

U.S.-BASED PUSHBACK ON B.E.P.S.

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Tags

Arm's Length
Base Erosion
B.E.P.S.
C.F.C.
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M.A.P.
Return on Capital
Risk Shifting
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INTRODUCTION

In addition to the aggressive actions by some foreign countries to levy more taxes on U.S. taxpayers before a consensus has been reached, the process established by the O.E.C.D. raises serious questions about the ability of the United States to fully participate in the negotiations.

Ultimately, we believe that the best way for the United States to address the potential problem of B.E.P.S. is to enact comprehensive tax reforms that lower the corporate rate to a more internationally competitive level and modernize the badly outdated and uncompetitive U.S. international tax structure.

So say Representative Dave Camp (R) and Senator Orrin Hatch (R), two leading Republican voices in Congress, on the O.E.C.D.'s B.E.P.S. project.

Does this somewhat direct expression of skepticism represent nothing more than U.S. political party politicking or a unified U.S. government position that in fact might be one supported by U.S. multinational corporations? The thought of the two political parties, the Administration and U.S. industry agreeing on a major political/economic issue presents an interesting, if unlikely, scenario. This article will explore that scenario.

OVERVIEW OF B.E.P.S./WHY B.E.P.S.?/WHY NOW?

Base erosion and profit shifting ("B.E.P.S.") refers to tax planning strategies that exploit gaps and mismatches in tax rules in order to make profits "disappear" for tax purposes or to shift profits to locations where there is little or no real activity and the

taxes are low. This results in little or no overall corporate tax being paid.⁶

The B.E.P.S. Action Plan sets forth 15 actions to improve, in the words of the O.E.C.D., “coherence, substance and transparency” and to address tax gaps arising from the digital economy. The Action Plan calls for a multilateral instrument that countries can use to implement the measures developed in the course of the work by the O.E.C.D. The Action Plan was released in July of 2013. In September 2013, the leaders of the G20 countries meeting in St. Petersburg endorsed the Action Plan. The O.E.C.D. is set to deliver final guidance in September on several of those items, including intangible property and documentation. From a macro-economic viewpoint, B.E.P.S. is based on the following self-serving paradigms.

The O.E.C.D. is convinced that:

- There is tax rate arbitraging being done by multinational corporations that use transfer pricing to shift income to low tax jurisdictions and expenses to high tax jurisdictions.
- There is shifting of intangible property and resulting royalties and license fee income to low tax jurisdictions. This is a primary goal of multinational corporations given the rise of information technology and other knowledge-intensive industries that exploit intangible assets currently owned by companies or potentially developed in the future.
- National governments aid and abet tax avoidance by cutting corporate tax rates (e.g., E.U. countries) or creating tax regimes designed solely to attract foreign investors (e.g., U.S. portfolio debt and patent box legislation in several E.U. countries). A complicating factor here is the potential reaction of emerging markets and developing countries considering their own form of international tax competition.

The specific B.E.P.S. Action Plan items operate within these paradigms to address the perceived areas of concern.

Four actions in the B.E.P.S. Action Plan (Actions 2, 3, 4, and 5) focus on ensuring that tax deductible payments by one person will result in income inclusions for the recipients so that double non-taxation is avoided.

In the area of transfer pricing, the O.E.C.D. seeks to address issues such as returns related to over-capitalization, risk, and intangible assets. It is important to note that the O.E.C.D. is considering special rules, either within or beyond the arm’s length principle, to correct these issues. Five actions in the B.E.P.S. Action Plan focus on aligning taxing rights with substance in order to ensure that tangible economic substance exists for an entity, as evidenced by office space, tangible assets, and employees (Actions 6, 7, 8, 9, and 10).

⁶ “BEPS - Frequently Asked Questions,” O.E.C.D., <http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>

The Action Plan also outlines certain procedures to improve transparency, such as:

- Improved data collection and analysis regarding the impact of B.E.P.S.;
- Taxpayers' disclosure about tax planning strategies; and
- Less burdensome and more targeted transfer pricing documentation.

Four actions in the B.E.P.S. Action Plan focus on improving transparency (actions 11, 12, 13, and 14).

U.S.-BASED CONCERNS REGARDING THE B.E.P.S. ACTION PLAN

The U.S. Government's main goal is to prevent other countries from taxing what it views as "its" tax base through B.E.P.S. While the U.S. government policy makers appear to broadly agree with the O.E.C.D. that the issues addressed by B.E.P.S. should be remedied, they seem to disagree that a multilateral framework is the best solution for addressing these problems. The following discussion reviews the B.E.P.S. Action Plans and notes U.S. pushback on certain aspects. The pushback has taken the form of proposed alternatives, comments, and an expressed view to reserve judgment on implementation to a later time. The U.S. business community likewise is concerned. This reflects recent intense scrutiny of U.S. multinational corporations' tax affairs by certain E.U. countries.

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 characterization 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 business models in this sector.

Comments

The Digital Economy Task Force ("D.E.T.F.") was established in September of 2013 under the leadership of Thomson Reuters. The goals of the D.E.T.F. are "to educate the public and work collaboratively across stakeholder groups, including government agencies, law enforcement, corporations, academia, public and non-profit agencies, as well as key industry players." The D.E.T.F. seeks an approach that "will be a balanced view of both the advantages and disadvantages surrounding the digital economy."

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There is little support among members of the D.E.T.F. for adopting a “virtual” permanent establishment. The concern is whether there will be a mistaken emphasis on attributing the revenue rather than a cogent approach to attributing the deductions to a “significant digital presence.”

Tax Executive Institute (“T.E.I.”) is the principal worldwide organization of in-house corporate tax executives with chapters in Europe, North America, and Asia representing over 3,000 of the largest companies in the world. T.E.I. issued comments on Action Plan 1 in April.

T.E.I. agrees that it is not correct to arbitrarily label enterprises “digital” or “non-digital” as the case may be. However, T.E.I. opposes options set forth in Section VII, including modifications to the permanent establishment exemptions, a new nexus standard based on significant digital presence, a virtual permanent establishment, and creation of a withholding tax regime on digital transactions.

These options are all generally unworkable as far as T.E.I. is concerned. They are not aligned with either G20’s statement that profits should be taxed where they are located, nor other B.E.P.S. Action Plans themselves, such as Action Plan 7 on Permanent Establishments; 8, 9, and 10 on Transfer Pricing; 2 on Hybrids; 4 on Base Erosion; and 6 on Treaty abuse. T.E.I. notes that digital businesses face similar issues in moving assets across jurisdictional lines as do traditional businesses. Digital business assets constituting intangible property, technical expertise, and similar intangible assets often present more complex cross border tax issues than are encountered when more traditional tangible assets are transferred. Improper initiatives relative to the taxation of digital businesses could very easily result in the taxation of these enterprises multiple times with regard to the same transaction.

Other measures noted in the Action 1 Discussion Draft would aim to restore taxation in both the market country and the country of the ultimate multinational parent. T.E.I. notes that many of these measures are designed to address low effective tax rates which are the result of deliberate tax policies of the O.E.C.D.’s Member States. T.E.I. concludes that most of the tax issues identified by the O.E.C.D. with respect to the digital economy could be addressed by proper application of existing international tax principles.

ACTION 2: Neutralize the effects of hybrid mismatch arrangements

Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize 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 coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.

Comment

The main debate with respect to the hybrid mismatch arrangements is whether the O.E.C.D. will adopt a top-down approach to curb some types of hybrid arrangements (which could apply to any debt instrument that is held cross-border) or instead use a bottom-up approach, which would only apply to instruments held between related parties (including parties acting in concert as well as hybrid financial instruments entered into as part of a structured arrangement).

The I.R.S. has expressed disagreement with the top down approach, contending that it would be largely unworkable, requiring testing for exceptions in all cases. It is also concerned with practical issues such as effective administration of the recommended action plan. While the goals are specific, the remedy is vague and application of vague remedies in different countries can easily result in multiple adjustments that reach conflicting results – all countries involved in the cross border transaction assert primary jurisdiction to impose tax. This should be compared to a belief that is shared by multiple countries that wide latitude must exist for application of enforcement mechanisms. The I.R.S. is attempting to have the topic of controlled foreign corporations (“C.F.C.’s”) included in the draft on hybrid arrangements.

The I.R.S. also has expressed disagreement with a proposal under the hybrid discussion draft that would reduce the required ownership between companies to 10% in order for the entities to be considered to be related. Again, the I.R.S. believes that this would lead to an increased burden on effective administration. The I.R.S. will attempt to raise the threshold in future discussions. Discussions on this point have gravitated to a higher threshold, generally 25%, with perhaps 50% in certain cases.

ACTION 3: Strengthen C.F.C. rules

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

Comments

The work in this area is consistent with current U.S. international tax reform proposals that generally seek to broaden the non-U.S. source income tax base of multinational corporations.

In November of 2013, the “Baucus Discussion Draft” was released by Senator Baucus under the auspices of the Senate Finance Committee. The Discussion Draft is notable in its attempt to address in an entirely U.S. context many of the same international tax issues addressed by the O.E.C.D. in B.E.P.S. Action Plans 2 (Hybrid Mismatch Arrangements), 3 (Strengthening CFC Rules), 4 (Limit Base

Erosion via Interest Deductions and Other Financial Payments), and 8, 9, and 10 (Transfer Pricing).

With respect to C.F.C. rules the Baucus Discussion Draft would replace the current U.S. deferral system with a statutory scheme referred to as “Option Y” or an alternative proposal referred to as “Option Z.” Either one could replace the concept of deferring non-U.S. source income with a system under which all income of foreign subsidiaries of U.S. companies would either be taxed currently at a certain minimum rate or be permanently exempt. Both options would result in subjecting a greater portion of C.F.C. income to U.S. taxation on a current basis.

A tax reform proposal was also released by the House Ways and Means Committee’s Chairman Camp in February 2014 (“the Camp Draft Plan”), which would similarly broaden the corporate tax base and prevent base erosion. However, the Camp Draft Plan would take a different approach than the Baucus Discussion Draft, by proposing an essentially territorial tax system through a 95% dividends received deduction. Like the Baucus Discussion Draft, the Camp Draft Plan would expand Subpart F income by creating a new category of Subpart F income (foreign base company intangible income). It would also impose a one-time retroactive tax on previously untaxed foreign earnings, albeit at a lower rate. Unlike the Baucus Discussion Draft, which does not commit to any particular corporate tax rate, the Camp Draft Plan would lower the corporate tax rate to 25%.

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 coordinated with the work on hybrids and CFC rules.

Comment

Action Plan 4 raises issues regarding the application of transfer pricing principles to the level of debt and the rate of interest payable. It also questions the freedom of enterprises to determine the amounts of funding that can be raised through the issuance debt and equity that appears on a balance sheet.

I.R.S. and Treasury note that it is a basic tenet of the arm’s length principle endorsed by the Action Plan (at least, in principle) that the tax treatment within a country should essentially be the same whether payments are made to a foreign group entity or to a third party. I.R.S. and Treasury also believe that a natural extension of this view, market dynamics of capitalization, and interest costs should

control deductions claimed for interest rather than the tax exposure faced by the lender. Under this view, the taxable status of the lender simply is not relevant.

Having said this, Action Plan 4 may align nicely with current U.S. tax laws restricting interest deductions found in the I.R.C. 163(j) earnings stripping rules, as well as legislative proposals from both Congress (Rep. Camp) and the Administration regarding thin capitalization and deferral of interest deductions attributable to un-repatriated earnings.

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.

Comment

In an early statement on point (June 2013 at the O.E.C.D. International Tax Conference in Washington D.C.), Robert Stack, U.S. Treasury Deputy Assistant Secretary for International Tax Affairs, Office of Tax Policy, stated in general that the B.E.P.S. Action Plans face both technical and political challenges. From the U.S. standpoint, B.E.P.S. should focus on addressing the stripping of income from higher-tax jurisdictions into low-tax or no-tax jurisdictions rather than on a fundamental reexamination of residence and source country taxation. Mr. Stack stated that the actions of both companies and governments should be examined, and he admitted that the U.S. “check the box” regulations have weakened the U.S. C.F.C. rules.

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.

Comment

Action 6 seeks to prevent treaty abuse and develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances

The U.S. is currently reflecting on its own limitations on benefits (“L.O.B.”) article, some of which is unpopular with other countries. Some countries are requesting

arbitration or a mutual agreement procedure in the event that U.S. denies treaty benefits under an L.O.B. provision. Countries are also concerned that some legitimate transactions are being caught inadvertently by the L.O.B article. The I.R.S. accepts the basic merit of these comments.

The I.R.S. disagrees with the idea that a general avoidance rule is declared if one of the main purposes of a transaction is a tax benefit. In fact, the I.R.S. indicates that the U.S. will not join any multilateral treaty that has a main purpose test. If enacted, the U.S. will reserve judgment on the model treaty due to a “main purpose test.”

ACTION 7: Prevent the artificial avoidance of permanent establishment status

Develop changes to the definition of permanent establishment to prevent the artificial avoidance of permanent establishment 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.

Comment

Action Plan 7 seeks to develop changes to the definition of permanent establishment. The I.R.S. wishes to curtail some of the exceptions to permanent establishment status for preparatory and auxiliary activities so that specific kinds of activities are no longer considered auxiliary but are deemed to be core. The I.R.S. believes that the examples used by the O.E.C.D. to help identify core versus auxiliary activities primarily targets U.S. companies.

ACTIONS 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation

Action 8: Intangibles

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 arrangements.

Comment

A working party is currently debating the second prong of Action 8, which calls on countries to ensure that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation. The U.S. indicates that while it may not agree with the current proposed measures, they will be addressed at a later time.

The U.S. believes that measures to analyze difficult-to-value intangibles could instead be remedied by the Internal Revenue Code (“Code”) or special legislation. However, the I.R.S. has signaled that some measure should be taken to address

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the situation of offshore entities owning intangible property which is subject to zero tax.

The I.R.S. proposes assessing difficult-to-value intangibles using a contingent payment regime that measures value based on actual returns. Thus, it advocates a commensurate-with-income standard where the U.S. parent transfers an intangible out of the U.S. at an extremely low price. Under that approach, a tax authority could assert that when extremely low valuation was demonstrated at the time an intangible left the country after which the value became extremely high, the earlier valuation could be adjusted retroactively to the time of export from the U.S. This is the method that applies under Code §482.

The I.R.S. also fears that B.E.P.S. is focusing on territories that have a zero-tax regime, such as Bermuda, but is ignoring low tax regimes such as Ireland. However, the I.R.S. acknowledges analyzing a low-tax jurisdiction is more difficult compared to analyzing a no-tax jurisdiction.

The I.R.S. is confident that it will succeed in recalibrating the intangibles discussion draft. Specifically, it is confident in revising the rule for identifying the member of a multinational group that should be entitled to the returns on intangible property.

Note that the I.R.S. does not favor retroactive application of whichever action plan is proposed. Those that have already valued and “exported” intellectual property would continue to be protected.

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 coordinated with the work on interest expense deductions and other financial payments.

Comment

Action 9 seeks to address the problem of transferring risk among or allocating excessive capital to group members.

The I.R.S. opinion on cash is that the party having capital is entitled to an arm's length return for its use. According to the I.R.S., the debate should rather be about whether an equity return or a debt return is proper in the circumstances. The important goal according to the I.R.S. is that cash-box entities should file a return. Other countries argue that members of a multinational group are linked. For that reason, an arm's length cap is appropriate on the profits attributable to capital.

With respect to debt incurred between related parties, the I.R.S. is concerned with base erosion but maintains the view that this problem should not be addressed through B.E.P.S. Nonetheless, an arm's length rule could be applied in certain intercompany loans. For example, it could be applied when an intercompany loan carries an excessive rate of interest charged or when the amount of debt is excessive and should be recharacterized as equity. In these circumstances, a facts

and circumstance test should be used to determine the allowable interest rate and the status of the instrument issued in connection with the transfer of funds. In general, the I.R.S. disapproves of a view that a transaction is illegitimate merely because there is a lack of comparable transactions among independent parties.

Action 10: Other high-risk transactions

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 re-characterized; (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.

Comment

B.E.P.S. Action Plans 9 and 10 have been consolidated, with a September 2015 deadline in mind. Both task the B.E.P.S. project with changing the O.E.C.D. transfer pricing guidelines and possibly the O.E.C.D. Model Tax Convention Action 9 is directed to preventing “arbitrary profit shifting” when group members transfer risks internally or allocate excessive capital to other group members. Action 10 is directed to preventing groups from engaging in transactions that wouldn't, or would only very rarely, occur between third parties.

In July, the new head of the O.E.C.D. transfer pricing unit, Andrew Hickman, addressed a Transfer Pricing Conference sponsored by the National Association for Business Economics. He defined the foregoing Action Plan tasks in terms of analysis of risk and recharacterization. The unanswered question at this time is the extent to which taxation authorities would be required to accept the facts and circumstances presented by taxpayers so that authorities could not demand that taxpayers change their specific facts and circumstances.

At the same conference, Deputy Assistant Treasury Secretary Robert Stack stated that the U.S. would focus its efforts to ensure that (i) the current arm's length standard is clearly articulated and (ii) profits are attributable to the place of economic activities. Deputy Assistant Secretary Stack enunciated the U.S. position in the following language:

- The place of economic activities is where the assets, functions, and risks of the multinational are located;
- The U.S. must further ensure that any special measures agreed to at the O.E.C.D. are firmly anchored in these principles; and
- Legal and contractual relationships are ignored in determining intercompany prices only in unusual circumstances.

Deputy Assistant Secretary Stack reiterated the U.S. position that the arm's length standard is the best tool available to deal with the difficult issue of pricing among affiliates of a multinational group. He noted that the worldwide concern with the arm's length standard emanates in large part from worldwide dissatisfaction with the very low effective tax rates reported by major U.S. multinational companies.

Tension exists among countries as to the relative value of activities performed within their borders in the product supply chain. This creates an environment in which the blunt-instruments approach of the B.E.P.S. transfer pricing Action Plans has gained traction. Nonetheless, the U.S. intends to steadfastly avoid turning long-standing transfer pricing principles into a series of vague concepts easily manipulated by countries to serve their revenue needs at the expense of the U.S. tax base and U.S. multinational groups.

The U.S. concern with the B.E.P.S. transfer pricing Action Plans reflects current events. Within the last decade, the O.E.C.D. reaffirmed its commitment to the arm's length principle in its O.E.C.D. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, as amended on July 22, 2010. The O.E.C.D. has also expressly rejected a so-called formulary approach within the context of its transfer pricing guidance. In contrast to that position, the B.E.P.S. transfer pricing Action Plan principle challenges the arm's length principal. The B.E.P.S. Action Plan notes certain "flaws" in the arm's length principle, and contemplates "special measures, either within or beyond the arm's length principle," in order to address issues with respect to "intangible assets, risk and over-capitalization."

Needless to say, Action Plans 9 and 10 have turned the transfer pricing world on its head; at least one I.R.S. official cautions that we are on the verge of international tax chaos. The B.E.P.S. transfer pricing project team is on record that "the arm's-length principle is 'not something that is carved in stone,'" and if 'we come to the point where we recognize that there is a limit to what we can do with the arm's-length principle, we may need special measures—either inside, or even outside, the arm's-length principle—to really address these situations.'" In this context, it is felt that the O.E.C.D. may approve new transfer pricing rules inconsistent with the arm's length principle.

The U.S. position is that a move away from the arm's length principle would abandon a sound, tested theoretical basis including transfer pricing precedents. This would thereby substantially increase the risk of double taxation. Experience under the arm's length principle has become sufficiently broad and sophisticated to establish a substantial body of common understanding among the business community and tax administrations. This shared understanding is of great practical value in achieving the objectives of securing the appropriate tax base in each jurisdiction and avoiding double taxation. Policy makers at the I.R.S. and the Treasury Department recognize that improvements to the international transfer pricing regime can be achieved. However, prior experience with the arm's length standard should be drawn on to effect changes to it.

A former Director of the I.R.S. Office of Transfer Pricing, Samuel Maruca, was quoted recently as saying "B.E.P.S. could lead to international chaos if not managed well." The issue has apparently come to a head with respect to consideration of the Revised Discussion Draft on the Transfer Pricing Aspects of Intangibles. The O.E.C.D. position is seen by the U.S. as a departure from a traditional arm's length analysis of functions and risks and more towards a formulary approach. The O.E.C.D. position places less emphasis on ownership and contractual assumptions of risk and more emphasis on the location of individuals performing what are considered to be important functions in the concept to customer chain. This approach, combined with the new proposed country-by-country reporting template intended to act as a transfer pricing risk tool, raises the specter of a multinational equivalent of formulary apportionment so common in the U.S. among state income tax systems.



ACTION 11: Establish methodologies to collect and analyze data on B.E.P.S. 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 confidence.

Comment

A decision is yet to be made as to how multinational companies will share their country-by-country reporting templates with tax authorities. The working party is considering whether a U.S. multinational would give its template to the I.R.S. so the government can share it under the relevant U.S. treaty, which is subject to confidentiality rules, or follow some other process for sharing the information. The I.R.S. prefers the treaty approach but believes that the issue will not be addressed in 2014.

In general, the I.R.S. believes that most reporting requirements can be fulfilled by existing U.S. Law (Code §6038); however, it has refrained from passing judgment on this measure until it reviews the final draft of the B.E.P.S. reporting template.

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.

Comment

The information returns used in the U.S. for international tax compliance and reporting are under consideration as a template for worldwide tax transparency to track how profits are moved around the globe. Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations) gathers significant

legal and commercial information with respect to C.F.C.'s that may not be generally available to tax administrations around the world. Form 5471 is being considered by the G20 nations and the O.E.C.D. as the model for the type of information that may be requested by other countries. The form requires reporting by U.S. citizens or residents, domestic corporations, domestic partnerships, and certain estates and trusts of assets held in foreign corporations in which a direct or indirect ownership percentage of at least 10% exists. The requirements affect a broad range of other individuals and businesses, including U.S. citizens or residents who are officers and directors of these corporations.

Supplementing the Form 5471 are other information gathering forms such as:

- Form 8938 (Statement of Specified Foreign Financial Assets), implementing I.R.C. §6038D;
- Form 1120, Schedule UTP (Uncertain Tax Position Statement), which addresses the likelihood that certain positions taken on the tax return are correct; and
- FINCEN Form 114, the electronic successor to Form TD F90-22.1.

Thus, the work being done in conjunction with Action Plan 12 is generally seen as consistent with U.S. concepts of ongoing informational reporting.

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 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.

Comment

The key issue with Action Plan 13 has been the country-by-country reporting aspect of transfer pricing documentation. The U.S. corporate community has argued that this should not be undertaken for various commercial/legal reasons involving risks in disclosing proprietary business information. The Treasury has resisted country-by-country reporting in the past. However, with support from the G8 and G20 leaders the exercise has become not a "whether to" but a "how to" exercise.

Under the B.E.P.S. Action Plan, the information that is gathered is only to be used by tax administrations for purposes of risk assessment and should not take the place of a transfer pricing analysis. The I.R.S. is confident in its ability to conduct robust transfer pricing audits under the new Transfer Pricing Roadmap procedures, announced in February 2014. Accordingly, the I.R.S. and Treasury see Action Plan 13 as a secondary source of information. This is apparently consistent with the views of the O.E.C.D. working party dealing with Action Plan 13.

Action Plan 13 has been the subject of comments regarding several practical information reporting issues raised by industry. Examples include:

- Appropriate depreciation methods;
- Reporting for groups within a country on an aggregate basis rather than a separate legal entity basis;
- Reporting of inter-group transactions in the master file only;
- Disclosure of share capital and accumulated earnings; and
- Taxes being reported when and as paid, rather than accrued.

Many fear that Action Plan 13 may be bogged down in detail of financial reporting, trying to balance the risk of inappropriate or illegal access to company proprietary information.

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.

Comment

Action Plan 14 is the O.E.C.D.'s idea of a taxpayer-friendly initiative, which it feels should be welcomed by taxpayers. The Action Plan focuses on:

- Access to Mutual Agreement Procedure ("M.A.P.");
- Arbitration;
- Multilateral M.A.P.'s & Advance Pricing Agreements ("A.P.A.'s");
- Adjustment issues, including timing for corresponding adjustments, self-initiated adjustments, and secondary adjustments;
- Interest and Penalties;
- Hybrid Entities;
- Legal status of a mutual agreement;

This approach generally aligns with the I.R.S. approach as set forth in Notice 2013-78, issued in November 2013, which proposed updated guidance related to requesting U.S. Competent Authority with a view to "improve clarity, readability, and organization." The Notice also intended to reflect I.R.S. structural changes that have occurred since 2006.

On behalf of the U.S. corporate community, T.E.I. commented on Notice 2013-78 in March of 2014. Comments made by T.E.I. were that:

- Opening the Competent Authority process to taxpayer initiated adjustments was welcomed;

- Competent Authority-initiated M.A.P. cases and the required inclusion of M.A.P. issues that are not a part of the taxpayer's request for assistance elicited concerns and questions;
- Provision of all information to both Competent Authorities is overreaching, particularly where the information may not be relevant to a given Competent Authority; and
- The interplay between the foreign tax credit rules, that mandate the exhaustion of all remedies under the laws of the foreign country before a foreign tax is creditable, and the denial of U.S. Competent Authority assistance in an M.A.P. case raise fears that a U.S.-based group will be required to challenge a foreign-initiated adjustment in instances where the I.R.S. will not provide assistance through an M.A.P. case.

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.

Comment

Deputy Assistant Secretary Robert Stack has expressed concerns regarding the implementation of this B.E.P.S. Action Plan in the United States. Action Plan 15 was criticized in connection with its call for the development of a multilateral instrument. It was characterized as an idea that is not well-defined in terms of its process and substance with little opportunity of implementation.

CONCLUSION

B.E.P.S. Action items 1, 2, 5, 6, 8, 13 and 15 currently have a September 2014 target delivery date. The O.E.C.D. expects to present final reports at the G20 Finance Ministers Meeting. Draft reports for many of these action items were released in February and March, and related comments have been collected. The O.E.C.D. has admitted that it is working at a frantic pace to deliver the final reports by the target date in order to pre-empt the development of unilateral B.E.P.S. legislation and regulation in O.E.C.D. and G20 member nations.

In light of the quickly approaching target delivery dates, U.S. lawmakers and regulators have publicly expressed doubt about the progress and effectiveness of the project. The statements noted at the beginning of this article were joint statements released by Senate Finance Committee Ranking Minority Member Orrin Hatch and House of Representatives Ways and Means Committee Chairman Dave Camp in late June 2014. They focused on the time frame and progress of the implementation of the B.E.P.S. Action Plan as well as concerns that the plan is being used by other member nations to increase the taxes collected on U.S.

corporations. According to Messrs. Hatch and Camp, the September 2014 deadline for implementation of the seven early action items is extremely ambitious, which limits the ability to review, analyze and comment on the rules being proposed. Accordingly, Messrs. Hatch and Camp believe the process raises serious questions about the ability of the United States to fully participate in the negotiations. Nevertheless, comprehensive U.S. Federal income tax reform has been suggested to lower the corporate income tax rate to a level which is internationally competitive and to modernize the U.S. international tax system.

Deputy Assistant Secretary Stack has expressed general concern regarding the implementation of the B.E.P.S. Action Plans in the United States.

Congress, the Administration, and the corporate community share several basic views regarding B.E.P.S.:

- There are areas of international tax law that are the province of the U.S. and should be managed without the layering on top of a newly created set of rules and principles;
- The basic tenet of transfer pricing, the arm's length standard, should remain a cornerstone of international tax; and
- U.S. international tax reform is urgently needed to compliment B.E.P.S. Action Plans and to protect U.S. economic interests.

As with many overriding issues and ideas, the devil is in the details. Action other than rhetoric seems to be missing. The only thing that is certain is that the saga will continue.

