

FINAL STAGES OF B.E.P.S. IMPLEMENTATION AND ITS EFFECTS

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The Organization for Economic Co-operation and Development (“O.E.C.D.”) is entering into the final implementation stages for the Base Erosion and Profit Shifting (“B.E.P.S.”) Action Plan. Many countries are attempting to meet the domestic implementation requirements by making some of the most significant changes in international taxation in decades.

According to one U.S. tax official, the changes enacted in chapters 1 and 6 of the O.E.C.D.’s transfer pricing guidelines on nonrecognition and intangibles will not result in radical policy changes. However, forthcoming changes to Actions 8, 9, and 10, which will not be disclosed until early October, are likely to have a more substantial impact.

CHANGES IN MEXICO

For many years, Mexico has been attracting companies with corporate tax breaks. But, encouraged by the O.E.C.D.’s campaign to fight profit shifting (which Mexico officially joined in 2014) and faced with decreasing oil exports, the government has recently begun looking for alternative sources of revenue.

V.A.T. Refunds

Since President Enrique Peña Nieto took office in late 2012, Mexico’s tax authority, the *Servicio de Administración Tributaria* (“S.A.T.”), has held back more than \$384 million in Value Added Tax (“V.A.T.”) refunds from Procter & Gamble, Unilever, and Colgate and initiated probes of 270 other multinationals for possible tax avoidance.

Many believe that the Mexican government is attempting to gain leverage in negotiations with multinationals that use tax planning to reduce corporate income tax. The apparent goal is to convince multinationals that they have no other choice but to submit to paying higher corporate income taxes in exchange for refunds of V.A.T.

It is believed that Unilever has reached an agreement to pay more income tax in Mexico and receive an estimated \$131 million in V.A.T. refunds, while Procter & Gamble and Colgate have yet to settle any agreement. However, the three corporations declined to comment on V.A.T. refund and income tax matters in Mexico. A panel of six tax experts interviewed by one news agency expressed a uniform view that linking V.A.T. refunds to income tax agreements violates Mexico’s constitution. Other experts have been less absolute, stating that the Mexican government is operating in a gray area.

In Mexico, V.A.T. is imposed on the sale of goods as well as services and is part of the principal taxes in the Federal tax structure. For those unfamiliar with the V.A.T. regime, the amount of V.A.T. paid by a business within a specified period is measured against V.A.T. collected from end users. If the payments of V.A.T. exceed the collections, the excess is refunded to the business.

The Mexican constitution, as interpreted by the courts, allows the government to act only when expressly authorized by law and provides that taxation must be proportionate. Mexican law requires that authorities refund any amount due and treat taxpayers in the least “onerous” way possible.

Cathy Schultz, vice president for tax policy at the National Foreign Trade Council, a U.S.-based trade group, said its members have complained about the practice in Mexico, using terms such as “strong-arm tactic” and “political extortion,” she said.

Previously, the top 132 foreign corporations paid less than 1.5% in corporate tax as a percentage of gross income in Mexico. But now, the taxes paid have increased as a percentage of gross income. The campaign to join other countries in the fight against profit shifting to low-tax countries and delays associated with the V.A.T. refunds may make Mexico an unwelcoming country for the big businesses.

The S.A.T. denies the delay in V.A.T. refunds are part of a plan to pressure companies into paying more income tax. One S.A.T. spokesperson suggested that the government encountered inconsistencies in some refunds and decided that detailed reviews were required before refunds would be issued. The government focused on companies with the largest refunds, as a matter of proper risk management.



IMPLEMENTATION IN CHINA

China is also planning to adopt key concepts from the B.E.P.S. project and is expected to release a revised draft of Circular No. 2 (2009) that would revamp the nation's transfer pricing rules. China's State Administration has been an active participant in the B.E.P.S. project and has placed bilateral advance pricing arrangements on hold in order to fully devote international tax resources to the project.

COUNTRY-BY-COUNTRY REPORTING

Action 13 will include a country-by-country reporting template, master file, and local file. Many countries have embraced these proposed changes; the question no longer is whether the measures will be adopted but rather when and how they will be adopted.

Australia has issued draft legislation that is scheduled to be adopted on or before January 1, 2016. South Korea has adopted the master file and local file for income years beginning on or after January 1, 2016 and will wait to adopt a country-by-country reporting template until action by other countries has been reviewed.

STATELESS INCOME

The concept of stateless income has significantly effected international tax policy and has been a major point for the B.E.P.S. Action Plan. The changes implemented as a result of the country-by-country reporting template and revised transfer pricing guidelines are expected to encourage multinational companies to move cash entities from zero-tax to lower-tax jurisdictions. Leaving such entities in a zero-tax jurisdiction will increase audit risk for multinational companies. As for changes to the transfer pricing guidelines, companies will be required to allocate risks to countries where risks can actually be controlled or to countries that have the financial capacity to bear those risks. In other words, the mere undertaking of a legal risk without the wherewithal to make payment when the risk materializes will not be tolerated by tax authorities.

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PATENT BOXES

The rise of the so-called Patent Box Regime is an unintended consequence of the B.E.P.S. project. A patent box imposes a special, ultra low tax rate on business income that is derived from intangible property. Germany and the U.K. have developed an acceptable Patent Box Regime that has been incorporated into Action 5. The U.K. Patent Box Regime has a 10% rate for patent-related profits, which is roughly half the country's overall corporate tax rate. Germany will wait until the B.E.P.S. project is complete to decide whether to adopt a Patent Box Regime.

The final B.E.P.S. instrument will be approved on September 23, and it will be delivered by the C.F.A. to the G20 finance ministers in Lima, Peru on October 8, 2015. Many believe that full implementation of the B.E.P.S. Action Plan will eliminate tax benefits that enticed U.S. corporations to move intangible property ownership to jurisdictions having Patent Box Regimes. The unknown factor is whether these U.S. corporations will return the ownership of intangible property to the United States.