Global Tax Alert

OECD releases highly anticipated 2014 output of BEPS Action Plan

EY Global Tax Alert Library

Access both online and pdf versions of all EY Global Tax Alerts.

- Copy into your web browser:

http://www.ey.com/GL/en/Services/Tax/International-Tax/Tax-alert-library#date

Executive summary

On 16 September 2014, the Organisation for Economic Co-operation and Development (OECD) released a series of deliverables (the 2014 Deliverables) that address seven of the focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The documents released consist of a brief explanatory statement, final reports with respect to Action 1 (Digital Economy) and Action 15 (Multilateral Instrument), an interim report with respect to Action 5 (Harmful Tax Practices), and reports with agreed draft recommendations on Action 2 (Hybrid Mismatch Arrangements), Action 6 (Treaty Abuse), Action 8 (Transfer Pricing for Intangibles), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting).

The OECD held a press conference in conjunction with the release of the 2014 Deliverables and a webcast to provide an overview of the output. The webcast featured Pascal Saint-Amans, who leads the OECD's tax work. Also participating were senior members of the OECD Secretariat that led the technical work on the 2014 Deliverables: Raffaele Russo, who has responsibility for the work on the digital economy and the multilateral instrument as well as overall responsibility for the BEPS project; Marlies de Ruiter, who has responsibility for the tax treaty, transfer pricing and financial transactions work; and Achim Pross, who has responsibility for the international co-operation and tax administration work.

During the webcast, Saint-Amans described the recommendations presented in this first set of deliverables as being a result of a collaborative effort between governments from OECD and G-20 member countries, with input from more than 80 developing countries and from the business community and other stakeholders. He noted that that the recommendations set forth in the deliverables released are not yet final and may be subject to some revision given the interrelationship between the focus areas covered in the 2014 Deliverables and the focus areas covered by the other BEPS Actions which have target delivery dates of September and

EY
Building a better working world

December of 2015. The reports released were described by Saint-Amans as reflecting agreement by the participating countries on the present status and future steps to be taken with respect to the covered Actions, while the draft recommendations released were described by Saint-Amans as "soft legislation" that contain the countries' consensus and commitment with respect to rules to be developed to address the matters dealt with by those Actions.

The 2014 Deliverables are to be presented at the upcoming G20 Finance Ministers' meeting to be held in Cairns, Australia on 20-21 September and further considered at the G20 Leaders' meeting in November 2014.

This Alert provides a high-level overview of the documents released with respect to the seven Actions. Further EY Global Tax Alerts will be issued with more detailed analysis of each of the documents.

In addition, EY is hosting a series of tax webcasts which will focus on key aspects of these developments in the OECD BEPS project and the implications for global businesses:

- Wednesday, 24 September – Review of current developments and outlook in the OECD BEPS project
- Wednesday, 1 October – OECD BEPS project: Proposals for new reporting and documentation
- Monday, 6 October – OECD BEPS Action 1: tax challenges of the digital economy

Detailed discussion

Below is an overview of each of the 2014 Deliverables.

Action 1 – Addressing the tax challenges of the digital economy

The report on Action 1 (the Digital Economy Report) builds on the objectives reflected in the discussion draft released by the OECD on 24 March 2014 (the Digital Economy Discussion Draft), which focused on the key features of the "new" business models in the digital economy, how those features may exacerbate BEPS risk in a global economy, and what broader direct and indirect tax challenges are raised by the digital economy. Moreover, the Digital Economy Discussion Draft provided an overview of potential options for addressing the tax challenges of the digital economy, along with a framework for evaluating these options. The alternatives discussed in the Digital Economy Discussion Draft included: (i) modifying permanent establishment (PE) rules (i.e., preparatory and auxiliary exemptions, PE nexus based on significant digital presence, and virtual PE), (ii) introducing withholding tax regime for digital transactions, and (iii) modifying existing value added tax (VAT) regimes.

The Digital Economy Report largely follows the discussion in the Digital Economy Discussion Draft. It continues to acknowledge that it would be impossible to ring-fence the digital economy (a key point repeated during the OECD webcast) and also underscores that the landscape is still moving rapidly, therefore making it a challenge to anticipate all potential issues. It also continues to stress the importance of the fair, equitable and efficiency principles introduced by the Ottawa Taxation Framework Conditions. The Digital Economy Report includes a new chapter that discusses the fundamental principles of taxation and, in doing so, reconsiders some of proposed approaches for addressing the tax challenges of the digital economy. Specifically, the Digital Economy Report: (i) reiterates that PE exemptions for preparatory and auxiliary activities should not be available for core activities; (ii) discusses how to deal with tax planning by businesses engaged in VAT-exempt activities; (iii) addresses the importance of data and its impact on transfer pricing; and (iv) identifies the need to adapt CFC rules. The Digital Economy Report indicates there remain certain areas of disagreement among stakeholders (e.g., import of data in driving value for tax purposes), but that there is consensus that action is needed to clarify PE issues in the Digital Economy (presumably, to be addressed more in Action 7) as well as the need to address consumption taxes on business-to-consumer transactions.

Importantly, the OECD indicated that as the recommendations on the other Actions Items are finalized, the OECD will evaluate how the outcomes affect the broader tax challenges raised by the digital economy and will complete

an evaluation of the options to address them. This work will be concluded by December 2015 and a supplementary report reflecting the outcomes of the work will be finalized at that time.

Action 2 – Neutralizing the effects of hybrid mismatch arrangements

The document on Action 2 (the Hybrid Mismatch Report) includes two sets of recommendations to address hybrid mismatch arrangements. Part I contains recommendations on domestic law rules to address arrangements that result in double non-taxation or long-term tax deferral. Part II contains recommended changes to the OECD Model Tax Convention to deal with the use of dual resident entities and transparent entities to obtain treaty benefits and to address the interaction between the domestic law recommendations and the provisions of the OECD Model Tax Convention.

The recommendations for domestic law reflect the approach originally described in the discussion draft released on 19 March 2014 (the Hybrid Mismatch Discussion Draft), with some important refinements. First, the OECD recommends the enactment of linking rules that seek to relate the tax treatment of a specific hybrid entity or arrangement in one jurisdiction to the tax treatment of such entity or arrangement in the other jurisdiction. Second, the report recommends a "rule order" under which primary and defensive rules would operate to address double non-taxation outcomes and avoid double taxation. Third, reflecting extensive comments received from stakeholders, the report limits the scope of the recommended rules by using the "bottom up approach." More specifically, the recommended rules would apply to hybrid arrangements involving related parties and members of the same controlled group and to certain "structured" arrangements. Moreover, for this purpose, the threshold for related party status is increased to 25%, from 10% as proposed in the Hybrid Mismatch Discussion Draft.

The recommendations with respect to the OECD Model Tax Convention include: (i) a change to Article 4 of the Model Tax Convention to deal with dual resident entities; (ii) a new provision in Article 1 and changes to the Commentary to address fiscally transparent entities; and (iii) various proposed changes to address treaty issues that may arise from the recommended domestic law changes.

The Hybrid Mismatch Report indicates that the OECD is continuing its work on Action 2 to develop guidance on the implementation of the recommended rules. In addition, the report notes that there are some specific areas where further refinements in the recommended domestic law rules may be needed, including the treatment of certain capital market transactions such as on-market stock-lending and repos and the treatment of imported hybrid mismatches. Moreover, concerns regarding the application of the rules to intra-group hybrid regulatory capital will be explored further. Similarly, additional work will be done on how income inclusions under CFC regime should be treated for purposes of the report. It is anticipated that this additional work will be finalized in September of 2015 and that the output will likely be in the form of commentary and transitional rules.

Action 5 – Countering harmful tax practices

Action 5 of the OECD BEPS project committed the OECD's Forum on Harmful Tax Practices (FHTP)[1] to revamp the work previously done by the OECD on harmful tax practices of countries. In this regard, the FHTP is to deliver three outputs:

- A review of member country preferential regimes.
- A strategy to expand participation to non-OECD member countries.
- Consideration of revisions or additions to the existing framework for analyzing whether regimes are harmful.

The interim report on Action 5 (the Harmful Tax Practices Report) discusses the progress on the first output. The work of the FHTP focused on designing a substantial activity test for any preferential regime and on improving transparency between tax administrations related to the existence and mechanics of preferential regimes, such as by mandating compulsory spontaneous exchange of information on rulings.

The second and third outputs are expected by September and December 2015, respectively.

In the review of preferential regimes, the FHTP concentrated first on intellectual property (IP) regimes. It suggested that a "nexus approach" would be most appropriate when determining whether the substantial activity test is met. Under this approach the application of an IP regime would be dependent on the level of R&D activities carried out by the taxpayer. Discussions of the approach are continuing. In the next stage the FHTP will evaluate all existing IP regimes of OECD and associated countries to determine whether or not they require "substantial activity." In addition, the approach that will ultimately be agreed on will need to be extended to tax regimes not related to IP. With respect to the goal of improving transparency, the FHTP developed a framework for compulsory spontaneous exchange of information by tax administrations on taxpayer-specific tax rulings and Advance Pricing Agreements (APAs). The framework would require rulings (or summaries of such rulings) on preferential regimes that meet certain criteria to be exchanged spontaneously with the competent authorities of the tax jurisdictions involved. The framework also deals with questions such as time-limits, legal basis, confidentiality and the type of information to be exchanged. An ongoing monitoring and review mechanism, including annual review by the FHTP, will be put in place to ensure countries' compliance. The FHTP expects to issue a progress report on the adherence to the framework in 2015.

Action 6 – Preventing the granting of treaty benefits in inappropriate circumstances

The draft recommendations under Action 6 (the Treaty Abuse Report) reflect the recommendations made as part of the discussion draft published on 14 March 2014 (the Treaty Abuse Discussion Draft). The Treaty Abuse Report includes proposals to:

- Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.
- Clarify that treaties are not intended to be used to generate double non-taxation.
- Provide tax policy considerations for contracting states to consider before entering into a tax treaty with another country.

To prevent the granting of treaty benefits in inappropriate circumstances, particularly through treaty shopping arrangements, the report recommends the inclusion of anti-abuse rules in the OECD Model Tax Convention. The report includes a "limitation on benefits" (LOB) provision, similar to those found in US tax treaties, and a general anti-abuse rule (GAAR), similar to the "main purpose" test found in UK tax treaties, based on the principal purposes of transactions or arrangements (a principal purpose test or "PPT" rule). In contrast to the Treaty Abuse Discussion Draft, the Treaty Abuse Report acknowledges that the adoption of both the LOB and PPT rules, together, might not be appropriate for all countries. Therefore, the report suggests that at a minimum, countries should: (i) affirm through an express statement in their tax treaties that they intend to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance; and (ii) adopt either (A) the LOB and the PPT rules, (B) the PPT rule, or (C) the LOB rule supplemented by a mechanism (such as a restricted PPT rule applicable to conduit financing arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would address conduit financing arrangements not already addressed in tax treaties.

The LOB provision includes many of the same tests as those included in the LOB provisions of existing US tax treaties. Notably, the LOB provision in the Treaty Abuse Report includes a derivative benefits test. The Treaty Abuse Discussion Draft had discussed derivative benefits tests but had raised concerns about the implications of such a test.

The Treaty Abuse Report also adds a proposed change to the OECD Model Tax Convention addressing the availability of treaty benefits to collective investment vehicles (CIVs) and other funds. It further states that there is more work to be done

in this area. In addition, the report indicates that further work will be needed with respect to the precise contents of the anti-abuse rules, in particular the LOB rule. Finally, the report indicates that the proposed OECD Model Tax Convention provisions and related Commentary should be considered as drafts that are subject to improvement prior to the release of the final version in September 2015.

Action 8 – Transfer pricing aspects of intangibles

The draft recommendations under Action 8 (the Transfer Pricing Aspects of Intangibles Report) contain revised standards for transfer pricing of intangibles and additional standards with respect to comparability and transfer pricing methods.

The first part of the Transfer Pricing Aspects of Intangibles Report contains amendments to Chapter I (The Arm's Length Principle) of the OECD Transfer Pricing Guidelines relating to the transfer pricing treatment of location savings and other local market features, assembled workforce, and the existence of multinational enterprise (MNE) group synergies. The second part of the report contains an entirely revised Chapter VI (Special considerations for intangibles) of the OECD Transfer Pricing Guidelines. It contains guidance on: (i) the definition of intangibles, (ii) identifying and characterizing specific controlled transactions involving the use or transfer of intangibles, and (iii) determining arm's length conditions in cases involving intangibles. The Transfer Pricing Aspects of Intangibles Report also contains interim guidance on ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles, the application of profit split methods, and arm's length pricing when valuation is highly uncertain at the time of the transaction. The interim guidance will be finalized in connection with the 2015 BEPS work on risk, recharacterization, and hard to value intangibles.

Key features of the Transfer Pricing Aspects of Intangibles Report, and key differences compared to previous work in connection with Action 8, include:

- The definition of an intangible, which is similar to that contained in the discussion draft of 30 July 2013 but which includes a new definition of "marketing intangibles."
- New guidance providing that it is not necessary to define when goodwill or going concern value may or may not constitute an intangible. If features of a business allow a company to charge higher prices, such contribution should be compensable without regard to the labeling.
- Interim guidance on ownership, the thrust of which is that legal ownership as such and the funding of the development of an intangible without performing important functions would not create an entitlement to the full intangible related return. The allocation of returns should be in line with value creation.
- New guidance on how profits or losses relating to unanticipated events should be shared between MNE group members contributing to the development, enhancement, maintenance and protection of the intangible.
- The use of valuation techniques as part of the five OECD transfer pricing methods or as a useful tool.
- New and revised examples to illustrate the revised guidance.

In the next several months, additional work will be undertaken in connection with risk, recharacterization, and hard to value intangibles, which will lead to partial revisions of Chapters I, II, VI, VIII and IX of the OECD Transfer Pricing Guidelines. In this process, so-called "special measures" which deviate from the arm's length principle may be considered. Some examples of potential special measures have been included in the report.

Action 13 – Guidance on transfer pricing documentation and country-by-country reporting

The draft recommendations under Action 13 (the Transfer Pricing Documentation and CbC Report) contain revised standards for transfer pricing documentation and a template for country-by-country reporting, to be included in the OECD Transfer Pricing Guidelines in the place of the existing Chapter V.

The Transfer Pricing Documentation and CbC Report is aimed at ensuring better transparency for tax administrations by providing them with adequate information to conduct transfer pricing risk assessments and at improving the consistency of requirements for taxpayers. The transfer pricing documentation standards and the country-by-country reporting standards will be revisited by the OECD members no later than the end of 2020 "with a view to continuously improving the operation of those standards."

The country-by-country reporting template requires MNEs to report the amount of revenue (related party and unrelated party), profits, income tax paid and taxes accrued, employees, stated capital and retained earnings, and tangible assets annually for each tax jurisdiction in which they do business. In addition, MNEs are also required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity conducts.

The guidance on transfer pricing documentation requires MNEs to include a high-level overview of their global business operations and transfer pricing policies in a "master file" that would be made available to all relevant country tax administrations. Specific information would be required for intangibles and intercompany financial activities. Moreover, the transfer pricing guidance will require that detailed information on all relevant material intercompany transactions be included in a "local file" in each country.

The Transfer Pricing Documentation and CbC Report contains some significant changes compared to the discussion draft released on 30 January 2014. For example, the country-by-country reporting template will require information to be reported on a jurisdiction by jurisdiction basis rather than on an entity by entity basis. Moreover, certain detailed information on payments and receipts for intercompany royalties, interest and services will not be included on the country-by-country report, but instead will be reported in the transfer pricing documentation local file. Furthermore, the country-by-country report will not be made a part of the transfer pricing documentation master file.

Additional work will be undertaken by the OECD over the next months with respect to implementation and filing of the master file and the country-by-country report. The Transfer Pricing Documentation and CbC Report states that "due regard will be given to considerations related to protection of the confidentiality of the information required by the reporting standards, the need for making the information available on a timely basis to all relevant countries, and other relevant factors." Guidance in this respect is expected to be delivered in early 2015.

Action 15 – Developing a multilateral instrument to modify bilateral tax treaties

The report on Action 15 (the Multilateral Instrument Report) examines the feasibility and desirability of a multilateral instrument as a way to implement treaty measures developed under the other Actions. The report considers that such an instrument is desirable because it would achieve swift implementation of these measures by avoiding the need to individually negotiate existing bilateral tax treaties and it would allow for a consistent outcome. The Multilateral Instrument Report acknowledges that there can be obstacles to a multilateral instrument from a technical (public international law and international tax law) and political perspective. Drawing from numerous examples of multilateral treaties in areas other than tax, it concludes that these obstacles can be overcome so that the instrument appears to also be feasible.

The Multilateral Instrument Report suggests that the scope of such multilateral instrument should at this stage only include treaty based outputs of the BEPS project. It further identifies a number of provisions that are "multilateral in nature" and could thus be included as such in a multilateral instrument (e.g., a multilateral mutual agreement procedure and provisions on dual-residence, hybrid mismatch arrangements, and treaty abuse). Other provisions (e.g., changes to the permanent

establishment definition) would need to take bilateral specificities into account and should thus offer more flexibility for contracting parties. Stressing the urgency of creating a multilateral instrument, the Multilateral Instrument Report proposes to convene an International Conference in 2015 under the aegis of the OECD and the G20. The International Conference would be open to all interested countries and would develop the content of the multilateral instrument. The proposed mandate of the International Conference should be limited in time to two years and in scope by focusing only on the treaty related BEPS outputs once finalized.

Implications

The release of the 2014 Deliverables represents a significant development in the OECD BEPS project. The reports and recommendations reflect agreements reached by the OECD and G20 member countries. The documents also describe further OECD work that will continue into 2015 in all of these focus areas. At the same time, the OECD has reiterated its commitment to issue output with respect to the remaining BEPS Actions by the end of 2015.

While the OECD continues its work on the BEPS Action Plan, countries around the world are already acting to address concerns about BEPS through legislative and regulatory changes and changes in administrative practices. Companies will want to keep informed about developments in the OECD BEPS project and related developments in the domestic tax laws and practices in the countries where they operate or invest.

Endnotes

1. The FHTP was created in 1998 when the OECD started its work in the field of harmful tax competition with the publication of the report, *Harmful Tax Competition: An Emerging Global Issue*.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, International Tax Services, Washington, DC

Barbara Angus	+1 202 327 5824	Barbara.Angus@ey.com
Eric Oman	+1 202 327 6559	Eric.Oman@ey.com
Yuelin Lee	+1 202 327 6378	Yuelin.Lee@ey.com
Maria Martinez	+1 202 327 8055	Maria.Martinez@ey.com
Lisa Findlay	+1 202 327 7180	Lisa.Findlay@ey.com
Andreia Leite Verissimo	+1 202 327 6034	Andreia.LeiteVerissimo@ey.com

Ernst & Young LLP, Global Tax Desk Network, New York

Gerrit Groen	+1 212 773 8627	Gerrit.Groen@ey.com
Jurjan Wouda Kuipers	+1 212 773 6464	Jurjan.Woudakuipers@ey.com
Dirk Jan Sloof	+1 212 773 1363	DirkJan.Sloof@ey.com
Daniel Brandstaetter	+1 212 773 9164	Daniel.Brandstaetter@ey.com

Ernst & Young LLP, International Tax Services, New York

Katherine Loda	+1 212 773 6634	Katherine.Loda@ey.com
Alon Kritzman	+1 212 773 6961	Alon.Kritzman@ey.com

Ernst & Young LLP, International Tax Services, Global Technology Sector, San Jose, CA

Channing Flynn	+1 408 947 5435	Channing.Flynn@ey.com
Jon Cisler	+1 408 947 5786	Jon.Cisler@ey.com

Ernst & Young LLP, International Tax Services, Global Technology Sector, San Francisco, CA

Stephen Bates	+1 415 894 8190	Stephen.Bates@ey.com
Jess Martin	+1 415 894 4450	Jess.Martin@ey.com

Ernst & Young Belastingadviseurs LLP, Transfer Pricing, Rotterdam, The Netherlands

Ronald van den Brekel	+31 88 407 9016	Ronald.van.den.Brekel@nl.ey.com
Clive Jie-A-Joen	+31 88 407 0807	Clive.Jie-A-Joen@nl.ey.com

Ernst & Young Tax Sarl, International Tax Services, Munsbach, Luxembourg

Anja Taferner	+352 42 124 7542	Anja.Taferner@lu.ey.com

Ernst & Young Advisory Services Ltd., Transfer Pricing, Johannesburg, South Africa

Michel Verhoosel	+27 11 502 0392	Michel.Verhoosel@nl.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2014 EYGM Limited.
All Rights Reserved.

EYG No. CM4734

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com