

OECD "base erosion and profit shifting" report looks to action plan

February 12, 2013

In brief

In response to concerns regarding base erosion and profit shifting (BEPS), the Organisation for Economic Co-operation and Development (OECD) began a project to address those issues. The project, which has received significant attention, has been supported by the G20 and various individual governments. Today, the OECD released a related 90-page report, *Addressing Base Erosion and Profit Shifting*.

The report is a comprehensive diagnosis of the current situation. This diagnosis includes empirical evidence on the use of BEPS techniques, discusses corporate global business models, and provides detailed analysis.

The OECD, as highlighted in the report, has committed to develop an action plan within six months to address the issues.

Background

Recently, tax authorities in various countries have expressed concern about losing tax revenue as a result of corporate planning that they believe erodes tax bases and shifts profits to lower-tax jurisdictions. At the same time, authorities and companies alike share a fundamental concern that the common principles by which taxing rights are shared between countries have not kept pace with the changing global business environment. This shortcoming is highlighted by the global nature of business (including the proliferation of internet-based transactions) and the increased importance of

intellectual property as a value driver.

In detail

The base erosion and profit shifting report

The OECD report analyzes the key tax principles and opportunities for base erosion and profit shifting. It notes that the "jurisdiction to tax" principle, including permanent establishment (PE) rules, has come under pressure due to the development of the digital economy. Also, the report points out that transfer pricing concepts already consider economically significant activities and responsibilities undertaken, assets used, and risks assumed. In addition, the

report highlights the different treatment of debt and equity in many countries and categorizes anti-avoidance techniques.

Furthermore, the report considers how to address BEPS concerns. The report identifies the following as "key pressure areas":

- international mismatches in entity and instrument characterization, including hybrid mismatch arrangements and arbitrage
- the application of treaty concepts to profits derived from the delivery of digital goods and services

- the tax treatment of related party debt-financing, captive insurance, and other intra-group financial transactions
- transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of asset ownership between legal entities within a group, and transactions between such entities that would rarely take place between independent entities
- the effectiveness of anti-avoidance measures, in particular general anti-avoidance rules (GAARs), controlled foreign corporation (CFC) regimes, thin capitalization rules, and rules to prevent tax treaty abuse
- the availability of harmful preferential regimes

The OECD action plan

As for proposed next steps, the report identifies no 'magic recipe' that could address BEPS. However it emphasizes that the OECD is ideally positioned to advance a collaborative solution (and that this is preferable to any unilateral action which could potentially exacerbate the problem).

Although the paper does not set forth specific steps, it mentions the

development of a comprehensive action plan by June 2013. The plan will (1) identify actions required to address BEPS; (2) set deadlines for those actions; and (3) identify the resources and methodology required to implement the proposed solutions.

In response to the key pressure areas, the report states that the action plan will include proposals to develop:

- instruments to end or neutralize the effects of hybrid mismatch arrangements and arbitrage
- improvements or clarifications to transfer pricing rules to address specific areas where the current rules are deemed to produce undesirable results from a policy perspective (the report notes that the current work on intangibles would be included in a broader reflection on transfer pricing rules)
- updated solutions to "jurisdiction to tax" issues, in particular for digital goods and services (these solutions may include revised treaty provisions)
- more effective anti-avoidance measures that complement the previous items. Such measures might include GAARs, CFC rules, limitation of benefits rules, and

other anti-treaty abuse provisions

- rules on the treatment of intra-group financial transactions, such as those related to the deductibility of payments and the application of withholding taxes
- solutions to counter harmful regimes more effectively, taking into account factors such as transparency and substance.

The report solicits input from tax administrations. Therefore, BEPS likely will be on the agenda for the Forum of Tax Administration meeting of Tax Commissioners in Moscow in May 2013.

The takeaway

Generally, today's OECD report summarizes the key issues raised by BEPS and aligns with previous OECD statements about the concerns of the organization and its member tax authorities.

Regardless of this timeline, taxpayers should consider the report's key pressure areas and the proposals to address those areas.

[Click here](#) to read the full OECD report.

Let's talk

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