow-up work will be undertaken to provide additional guidance on profit attribution to the permanent establishments (PEs) resulting from the changes proposed in that report. Follow-up work will also be needed in 2016 to incorporate the changes resulting from the report on Action 7 into the Model Tax Convention through an update of the Model. This follow-up work will allow the Committee, where necessary, to provide additional clarification on the new treaty wording introduced by the report and to address any unintended consequences of the changes resulting from that report, notably by examining an issue related to the global trading of financial products.

18. The BEPS package also includes a common approach which will facilitate the convergence of national practices by interested countries **to limiting base erosion through interest expenses,** for example via intra-group and third party loans that generate excessive deductible interest payments, as well as on domestic legislation and related treaty provisions where necessary **to neutralise hybrid mismatches** which undermine their tax base or the tax base of their partners. Recommendations for the design of domestic rules and model treaty provisions have been agreed together with detailed commentary for their implementation. There is also guidance based on best practices for countries which seek to strengthen their domestic legislation relating to **mandatory disclosure by taxpayers of aggressive or abusive transactions, arrangements, or structures**, and the building blocks of **effective Controlled Foreign Company (CFC) rules**.

19. The past decade has seen the rapid expansion of the digital economy, and today it is increasingly the economy itself; therefore a ring-fenced solution to the tax challenges it poses is not appropriate. **BEPS risks are however exacerbated by the digital economy, and the measures developed in the course of the BEPS Project are expected to substantially address these risks.** The key features of the digital economy have in fact been taken into account across the BEPS Project, in particular the changes to the permanent establishment definition, the update of the Transfer Pricing Guidelines and the guidance on CFC rules. In the area of indirect taxes, guidelines have been developed and implementation mechanisms identified to facilitate VAT collection based on the country where the consumer is located, which is particularly relevant for online ordering and delivery of goods and services. The work also considered several options to address the broader tax challenges raised by the digital economy, including a new nexus in the form of a significant economic presence. None of these options were recommended at this stage. This is because, among other reasons, it is expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country. Countries could, however, introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. OECD and G20 countries have agreed to monitor developments and analyse data that will become available over time. On the basis of the future monitoring work, a determination will also be made as to whether further work on the options discussed and analysed should be carried out. This

determination should be based on a broad look at the ability of existing international tax standards to deal with the tax challenges raised by developments in the digital economy.

20. An innovative mechanism has been launched to update the global network of more than 3 500 bilateral tax treaties: about 90 countries have joined an ad hoc group to **negotiate a multilateral instrument** to implement the treaty-related BEPS measures which will facilitate the modification of bilateral tax treaties in a synchronised and efficient manner, without the need to invest resources to bilaterally renegotiate each treaty. To be concluded by the end of 2016, the multilateral instrument will further enhance coordination and improve international tax cooperation.

21. With recent announcements indicating important changes to tax structuring by some large MNEs, the impact on taxpayer behaviour can already be seen before implementation is even fully underway. An Action-by-Action summary of the BEPS package is found in the Annex to this Explanatory Statement.

Post-BEPS Environment

22. With the adoption of the BEPS package, OECD and G20 countries, as well as all developing countries that have participated in its development, will lay the foundations of a modern international tax framework under which profits are taxed where economic activity and value creation occurs. It is now time to focus on the upcoming challenges, which include supporting the implementation of the recommended changes in a consistent and coherent manner, monitoring the impact on double non-taxation and on double taxation, and designing a more inclusive framework to support implementation and carry out monitoring.

A. Implementation starts now

23. Some of the revisions may be immediately applicable such as the revisions to the Transfer Pricing Guidelines, while others require changes that can be implemented via tax treaties, including through the multilateral instrument. Some require domestic law changes, such as the outputs of the work on hybrid mismatches, CFC rules, interest deductibility, Country-by-Country Reporting, and mandatory disclosure rules, as well as to align, where necessary, domestic rules on preferential IP regimes with the harmful tax practices criteria. Countries are sovereign. It is therefore up to them to implement these changes, and measures may be implemented in different manners, as long as they do not conflict with their international legal commitments. However, BEPS by its nature requires coordinated responses, particularly in the area of domestic law measures; it is therefore expected that they will implement their commitments, and that they will seek consistency and convergence when deciding upon the implementation of the measures.

24. Challenges have arisen in the course of the development of the measures: some countries have enacted unilateral measures, some tax administrations have been more aggressive, and increasing uncertainty has been denounced by some practitioners as a result of both the changes in the world economy and the heightened awareness of BEPS. As noted in the BEPS Action Plan:

… the emergence of competing sets of international standards, and the replacement of the current consensus based framework by unilateral measures, could lead to global tax chaos marked by the massive re-emergence of double taxation.

25. Governments recognise these challenges and that **consistent implementation and application are key**: options developed to be adaptable to different tax systems should not result in conflicts between domestic systems; interpretation of the new standards should not result in increased disputes. Instead, to support an effective and consistent **implementation, OECD and G20 countries agree to continue to work together in the BEPS Project framework. Initiatives to further ensure consistent and coordinated implementation are already underway amongst OECD and G20 countries, and beyond.** For example, the European Commission has recently published a Communication on a Fair and Efficient Corporate Tax System in the European Union which aims to set out how the BEPS measures can be implemented within the EU. The participation of about 90 countries in the negotiation of the multilateral instrument is also a strong signal that countries are committed to swift and consistent implementation in a multilateral context.

26. **OECD and G20 countries will also keep working on an equal footing to complete the areas which require further work in 2016 and 2017.** These include finalising transfer pricing guidance on the application of transactional profit split methods and on financial transactions, discussing the rules for the attribution of profits to permanent establishments in light of the changes to the permanent establishment definition, and finalising the model provisions and detailed Commentary on the Limitation on Benefit (LOB) rule with a continued examination of the issues relating to the broader question of treaty entitlement of investment funds (other than collective investment funds i.e. non-CIV funds). It will also mean finalising the details of a group ratio carve-out and special rules for insurance and banking sectors in the area of interest deductibility and developing a strategy to expand participation of non-OECD, non-G20 countries to the work on harmful tax practices, including the possible revision of the relevant criteria.

27. Beyond the finalisation of these actions, OECD and G20 countries will seek to improve clarity and certainty in the application of the rules and will also consider work in related areas which have emerged in the course of the work on BEPS.

B. Monitoring implementation and impact

28. Recognising all the progress made, including in establishing a new OECD-G20 framework for more inclusive deliberations, it appears necessary to further deepen cooperation and **focus on monitoring the implementation and effectiveness of the measures adopted in the context of the BEPS Project as well as the impact on both compliance by taxpayers and proper implementation by tax administrations**.

29. **OECD and G20 countries agree to keep working on an equal footing to monitor the implementation of the BEPS measures.** The monitoring will consist of an assessment of compliance in particular with the minimum standards in the form of reports on what countries have done to implement the BEPS recommendations. It will involve some form of peer review which will have to be defined and adapted to the different Actions, with a view to establishing a level playing field by ensuring all countries and jurisdictions implement their commitments so that no country or jurisdiction would gain unfair competitive advantages. In addition, a **better understanding of how the BEPS recommendations are implemented in practice could reduce misunderstandings and disputes between governments**. Greater focus on implementation and tax administration should therefore be mutually beneficial to governments and business, with an important role to play for the Forum on Tax Administration. Finally, proposed improvements to

data and analysis will help support ongoing evaluation of the quantitative impact of BEPS, as well as evaluating the impact of the countermeasures developed under the BEPS Project.

C. Designing an inclusive framework

30. Globalisation requires that global solutions and a global dialogue be established which go beyond OECD and G20 countries. The strong interest expressed by developing countries through their participation in the BEPS Project should be **sustained by the establishment of an even more inclusive framework,** which will continue to include other international organisations and regional tax organisations. Drawing on the successful experience of the Global Forum on Transparency and Exchange of Information for Tax Purposes, in early 2016 **OECD and G20 countries will work together to design and propose a more inclusive framework to support and monitor the implementation of the BEPS package, with countries and jurisdictions participating on an equal footing**. Such work will include consideration of the manner in which non-OECD non-G20 countries and jurisdictions can commit to the agreed standards and their implementation. It will draw on the mandate from the G20 Finance Ministers and Central Bank Governors as included in their Communiqué issued in Ankara on 5 September 2015:

"… *The effectiveness of the project will be determined by its widespread and consistent implementation. We will continue to work on an equal footing as we monitor the implementation of the BEPS project outcomes at the global level, in particular, the exchange of information on cross-border tax rulings. We call on the OECD to prepare a framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions, particularly developing economies, on an equal footing…*"

D. Next steps

31. The OECD and G20 countries will extend their cooperation on BEPS until 2020 to complete pending work and ensure an efficient targeted monitoring of the agreed measures. They will, in early 2016, conceive a framework for monitoring with a view to better involve other interested countries and jurisdictions.

Annex A

Overview of BEPS Package

Action 1 – Address the Tax Challenges of the Digital Economy

The Action 1 report concludes that the digital economy cannot be ring-fenced as it is increasingly the economy itself. The report analyses BEPS risks exacerbated in the digital economy and shows the expected impact of the measures developed across the BEPS Project. Rules and implementation mechanisms have been developed to help collect value-added tax (VAT) based on the country where the consumer is located in the case of cross-border business-to-consumers transactions. These measures are intended to level the playing field between domestic and foreign suppliers and facilitate the efficient collection of VAT due on these transactions. Technical options to deal with the broader tax challenges raised by the digital economy such as nexus and data have been discussed and analysed. As both the challenges and the potential options raise systemic issues regarding the existing framework for the taxation of cross-border activities that go beyond BEPS issues, OECD and G20 countries have agreed to monitor developments and analyse data that will become available over time. On the basis of the future monitoring work, a determination will also be made as to whether further work on the options discussed and analysed should be carried out. This determination should be based on a broad look at the ability of existing international tax standards to deal with the tax challenges raised by developments in the digital economy.

Action 2 – Neutralise the Effects of Hybrid Mismatch Arrangements

A common approach which will facilitate the convergence of national practices through domestic and treaty rules to neutralise such arrangements. This will help to prevent double non-taxation by eliminating the tax benefits of mismatches and to put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid. By neutralising the mismatch in tax outcomes, but not otherwise interfering with the use of such instruments or entities, the rules will inhibit the use of these arrangements as a tool for BEPS without adversely impacting cross-border trade and investment.

Action 3 – Strengthen CFC Rules

The report sets out recommendations in the form of building blocks of effective Controlled Foreign Company (CFC) rules, while recognising that the policy objectives of these rules vary among jurisdictions. The recommendations are not minimum standards, but they are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries. It identifies the challenges to existing CFC rules posed by mobile income such as that from intellectual property, services and digital transactions, and allows jurisdictions to reflect on appropriate policies in this regard. The work emphasises that CFC rules have a continuing, important role in tackling BEPS, as a backstop to transfer pricing and other rules.

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

A common approach to facilitate the convergence of national rules in the area of interest deductibility. The influence of tax rules on the location of debt within multinational groups has been established in a number of academic studies and it is well-known that groups can easily multiply the level of debt at the individual group entity level via intra-group financing. At the same time, the ability to achieve excessive interest deductions including those that finance the production of exempt or deferred income is best addressed in a coordinated manner given the importance of addressing competitiveness considerations and of ensuring that appropriate interest expense limitations do not themselves lead to double taxation. The common approach aims at ensuring that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities and fostering increased coordination of national rules in this space.

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

Current concerns on harmful tax practices are primarily about preferential regimes which can be used for artificial profit shifting and about a lack of transparency in connection with certain rulings. The Action 5 report sets out a minimum standard based on an agreed methodology to assess whether there is substantial activity in a preferential regime. In the context of IP regimes such as patent boxes, consensus was reached on the "nexus" approach. This approach uses expenditures in the country as a proxy for substantial activity and ensures that taxpayers benefiting from these regimes did in fact engage in research and development and incurred actual expenditures on such activities. The same principle can also be applied to other preferential regimes so that such regimes would be found to require substantial activities where they grant benefits to a taxpayer to the extent that the taxpayer undertook the core income-generating activities required to produce the type of income covered by the preferential regime. In the area of transparency, a framework has been agreed for mandatory spontaneous exchange of information on rulings that could give rise to BEPS concerns in the absence of such exchange. The results of the application of the elaborated substantial activity and transparency factors to a number of preferential regimes are included in the report.

Action 6 – Prevent Treaty Abuse

The Action 6 report includes a minimum standard on preventing abuse including through treaty shopping and new rules that provide safeguards to prevent treaty abuse and offer a certain degree of flexibility regarding how to do so. The new treaty anti-abuse rules included in the report first address treaty shopping, which involves strategies through which a person who is not a resident of a State attempts to obtain the benefits of a tax treaty concluded by that State. More targeted rules have been designed to address other forms of treaty abuse. Other changes to the OECD Model Tax Convention have been agreed to ensure that treaties do not inadvertently prevent the application of domestic anti-abuse rules. A clarification that tax treaties are not intended to be used to generate double non-taxation is provided through a reformulation of the title and preamble of the Model Tax Convention. Finally, the report contains the policy considerations to be taken into account when entering into tax treaties with certain low or no-tax jurisdictions.

Action 7 – Prevent the Artificial Avoidance of PE Status

Tax treaties generally provide that the business profits of a foreign enterprise are taxable in a State only to the extent that the enterprise has in that State a permanent establishment to which the profits are attributable. The definition of permanent establishment included in tax treaties is therefore crucial in determining whether a non-resident enterprise must pay income tax in another State. The report includes changes to the definition of permanent establishment in Article 5 of the OECD Model Tax Convention, which is widely used as the basis for negotiating tax treaties. These changes address techniques used to inappropriately avoid the tax nexus, including via replacement of distributors with commissionaire arrangements or via the artificial fragmentation of business activities.

Actions 8-10 – Assure that Transfer Pricing Outcomes are in Line with Value Creation

Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the arm’s length principle the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm’s length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm’s length principle. The work has focused on three key areas. Action 8 looked at transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are often hard-to-value. Misallocation of the profits generated by valuable intangibles has heavily contributed to base erosion and profit shifting. Under Action 9, contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Action 10 has focused on other high-risk areas, including the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation. The combined report contains revised guidance which responds to these issues and ensures that transfer pricing rules secure outcomes that better align operational profits with the economic activities which generate them.

The report also contains guidance on transactions involving cross-border commodity transactions as well as on low value-adding intra-group services. As those two areas were identified as of critical importance by developing countries, the guidance will be supplemented with further work mandated by the G20 Development Working Group, which will provide knowledge, best practices, and tools for developing countries to price commodity transactions for transfer pricing purposes and to prevent the erosion of their tax bases through common types of base-eroding payments.

Action 11 – Measuring and Monitoring BEPS

There are hundreds of empirical studies finding evidence of tax-motivated profit shifting, using different data sources and estimation strategies. While measuring the scope of BEPS is challenging given the complexity of BEPS and existing data limitations, a number of recent studies suggest that global CIT revenue losses due to BEPS could be significant. Action 11 assesses currently available data and methodologies and concludes that significant limitations severely constrain economic analyses of the scale and economic impact of BEPS and improved data and methodologies are required. Noting these data limitations, a dashboard of six BEPS indicators has been constructed, using different data sources and assessing different BEPS channels. These indicators provide strong signals that BEPS exists and suggest it has been increasing over time. New OECD empirical analyses estimate, while acknowledging the complexity of BEPS as well as methodological and data limitations, that the scale of global corporate income tax revenue losses could be between USD 100 to 240 billion annually. The research also finds significant non-fiscal economic distortions arising from BEPS, and proposes recommendations for taking better advantage of available tax data and improving analyses to support the monitoring of BEPS in the future, including through analytical tools to assist countries to evaluate the fiscal effects of BEPS and impact of BEPS countermeasures for their countries. Going forward, enhancing the economic analysis and monitoring of BEPS will require countries to improve the collection, compilation and analysis of data.

Action 12 – Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements

The lack of timely, comprehensive and relevant information on aggressive tax planning strategies is one of the main challenges faced by tax authorities worldwide. Early access to such information provides the opportunity to quickly respond to tax risks through informed risk assessment, audits, or changes to legislation. The Action 12 report provides a modular framework of guidance drawn from best practices for use by countries without mandatory disclosure rules which seeks to design a regime that fits those countries’ need to obtain early information on aggressive or abusive tax planning schemes and their users. The recommendations in this report do not represent a minimum standard and countries are free to choose whether or not to introduce mandatory disclosure regimes. The framework is also intended as a reference for countries that already have mandatory disclosure regimes, in order to enhance the effectiveness of those regimes. The recommendations provide the necessary flexibility to balance a country’s need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

Action 13 – Re-examine Transfer Pricing Documentation

Improved and better-coordinated transfer pricing documentation will increase the quality of information provided to tax administrations and limit the compliance burden on businesses. The Action 13 report contains a three-tiered standardised approach to transfer pricing documentation, including a minimum standard on Country-by-Country Reporting. This minimum standard reflects a commitment to implement the common template for Country-by-Country Reporting in a consistent manner. First, the guidance on transfer pricing documentation requires multinational enterprises (MNEs) to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies in a "master file" that is to be available to all relevant tax administrations. Second, it requires that detailed transactional transfer pricing documentation be provided in a "local file" specific to each country, identifying material related-party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions. Third, large MNEs are required to file a Country-by-Country Report that will provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued and other indicators of economic activities. Country-by-country reports should be filed in the ultimate parent entity's jurisdiction and shared automatically through government-to-government exchange of information. In limited circumstances, secondary mechanisms, including local filing can be used as a backup. An agreed implementation plan will ensure that information is provided to the tax administration in a timely manner, that confidentiality of the reported information is preserved and that the Country-by-Country Reports are used appropriately.

Taken together, these three documentation tiers will require taxpayers to articulate consistent transfer pricing positions, and will provide tax administrations with useful information to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. By ensuring a consistent approach to transfer pricing documentation across countries, and by limiting the need for multiple filings of Country-by-Country Reports through making use of information exchange among tax administrations, MNEs will also see the benefits in terms of a more limited compliance burden.

Action 14 – Make Dispute Resolution Mechanisms More Effective

Countries recognize that the changes introduced by the BEPS Project may lead to some uncertainty, and could, without action, increase double taxation and MAP disputes in the short term. Recognising the importance of removing double taxation as an obstacle to cross-border trade and investment, countries have committed to a minimum standard with respect to the resolution of treaty-related disputes. In particular, this includes a strong political commitment to the effective and timely resolution of disputes through the mutual agreement procedure. The commitment also includes the establishment of an effective monitoring mechanism to ensure the minimum standard is met and countries make further progress to rapidly resolve disputes. In addition, a large group of countries has committed to quickly adopt mandatory and binding arbitration in their bilateral tax treaties.

Action 15 – Develop a Multilateral Instrument

Drawing on the expertise of public international law and tax experts, the Action 15 report explores the technical feasibility of a multilateral instrument to implement the BEPS treaty-related measures and amend bilateral tax treaties. It concludes that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. Based on this analysis, a mandate has been developed for an ad-hoc group, open to the participation of all countries, to develop the multilateral instrument and open it for signature in 2016. So far, about 90 countries are participating in the work on an equal footing.

Notes

1. References to OECD and G20 countries also include Colombia and Latvia.

2. Albania, Argentina, Australia, Austria, Azerbaijan, Bangladesh, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, People's Republic of China, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Morocco, Netherlands, New Zealand, Nigeria, Norway, Peru, Philippines, Poland, Portugal, Russian Federation, Saudi Arabia, Senegal, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, United Kingdom, United States and Vietnam.

3. Available at www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf.

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OECD/G20 Base Erosion and Profit Shifting Project

BEPS Project Explanatory Statement

Addressing base erosion and profit shifting is a key priority of governments around the globe. In 2013, OECD and G20 countries, working together on an equal footing, adopted a 15-point Action Plan to address BEPS.

Beyond securing revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers. A key focus of this work is to eliminate double non-taxation. However in doing so, new rules should not result in double taxation, unwarranted compliance burdens or restrictions to legitimate cross-border activity. This Explanatory Statement offers an overview of the BEPS Project and outcomes.

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