
OECD releases final recommendations on BEPS proposals: What does it mean for global mobility?

October 30, 2015

In brief

On October 5, 2015, the Organisation for Economic Co-operation and Development (OECD) published the final Base Erosion and Profit Shifting (BEPS) package after two years of work on the 15-point action plan. In general, the BEPS project seeks to tax profits where actual business activity is performed and where value is created. The actions have been categorised by the OECD into three key themes: Addressing substance, coherence of the international tax system, and transparency. The recommendations included in the various reports released by the OECD have been designed to be implemented via changes in domestic legislation and practices, as well as via treaty provisions.

Although most of the initiatives will not take effect immediately, some countries have begun to take action by introducing changes to their domestic laws. We can now expect an increased focus from tax authorities globally on the recommendations arising from the BEPS Action Plan.

BEPS is not just a corporate tax issue - a number of these actions will affect how organisations manage, track, and report on their globally mobile workforce. In light of the behavioural changes expected from tax authorities globally, businesses should take appropriate action now. Companies should assess their risk in the context of BEPS and seek to mitigate any adverse impacts.

In detail

BEPS Action Plan themes

The BEPS Action Plan categorised its various areas of focus into three key themes:

1. Addressing substance – Actions seeking to align taxing rights with the relevant value-adding activity. This category includes Transfer Pricing (TP) and Permanent

Establishment (PE) modifications.

2. Coherence of the international tax system – Actions aimed at removing gaps and ‘black holes.’
3. Transparency – Actions looking to provide significant additional disclosure, such as Country-by-Country Reporting.

Practical impact of BEPS

There are three fundamental ways in which BEPS recommendations are expected to have a practical impact.

First, there will be direct application of the BEPS package itself, including:

- changes to tax treaties (through amendment of the OECD Model Tax Treaty

and/or multilateral instrument), and

- changes to domestic legislation, as a result of individual recommendations of the BEPS action points.

Second, some countries may opt for taking specific actions inconsistent with the BEPS package, typically where they disagree with the direction of the BEPS package, or think the recommendations should be more expansive. This could be the case for some developing countries.

Third, and probably the most important direct impact of BEPS, is its behavioural effect, which is likely to result in greater scrutiny of international transactions from tax authorities globally. This result has already been noticed in respect of PE challenges and TP discussions.

When are the changes going to be implemented?

The policy formulation stage of the BEPS Action Plan by the OECD will conclude at the end of this year.

The negotiation of the multilateral instrument, which is designed to implement many of the OECD proposals with respect to tax treaties, is under way and is expected to be finalised by the end of 2016.

Changes to domestic legislation already are in progress and, in some countries, changes already have been implemented.

What are the relevant changes for global mobility?

PE definitions and commentary

Globally mobile employees can create significant PE risk. Failure to appropriately manage the PE risks associated with globally mobile employees may result in additional

reporting requirements, corporate tax exposure, and penalties for non-compliance.

The final BEPS report proposes a widening of the dependent agent test; narrowing of the independent agent exemption; and a tightening of the specific activity exemptions relating to fixed place of business status (preparatory and auxiliary activities). This means that there may well be a greater number of cases where individuals who travel cross-border will be deemed to create a PE.

Dependent Agent PE (DAPE)

A change in the definition of the DAPE has been proposed. The new wording extends the scope to cover persons who “habitually conclude contracts, or habitually play the principal role leading to the conclusion of contracts that are routinely concluded without material modification [by the principal].”

Guidance on the intended interpretation of the revised wording has been provided in the commentary. DAPE would apply where a person, regardless of who employs them, habitually:

- accepts, on behalf of an overseas enterprise, an offer made by a third party to enter into a standard contract with that enterprise,
- negotiates all the elements and details of a contract, even when the contract is signed by another person outside that territory, or
- solicits and receives (but does not formally finalise) orders which are concluded by an overseas entity.

However, DAPE would not be applicable where a person merely promotes and markets goods or services, in a way that does not

directly result in the conclusion of contracts.

This terminology goes beyond the previous definition, under which concluding contracts was very much linked to where a contract was physically signed. Under the revised definition, more of the typical activities of senior executives and sales representatives involved in negotiating contracts abroad may result in creating a PE. It will be important to consider the substance of what these individuals are doing in practice - i.e., where and by whom was the third party convinced to enter into the contract - not just where the contract was signed. The new wording also introduces a significant amount of subjectivity, meaning that there is increased possibility of disputes with, and between, tax authorities.

Independent agent rule

The independent agent rule also was modified. The proposal denies the possibility of independence where a person acts exclusively or almost exclusively for one or more enterprises that are closely related. The changes to this test could have an impact in some situations where an individual works for an overseas enterprise through a personal service company.

Fixed place of business PE

The availability of the exemption for certain specific activities (e.g., warehousing) would be restricted to those activities that could be shown to be preparatory (short term) or auxiliary (i.e., not a core part of the business). Organisations will need to be mindful of this change when establishing operations in new territories, or securing access to third party sites.

Transfer Pricing (TP) and PE

Of the various TP changes proposed by the final package, the most relevant for global mobility are as follows:

- There will be greater scrutiny by the tax authorities of the actual behaviour of parties to a TP arrangement, with the emphasis on aligning taxing rights with where value is created. This will mean less automatic acceptance of the mere contractual or legal arrangements, and more focus on what is happening in practice.
- Intercompany service fees will need to reflect the value of services performed by globally mobile employees and whether they are moving IP with them.
- People functions that relate to decision-making will be of particular interest to the tax authorities. Accurately mapping and tracking these functions will become increasingly important.

Transparency and disclosure

A three-tiered approach to TP documentation for Multinational Enterprises (MNEs) has been proposed, under which organisations now would have to prepare:

- a master file containing specific information relevant for all MNE group members,
- a local file referring to material transactions of the local taxpayer, and
- a country-by-country report containing high-level data on the global allocation of the MNE's income and taxes, and certain other measures of economic activity. This includes specific

information related to the number of employees in a particular location.

It therefore will be more important than ever for organisations to focus on data capture for employees internationally, which should aid an understanding of where value is and assist compliance.

What you need to think about

With a greater possibility of globally mobile employees creating PE risks, the increased focus on substance over contractual or legal arrangements and the growing attention from tax authorities on globally mobile employees in general, businesses should be taking a closer look at the following:

- Employees with global and regional roles and senior executives playing the principal role leading to the conclusion of contracts, should be reviewed to determine for whom they are concluding contracts, and which country is bearing the risk and reward of the contract.
- Mechanisms to track business travellers should be established or reviewed, including changes in travel patterns and activities; and to flag when and where individuals may be creating a PE risk.
- Sales workforce activities and presence in overseas territories - consider building a pre-travel assessment to identify risk.
- Existing corporate structures (e.g., global/regional employment companies) that have not been reviewed in recent years should be reviewed to ensure that they are still compliant under BEPS.

- Current employment structures for mobile employees - e.g., should secondments (frequently used for mobile individuals) in a particular jurisdiction continue to be used.
- Intercompany agreements in relation to the various types of mobile employees that have not been reviewed recently should be reviewed, to determine in particular whether they reflect accurately the relationship between the movement of individuals and the movement of intellectual property. These agreements may include subcontracts as well as secondment agreements.

It is important to note that all analysis described above likely will need to be done on a case-by-case basis and will be highly dependent on the specific facts.

The takeaway

BEPS will cause fundamental changes in international tax law and the behaviour of tax authorities globally. Greater scrutiny from the authorities, the media, and the general public will put MNEs in the spotlight more than ever.

It is important that your organisation prepare for the changes with the goals of being better equipped to deal with any challenges to your position and proactively managing the risks.

Finally, all parts of your business will need to understand the general impacts of the BEPS project regarding substance requirements that will underpin the wider tax, mobility, and business strategy.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact your regular *PwC Global Mobility Services team* or one of the following representatives. They will be happy to refer you to the relevant contact in the location where you operate:

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