

## BUSY MONTH FOR B.E.P.S.

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### Tags

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### FOUR B.E.P.S. TAX PLANNING ITEMS COMPLETED

Working Party No. 11 of the Organization for Economic Cooperation and Development (“O.E.C.D.”) dealing with aggressive tax planning has completed work on four action items under the B.E.P.S. project.

Douglas Poms, Treasury acting deputy international tax counsel and a U.S. delegate to Working Party No. 11, said on July 28, 2015, that the working party finished its work on hybrid mismatch arrangements (Action 2), controlled foreign company (“C.F.C.”) rules (Action 3), deductibility of interest (Action 4), and mandatory disclosure rules (Action 12). For completion of the work full consensus was required. Getting full consensus from 60 countries was a challenge, and the process affected the deliverables.

On September 23, 2015, the O.E.C.D.’s Committee on Fiscal Affairs is scheduled to adopt recommendations on the remaining B.E.P.S. items, including Actions 2, 3, 4, and 12, which will be delivered to the G-20 finance ministers meeting in Lima, Peru on October 8, 2015.

### ACTION 3: C.F.C. RULES

With respect to the C.F.C. work on Action 3, Mr. Poms said that the issue of income not being taxed anywhere in the world is a big part of the B.E.P.S. problem. C.F.C. rules are a tool to make sure that certain types of income will be taxed somewhere, either in the jurisdiction where the C.F.C. is resident or in the jurisdiction where the parent is based. The U.S. had high hopes that the B.E.P.S. project would produce C.F.C. rules to address the B.E.P.S. problem. However, the work on Action 3 will not recommend a particular kind of C.F.C. rule and did not even produce a set of best practices guidelines for designing C.F.C. rules. The final report will reflect a series of optional provisions, including an excess profits approach. The excess profits approach is consistent with the 2014 budget proposal of the current Administration, which proposed imposing U.S. tax on the excess profits derived by an intangible transferred outside the U.S. if those profits are not otherwise taxed outside the U.S. at a rate of at least 10%.

Mr. Poms commented that, whereas the U.S. has strong C.F.C. rules, strong rules are missing from the tax laws of many other countries participating in the B.E.P.S. project. Some countries view C.F.C. rules as a tool that should be used sparingly, only for certain kinds of income, such as financial income, and not as a broader tool to address many B.E.P.S. issues. This may change as a result of the B.E.P.S. project.

## ACTION 2: HYBRID MISMATCH

With respect to hybrid mismatch arrangements (Action 2), Mr. Poms noticed a greater degree of consensus among working party delegates. While it was not easy to agree on the specific design of the rules, the working party produced a lengthy report that includes a specific ordering rule identifying priority by which countries touched by the hybrid arrangement may impose tax under the anti-hybrid rule.

Mr. Poms expects that after countries adopt the hybrid rules, anomalies will remain that will need to be addressed. He thought the working party can be a resource in eliminating the problem of possible double taxation because two affected jurisdictions view the transaction and the rule differently.

## ACTION 4: INTEREST EXPENSE

Interest expense deductions are regarded as a major contributor to the B.E.P.S. problem. Mr. Poms said that the working party was able to agree on a best practices rule regarding the amount of interest expense that should be deductible currently. The final report could be a ceiling expressed as a fixed percentage of E.B.I.T.D.A. – earnings before interest, taxes, depreciation, and amortization. This would be comparable to Code §163(j) of U.S. tax law. However, the percentage would be lower than the 50% of E.B.I.T.D.A. rule of that section, perhaps between 10% to 30% of E.B.I.T.D.A.

## PATH FORWARD

The U.S. has not yet committed to the B.E.P.S. initiative. Once the B.E.P.S. project ends, the U.S. will be cautious about how much it will commit to further O.E.C.D. work. The U.S. has invested an enormous amount of resources in the B.E.P.S. project and now has other priorities to address.

## CONGRESS PUSHES ON TREASURY

While the Treasury is directly involved in the B.E.P.S. project, Congress wants the Treasury to be clear on who writes tax law in the U.S., JCT Legislation Counsel Kristen Witt stated at a July 22, 2015 tax seminar held by the Practising Law Institute. To illustrate the level of congressional pressure that is now being applied to the U.S. Treasury Department, Ms. Witt pointed to a letter dated June 9, 2015, signed by Senate Finance Committee Chairman Hatch and House Ways and Means Committee Chairman Ryan. The letter questioned the legal basis for the Treasury's involvement in the B.E.P.S. country-by-country reporting regime. Additionally, congressional leaders seem to question the benefits to the U.S. in joining the B.E.P.S. guideline drafting process. In a floor speech given on July 16, 2015, Chairman Hatch expressed his opposition to using U.S. resources as bargaining chips for international agreements that may, or may not, advance the interests of the U.S.



## EUROPEAN SUPPORT

The Chairman of the European Parliament's Economic and Monetary Affairs ("ECON") Committee and his delegation expressed strong support for the B.E.P.S. project in a meeting with the Treasury in late July. ECON Chairman Gualtieri advised that economic democracies need a common alliance to address loopholes that have recently emerged. From a government viewpoint, the B.E.P.S. project is a win-win opportunity. Mr. Gualtieri repeated the O.E.C.D. mantra that the B.E.P.S. initiative is the way to avoid unilateral action, which countries may otherwise pursue to combat tax evasion. The project serves as a modern, efficient system of taxation in a multilateral framework.

Mr. Gualtieri said that automatic exchange of information and country-by-country reporting are top priorities in the European Parliament and that he is looking forward to the final B.E.P.S. report, which should include the O.E.C.D. final recommendation on country-by-country reporting.

## B.E.P.S. SIDE-EFFECT: DEMAND FOR TRANSFER PRICING REPORTS INCREASES

While the B.E.P.S. reports are not final, the project has already increased controversy and litigation around the world and has been a huge game changer for economists, as transfer pricing audits tripled in the past year.

Following the introduction of the B.E.P.S. proposed actions, multinational companies must defend not only transfer pricing policies but also the economic substance of their multinational structures. Katherine Amos, vice president of transfer pricing strategy at a multinational electric equipment maker, addressed a conference by the National Association for Business Economics. She commented that real-world comparables will be required to support a transaction in which one side pays all up-front costs for an item and then makes payments to a related party for the use of that item.

Under the country-by-country reporting regime developed by the B.E.P.S. initiative, companies are expected to include a description of the top five value chains and any value chain that accounts for 5% or more of the company's revenues. Economists will be required to develop strategies used in defining value chains.

Michael Heimert, a global leader on transfer pricing services at a firm of consulting economists, predicted that the B.E.P.S. project will change the way economists address transfer pricing. After the adoption of the B.E.P.S. recommendations, economists will have to be industry specialists in order to understand certain types of transactional analogues taking place in the real world.

Robert Weissler, an economist with the I.R.S., agrees that there may be an increasing need for economists with industry-specific expertise within the I.R.S. He explained that, if the B.E.P.S. project encourages a country to claim a share of tax jurisdiction on worldwide profits, it may require a coordinated industry effort to challenge the position.

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