

government would 'propose supplementary rules' to tackle issues raised by digital business if progress on updating the existing international framework 'fails to materialise' (see preceding table). There is no indication yet that the UK government might launch a formal consultation on domestic tax policy. Ireland is consulting on how its domestic tax system might best respond to the changing international tax environment.

### 'We have to be part of the solution'

Responding to a debate at the OECD forum on tax and development in May, **Alan McLean**, tax vice-president at **Royal Dutch Shell** in the Netherlands and vice chair of the taxation and fiscal policy committee at **BIAC**, the business and industry advisory committee to the OECD, said there have been 'lots of suggestions' that multinationals are 'part of the problem'.

He added: 'If that is the case, and I'm open minded about that, then we also have to be part of the solution. Governments, businesses and citizens need to work together to ensure that there is the right capacity, that the right tax rules are put in place and that they are administrable – this is at the heart of the solution.'

But some tax professionals are beginning to voice concerns. **EY** said a recent survey has identified as a 'new risk' the BEPS agenda's 'galvanizing effect on tax administration'. Many companies have reported that the approach of tax administrations seems to be changing, 'ahead of any law changes that may be made as a result of BEPS recommendations'. These early actions 'may actually threaten the coherence of the overall BEPS project', the firm said.

*Reported by Andrew Goodall, freelance tax writer and journalist (andrewgoodallcta.com).*

## What does success look like for BEPS, and what is failure?

### Philip Baker QC

Barrister, Tax Chambers, Gray's Inn  
Email: pb@taxbar.com.



**Any major project undertaken by a corporation or a public body ought to have criteria for determining the success or failure of the project. The BEPS project is to last for at least two and a half years, and involves a significant commitment of resources both by the OECD, by participating governments, and by business and civil society in commenting on the proposals. It is perfectly appropriate, now that the project has been underway for a little over a year, to ask what are the criteria for success or failure.**

If we are to evaluate the criteria for judging success or failure, then the starting point has to be an identification of the real BEPS problems. Success would then be the resolution of those problems; failure would be their continued existence. Unfortunately, there is more than one candidate for the real target of the BEPS project.

### What are the real problems?

The first possible candidate is the public disquiet at the low effective tax rates paid by some multinational companies, including some of the largest multinationals with their headquarters in the US. This is what one might refer to as the

'Margaret Hodge' factor. This public disquiet has been fanned by parliamentary committees on both sides of the Atlantic and by newspaper journalists who have found a new interest in tax matters. However, parliamentary committees and newspaper journalists – as with the public – can be somewhat fickle, and one wonders if this public disquiet will survive the end of fiscal austerity. Assuming that austerity ends relatively soon, will the public continue to be concerned about multinationals paying low taxes? Or will they recognise that higher taxes would need to be reflected in more expensive products, lower returns on shareholdings, or lower payments to employees, all of which would hit the public in one way or another.

Quite a strong, second candidate for the real BEPS problem is the dysfunctional nature of the US tax system, particularly the US taxation of international income. A series of changes over the last 15 years has ensured that US headquartered multinationals enjoy very low effective tax rates. Highest amongst the culprits was the introduction of the 'check the box' system, plus the reform of the CFC rules to make them largely ineffective. The consequence of these changes is that the US tax system – theoretically a worldwide system – has become territorial in practice, so long as US multinationals can avoid remitting their profits to the US.

Viewed by some across the Atlantic and outside the European Union, however, the real BEPS problem is the continued existence of regimes of harmful tax competition, particularly among European countries. The prevalence of patent boxes and similar regimes, as well as the ruling practices in certain countries, has created fertile ground for multinationals to bring down their low effective tax rates.

Finally, and more broadly, some would say that the real BEPS problem is the diminishing acceptance of the traditional international tax order, developed between the end of the First World War and the start of the 21st century. In particular, this traditional international tax order is not necessarily accepted by all of the BRICS or developing countries. The diminishing acceptance is seen in the reduced acceptance of tax treaties based on the OECD Model and the rejection of traditional transfer pricing approaches.

Looked at from the perspective of the problems that the BEPS project is setting out to solve, some people would see success in the US abandoning the 'check the box' system and making the Sub-Part F rules effective once more. On the other hand, others would say that the continued existence of patent box regimes would prove the failure of the BEPS project.

With these comments in mind, one can perhaps suggest what success looks like (and what failure might look like).

### What would success look like?

It is important to put aside the fact that the BEPS project will be declared a success by government leaders, no matter what the outcome. The real question is how hollow will the sounds of triumph ring when the G20 leaders declare the project a success.

Real success would involve the restoration of an element of stability in the international tax system. Key for businesses would be the certainty of outcome when they trade or invest across borders. Ideally, there would be a consensus worldwide as to the principles of the new international tax order, and this consensus would ensure the removal of the barriers to trade and investment that can arise from double taxation, or from uncertain and unpredictable interventions by revenue authorities. Ideally, success would involve a reduction in disputes over cross-border taxation, or at least it should involve

---

an improved resolution mechanism for tax disputes. Arguably, success should involve a greater revenue contribution from the large multinationals (though this is debatable, given that the burden of that larger contribution is going to flow to the public in one way or another).

### And what is failure?

Taking these as criteria of success, failure can be identified as the converse. The BEPS project will be seen to be failing if it is clear that agreement between the countries participating is becoming more and more delayed, and elements of the 15 point action plan are being abandoned. One difficulty here is that the work on the 15 action point is being delivered at different times: the first tranche is delivered for September 2014, and the second tranche for September 2015. However, in reality, these elements are interlinked and it may prove difficult (if not impossible) to get full agreement on the first tranche until it is clear what the second tranche is going to look like.

The project will also be seen to be failing if it is clear that certain countries are not on board to implement the conclusions. That would involve not only countries that do not join in the approval of some of the BEPS outcomes, but also countries that may appear superficially to approve but in practice are unlikely to implement the outcomes.

In the long term, failure of the project will be seen in a continuing instability in the international tax system and a lack of certainty of the outcomes for businesses trading and investing cross-border. It will be seen in countries adopting unilateral measures, rather than acting by way of consensus, and by unrelieved double taxation becoming more and more of a barrier to trade and investment. In that environment, tax disputes may also increase, with more and more of them remaining unresolved. Curiously, a greater revenue contribution from large multinationals may itself be evidence of failure, particularly if that contribution is passed on in lower wages and fewer employment opportunities in some countries, particularly developing countries.

### The dangers to the OECD

Both success and failure may have implications for the institutional structure of the international tax order. The OECD has dominated the work on international tax since the late 1950s, but its role in that position is something of a historical accident, caused by the decision of the UN to close down its Fiscal Commission when it became mired in Cold War arguments. There is no logical reason why the OECD should not yield up that role now that the Cold War is over.

There are dangers to the OECD both in success and failure. As far as success is concerned, the BEPS project is a venture driven by the G20, with the OECD acting as secretariat, cheerleader and works foreman. However, if the G20 can deliver a major success, why should it not become the leading body on international taxation? In fact, why should the G20 not establish a World Tax Organisation to take forward the work?

On the other hand, a clear failure of the project would be labelled as the OECD's failure. It will have failed to deliver consensus or solutions to the problems. In that situation, there are quite a number of other bodies waiting in the wings to take over the institutional mantle from the OECD. These include the United Nations; this is probably the best candidate in terms of its having the broadest representation, but the UN could not take on this work under its current institutional structure,

where the work of the Committee of Experts covers only a very narrow agenda. Other candidates are the World Bank and, in particular, the IMF – which is already making a claim to broader representation.

---

## Some would say that the real BEPS problem is the diminishing acceptance of the traditional international tax order

---

The BEPS project has already lasted for a year without any overt debate on the criteria on success or failure. In part, this is due to the rapidity with which the project was initiated. However, as the project enters its second year, it is appropriate to give some thought to what success or failure will ultimately look like.

### How some countries are going it alone

**Chris Sanger**  
Global head of tax policy, EY  
Email: csanger@uk.ey.com.



**The unilateral policy changes being made by some countries risk undermining the coherent approach to reform which the BEPS project is seeking to achieve.**

A key driver behind the OECD/G20 BEPS project was to change the international tax architecture in unison and thereby reduce risks to international trade. Unilateral action risks creating double taxation, something that the OECD has long sought to avoid.

However, since the action plan was published, we have seen a range of BEPS inspired policy changes across the globe and across the broad categories of cross-cutting, coherence, substance and transparency. To some extent, this is to be expected, as the BEPS discussions have helped to ensure a shared understanding of tax risks.

### Action on cross-cutting issues

We might be forgiven for thinking that action 1 – on the digital economy – is among the least well suited to unilateral action, given how quickly the sector changes. But at the same time, digital is one of the sharpest political pressure points around BEPS, with key players featuring prominently in the public debate. To date, we have seen various changes, from adopting a broader interpretation of the permanent establishment (PE) rules in countries such as Spain and India, to the consideration of a tax on the purchase of online advertising space in France. This idea has not been pursued, but the government has called for the OECD to redefine PE at a treaty level.

### Action on 'coherence' issues

Going solo on actions 2 and 4 (hybrid mismatches and interest deductibility) always looked more likely, as a number of

countries already operate rules in this area. The risk, of course, is that moving first will expose movers to competition from non-movers, with diversions in investment flows. Nevertheless, we have seen unilateral action through tax reform in Mexico, which included rules targeting certain interest, royalty and technical services payments to related parties where payments are not taxed. Elsewhere, the Board of Taxation in Australia released a consultation paper inviting comment on whether improvements can be made to address any inconsistencies between debt and equity rules in other jurisdictions. Proposals in Japan include denying participation exemption of foreign source dividends that are deductible in the source country. And in a show of mini-multilateralism, the EU has amended the Parent and Subsidiary Directive to address hybrids.

Action 3 – strengthening controlled foreign companies (CFC) rules – is another case where the risk of unilateral action exists and we have seen new or strengthened CFC rules coming in across a slew of countries, including Australia, Chile, China, Greece, Israel and New Zealand. Russia has proposed CFC rules applying to entities in which the Russian taxpayer (individual or legal entity) has an influence or a direct or indirect holding of more than 10%, and which are resident in specific ‘blacklisted’ countries.

### Action on ‘substance’ issues

Action 6 covers treaty abuse and we have seen an increased focus here in jurisdictions as diverse as China, Israel and Vietnam (all have issued anti-treaty shopping guidance with strict beneficial ownership criteria). Meanwhile, India has seen an increased focus by tax authorities on claims for treaty benefits. Mexican tax reform also includes a provision that could restrict access to treaties or impose additional administrative requirements.

On the definition of permanent establishments (PE) – action 7 – there have been national moves in Belgium and the Slovak Republic where the permanent establishment definition has been broadened, including by introducing the concept of a service PE.

There has been a good deal of activity on transfer pricing (actions 8, 9 and 10), with changes in Poland, Mexico, France, Australia and the Netherlands. While these may not stem directly as a result of the BEPS project, they are generally consistent with its goals. Moreover, the BEPS influence is clear in the generally heightened scrutiny being applied to intangibles, business restructurings and/or high-risk transactions.

### Actions of ‘transparency’ issues

This area of disclosure of avoidance schemes (action 12) has been one of the quieter areas for unilateral moves. The French Finance Bill 2014 provisions to introduce an obligation to disclose aggressive tax planning arrangements have given rise to difficulties with the Constitutional Court. Even so, both the Czech Republic (requiring taxpayers to disclose their aggressive tax planning arrangements and setting up a specialised tax authority for large taxpayers to encourage transparency and disclosure) and Canada (with an offshore tax informant programme) have been active in this area.

In contrast, country by country (CbC) reporting is an area where there is strong support for multilateral action. Whilst the European Commission has moved forward with the reporting of CbC for banks under the Capital Requirements Directive IV (CRD IV), countries are waiting for September’s release and the subsequent recommendations on implementation.

What this leaves us with is a very mixed picture where different jurisdictions are moving forward at different speeds and

to different destinations. The result may be a whole that is much less than the sum of its parts.

So why is this happening? To a certain extent, it was inevitable that once BEPS had raised the profile of base erosion issues, pressure would build for early action. Faced with this, national governments may well be tempted to act, rather than waiting for BEPS actions to gain approval.

### But does it really matter?

It does matter, and potentially quite a lot. If the real value of BEPS lies in its capacity to deliver a coherent, comprehensive framework that will offer certainty to both policy makers and businesses as they navigate their way around the global economy, then a fragmentary approach clearly heads in the opposite direction. This then has two further negative implications. First, it creates an uncertain and unstable climate for business. Second, it could weaken the longer-term prospects for securing multilateral fixes, as jurisdictions settle for self-protection rather than waiting for collective security. And, of course, as was underlined in the recent IMF report on spillovers, national decisions on tax policy can have international consequences.

## BEPS: the US perspective



### Donald L. Korb

Partner (Washington), Sullivan & Cromwell, and former Chief Counsel for the Internal Revenue Service  
Email: korbd@sullcrom.com

### S. Eric Wang

Partner (London), Sullivan & Cromwell  
Email: wangse@sullcrom.com

### For different reasons, US multinationals and the US federal government are both growing increasingly concerned about the BEPS project.

Both US companies and the US federal government have a significant interest in BEPS and its ultimate impact. For US companies, taxes are often the third largest category of expense, behind only labour and new materials. Accordingly, in an increasingly global business environment, companies are concerned that BEPS could potentially result in a significant increase in overall taxes. For the US federal government, in an era when it continues to run up huge deficits, the last thing it needs is for its corporate tax revenue to be put at significant risk, which is what could happen as a result of BEPS.

Among the specific concerns of US multinationals are the following:

- Perhaps the biggest concern is the danger of various countries taking BEPS measures unilaterally, resulting in significant double taxation.

- Another major concern is the significant increase in administrative costs, both in producing the 'country by country' reports and also in responding to the inevitable increase in follow-up requests from tax authorities around the world.
- Finally, some companies even see the potential for introducing some sort of formulary apportionment as a partial, or perhaps total, replacement of the arm's length standard.

From the US government's perspective, top US tax administrative and policy officials have a separate list of concerns:

- A Treasury department official has said that while BEPS may make some sense for addressing certain 'arbitrage' opportunities (such as hybrid mismatches, interest expenses, treaty abuse and intangibles), it is unclear whether a consensus could be reached on issues such as the digital economy. The concept of a virtual permanent establishment inevitably creates 'winners and losers,' and he is concerned that the US will often be the loser in terms of its tax base.
- The same Treasury official has also questioned whether a 'failure' of BEPS to reach clear international norms would inevitably lead to international tax chaos. He has suggested that a world in which tax administrators work through issues on a bilateral basis may actually be preferable to the situation where each country unilaterally applies vague principles arising from the BEPS project.
- The Commissioner of Internal Revenue has said that country by country reporting would be difficult for the IRS because it would result in thousands of information requests from tax authorities around the world.
- Finally, another IRS official has warned that implementation of the BEPS initiatives will cause the IRS to shift its focus from outbound taxation to inbound taxation in order to protect the US corporate tax revenue base from assertions by other countries on the right to tax that revenue.

The bottom line is that there is significant scepticism of and concern with the BEPS project from the perspective of both US companies and the US federal government.

## Tax Journal's debate on 'BEPS and the UK'



Participants at Tax Journal's recent event on 'BEPS and the UK' (left to right): John Watson (former head of tax at Ashurst); Philip Baker QC (barrister, Gray's Inn); Paul Morton (head of group tax, Reed Elsevier); Kate Ramm (senior adviser on BEPS, OECD); Mike Williams (director, business and international tax, HM Treasury); and David Gauke MP (exchequer secretary to the Treasury). The event was kindly sponsored by law firm Pinsent Masons and chaired by James Bullock (the firm's head of litigation and compliance).

Tax Journal's evening debate on 'Base erosion and profit shifting (BEPS) and the UK' (Thursday 19 June) was well attended by tax specialists in industry and practice – hardly surprising for such a hot topic.

'David Cameron announced: "Wake up and smell the coffee,"' said chair **James Bullock** of Pinsent Masons. As a result, the UK was playing a pivotal role in the biggest transformation of tax rules for 30 years. The OECD's BEPS project had G20 sponsorship; 40 countries were involved and change was definitely happening.

**David Gauke**, now financial secretary to the Treasury, wanted global rules that aligned tax with economic substance. The UK tax system would be competitive within that framework. Already, the government had reduced corporation tax, introduced a patent box and R&D tax credits and modernised the CFC rules. As a result, multinational corporations had been attracted into the UK.

G20 finance ministers would discuss the first tranche of OECD recommendations at a summit in September 2014. This included transfer pricing documents, CbC reporting of tax, the digital economy and the features of a multilateral instrument that would sit alongside double tax agreements.

**Mike Williams** of HM Treasury said EU VAT law proved that both consensus and the use of a multilateral instrument were achievable. 2015 would bring recommendations on permanent establishments, interest deductibility, CFCs, harmful tax practices, dispute resolution and trickier areas of transfer pricing, such as intellectual property. Williams believed the existing international tax framework coped successfully with transactions between high tax countries. It only needed modernising where tax havens were involved.

Gauke had no problem with profits arising in tax havens if there was real commercial substance. Williams gave reinsurance in Bermuda as an example. **John Watson**, former head of tax at Ashurst, wondered if the political debate would stop there. Starbucks had put true economic substance into tax havens, he pointed out.

**Paul Morton**, head of group tax at Reed Elsevier, commended HM Treasury and HMRC on the deep and constructive dialogue developed in the consultation process. The OECD, too, had made herculean efforts to consult. In fact, the OECD's **Kate Ramm** referred to 1,400 pages of responses received by the OECD on CbC reporting alone. 'CbC reporting could be a game changer,' Williams said. Morton cautioned that nobody yet knew how tax authorities would use CbC reporting. HMRC kept data confidential; not all tax authorities could be trusted to do so.

While the Congressional stalemate gave rise to concern over the US administration's ability to implement the OECD's recommendations, Williams pointed out CbC reporting at least did not require Congressional approval and would be implemented. Gauke was confident that CbC reporting would be finalised in the UK by May 2015, even if not enacted.

Morton stressed the need for a practical tax system and said the BEPS project was not a panacea for the world's tax problems. Many issues that exercised the tax profession would still remain. Furthermore, **Philip Baker** QC suggested the project was geared towards richer nations. Developing countries outside the OECD and G20 might prefer to use VAT to raise revenues.

Despite concerns, Morton agreed with Bullock that this was a chance to construct a 21st century tax system. Developments were eagerly awaited.

Reported by Helen Blenkinsop. Helen has headed the tax function at two FTSE PLCs, and carries out in-house interim assignments, often focused on international tax. Email: [helenblenkinsop@blueyonder.co.uk](mailto:helenblenkinsop@blueyonder.co.uk); tel. 07967 467014.