Developing countries show strong interest in the OECD's BEPS recommendations

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In brief

Many developing countries may implement the recommendations of the G20-requested and OECD-led project on base erosion and profit sharing (BEPS) that are relevant to them. This list of countries and topics seems to be wider than many commentators expected.

The OECD Task Force on Tax and Development meeting on 2-3 November 2015 allowed a number of countries to specify points of satisfaction or dissatisfaction with the BEPS recommendations. There were further, similar opportunities at recent regional BEPS meetings in Costa Rica, Togo and Georgia, together with the Centre de Rencontre des Administrations Fiscales (CREDAF) Working Group meeting in Paris and Asia-Pacific Technical Committee meeting in Indonesia. The first plenary session of the ad hoc group on the multilateral instrument and the 20th Global Forum on Tax Treaties also showed high levels of participation from developing countries.

The OECD, in conjunction with other supranational organisations, is developing toolkits that cover BEPS and other areas of particular interest to developing countries. These toolkits should help address their limited capacity for changing their tax systems. A 'framework' is also being established for broader involvement on an equal footing of developing countries and interested supranational organisations, including the United Nations (UN), International Monetary Fund (IMF) and World Bank Group (WBG), in the monitoring and implementation of the BEPS recommendations.

In detail

Levels of BEPS engagement

The benefits of participation by representative developing countries and regional organisations was recognised during the course of the BEPS project.

The political pressure to address quickly some developed country issues inevitably meant that it was not feasible to consider every aspect of the international tax rules of interest to all countries.

Despite criticism about lack of involvement from the outset and then insufficient attention to their specific issues, many developing countries area ready to adopt a number of the recommendations, albeit with extended time frames, simplifications and help needed to apply the principles.

Developing countries have been acknowledging that direct participation in the Committee on Fiscal Affairs and working party meetings was a great opportunity, but that resource constraints would always affect direct engagement. The 'framework' within which developing countries and supranational organisations, like the UN, IMF and WBG, will participate on an equal footing in the implementation of BEPS recommendations and their subsequent monitoring should be agreed early in 2016.

Perception of the BEPS recommendations

In various forums in which developing countries have expressed views on the BEPS recommendations, they have asserted their greater reliance relative to developed countries on corporate income tax, particularly from multinationals. This results in greater importance to them of transfer pricing and other BEPS issues. However, many have pointed out that this should be seen in the context of the principal requirement to promote cross-border commercial activities.

Over 200 people attended the OECD's Task Force on Tax and Development meeting on 2-3 November 2015. Many countries appeared satisfied with their role and the outcomes of the BEPS project — one spoke of direct participation in transfer pricing generally and another of the influence of the relevant regional organisation of tax administrations on the commodity pricing recommendations. More generally, attendees expressed the view that the BEPS recommendations would help developing countries address perceived abuses and aggressive tax planning strategies. Some also highlighted the opportunity of learning from other countries' experiences and best practices. These views apparently were supported in the summaries of recent regional BEPS meetings in Costa Rica, Togo and Georgia, together with the CREDAF Working Group meeting in Paris and Asia-Pacific Technical Committee meeting in Indonesia.

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Overall, however, developing countries indicated a need to adapt the implementation of measures to the context of each county and region.

Regardless of their capacity, some countries have traditionally experienced difficulties implementing significant tax reforms. The nature of the domestic tax systems in these countries presents particular challenges to the proposed modifications.

Apart from the interest indicated above in the areas of treaty application and abuse (Action 6) as well as the multilateral instrument (Action 14), developing countries seem to have been most interested in:

- Action 4 — the focus on interest deductions shows developing countries are more concerned about interest deductibility than developed countries, particularly given the lack of capacity insofar as transfer pricing and thin capitalisation is concerned. When combined with treaty shopping, interest deductibility may expose developing countries to base erosion.
- Action 7 —the prevention of the artificial avoidance of permanent establishment status
- Action 8-10 — a wide range of transfer pricing issues (but particularly commodity pricing)
- Action 13 — transfer pricing documentation and the country-by-country reports, with concerns expressed on the threshold and the access issues caused by a lack of good treaty networks (apparently misplaced with the threshold applying for the global group as a whole and exchange of information provisions in the Multilateral Convention on Mutual Administrative Assistance also usable).

Framework for involvement of interested parties

Developing countries have expressed particular support for a platform to work together on an equal footing with regard to the monitoring and implementation of the BEPS outcomes.

The framework should, they highlight, reflect that effective implementation needs a combined effort. International organisations plus regional tax and other organisations as well as individual countries need to participate alongside business. While many would like to be involved directly, there seemed to be a recognition that collective representation via regional organisations such as the Inter-American Center of Tax Administrations (CIAT), the African Tax Administration Forum (ATAF) and the Study Group on Asian Tax Administration and Research (SGATAR) would help deal with their capacity constraints.

Other operational framework suggestions included the need for consultation and online surveys; the benefits of sharing experiences and regulatory options including model legislation; guidance for tax administrations; and training materials. Many of these requests are reflected in the toolkits being developed.

The positive experience represented by the Global Forum on transparency and Exchange of Information for Tax Purposes, including the peer review mechanism, has been highlighted as a model, but differences between the scope of the two initiatives have been noted.

The OECD's Committee on Fiscal Affairs (as expanded for the BEPS project) will probably consider ideas for the framework at its January 2016 meeting. In addition, the G-20 requested an update for their February meeting of finance ministers. Furthermore, the Task Force on Tax and Development referred to the framework establishment by the end of February.

Toolkits

The development of toolkits to assist developing countries with practical considerations in implementing BEPS and best practice policy issues are in progress. The matters covered and potential publication dates include, according to a list announced at the Task Force on Tax and Development:

- November 2015 - tax incentives (see note below)
- September 2016 - indirect transfers of assets
- October 2016 - TP comparatives (+ mineral pricing)
- October 2016 - TP documentation
- December 2016 - treaty negotiation
- June 2017 - base eroding payments
- March 2018 - supply chain management
- March 2018 - BEPS risk assessment

The developing countries hope that these toolkits will be based on the experiences of different countries. Some commentators have insisted on the importance of assessments to ensure that the solutions are proportionate to the level of each country's capacity.

The International Organisations or IOs (IMF, OECD, UN and WBG) state that they have drawn on recent country experiences and an extensive range of academic and other studies, in preparing their report "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment", published on 6 November. The report offers guidance on the design and governance of tax incentives and suggests good practices in these areas. It states that "since much of the pressure to offer incentives stems from an awareness of those offered by other countries, the report also discusses options for international coordination to address the risk of mutually damaging spillovers from such tax competition". A separate background document reviews practical tools and models that can help assess the costs and benefits of tax incentives, which the IOs note is "essential to enhance transparency and support informed decision making".

Capacity building

Both the IOs and developed countries recognise the limited capacity of developing countries' tax administrations to deal with BEPS issues. A number of developing countries have, in particular, pointed to the lack of expertise in transfer pricing including low value-adding services (where both the mark-up and cost base are important) and the valuation of intangible assets.

Recent support from donors or providers, including the European Commission (EC), IMF and WBG, has often focused on transfer pricing. The recipients have talked about the amount of training delivered and the resulting increases in numbers of tax audits and greater tax take.

Efforts have increased following the 2015 UN Financing for Development Conference in Addis Ababa. More than 30 countries and international organisations signed the Addis Tax Initiative to declare their commitment to help developing countries raise domestic public revenue and to improve the fairness, transparency, efficiency and effectiveness of their tax systems, cooperating to combat tax evasion as well as tax avoidance and to double their support for technical cooperation in the area of taxation/ domestic revenue mobilization by 2020.

Specifically, the OECD/WBG/EC transfer pricing/BEPS capacity-building support should be expanded to at least 20 countries by 2016. In this respect the support providers seem to have different priorities. The IMF is focused on balancing investment and revenues, WBG apparently wants to concentrate on low income countries and the EC's 'Collect more – spend better' report suggests that increasing domestic revenue mobilisation (DRM) is part of a cycle involving more effective use of financial resources.

A new partnership between the OECD and UN Development Programme (UNDP) aims to scale up the Tax Inspectors Without Borders (TIWB) initiative, which was formally launched recently but its pilots have been operating for a year or more, and which stands ready to assist developing countries to address audit challenges. The global reach, country-level network and local knowledge of UNDP will complement the OECD's capability in international tax issues.

Regional emphasis

The BEPS recommendations may not apply in all instances for developing countries the world over, given that tax systems and policy goals differ from each other and from developed countries. While there are many common issues other than a desire to be involved in future BEPS work and a lack of tax capacity, as discussed above, a brief review of some regional highlights may be useful.

Delegates at the 45th Meeting of the Study Group on Asian Tax Administration and Research (SGATAR) were urged to focus on country-by-country reporting (CBCR). Arriving at a common understanding of the appropriate use of CBCR information sets the stage for its consistent implementation across the region, according to Ms Sim Ann, Singapore's Senior Finance Minister, who opened the conference. This will, she said, help the region create a stable environment that facilitates investment and growth and, at the same time, minimise opportunities for tax arbitrage. The first Asia-Pacific Technical Meeting on BEPS concluded the need to work with the OECD through SGATAR. Participants provided useful examples of how incentives operate in their economies, noting the opportunities and challenges with the various incentive schemes, and understood the importance of enhanced regional and international cooperation. Of the economies represented at the meeting, 12 out of the 17 have already joined the ad hoc group for the multilateral instrument negotiation.

Latin American attendees at the regional BEPS meeting noted that nothing suggested that the BEPS measures will be easier or quicker to implement than other tax reforms, although there is a clear will "to renovate the domestic rules to comply with the BEPS recommendations". The participants discussed various issues related to tax incentives (especially tax free zones), the mineral pricing issues and the lack of comparables, concluding that these topics align with their needs. Participants also acknowledged the need to keep discussing the allocation of taxing rights in the framework of the OECD and the UN Model Tax Conventions, as well as the Andean Pact and others such as the model being developed by the African Tax Administration Forum (ATAF).

At the Eastern Europe and Central Asia (EECA) Regional BEPS Network Meeting, 12 out of the 15 countries represented had already joined the ad hoc group for the negotiation of the multilateral instrument. The Inter-European Organisation of Tax Administrations (IOTA) will join as an observer. Participants considered that mineral pricing issues, and more generally, tax risks related to the extractive industries and commodities, are significant and need to be addressed. Indirect asset transfers were considered a highly important issue by the EECA region countries, due to the challenges and complexities involved in levying taxes on capital gains effectively.

Representatives from 11 francophone and mostly African countries in CREDAF in a BEPS working group meeting focused discussions on transfer pricing documentation, indirect asset transfers, tax incentives and comparability issues in transfer pricing. However, interest deductibility and PE status were also of particular interest to this group.

As regards other large African countries, notably in the South, information is more difficult to assemble but apparently there is an agreement to share information on aggressive tax schemes used within the region. ATAF will probably take the lead on other sharing opportunities, such as transfer pricing expertise, notwithstanding South Africa's relatively sophisticated legislation and tax administration. Under ATAF, the governments of Kenya, Tanzania and Uganda apparently intend to collectively draft proposals, including legislative changes, which these countries will adopt individually to implement elements of the OECD-led BEPS project before rolling it out to the rest of the East Africa Community (currently Burundi and Rwanda, though Somalia and South Sudan have applied to join). These are expected to address the definition of permanent establishment, review thin capitalisation rules, strengthen transfer pricing legislation, and review existing limitation of benefits clauses. They are also considering, it is believed, CFCs and artificial transfer of assets to preferential tax jurisdictions.

Finally, the Middle East region should not be ignored. The 'oil rich' Gulf Cooperation Council countries have historically been rather 'immune' to tax discussions but are developing in terms of their fledgling tax systems. Tougher economic conditions and the falling price of oil have increased the focus on taxes and particularly trade tariffs and VAT as potential revenue sources. Other countries in the region have cherry-picked from OECD work in the past and seem committed to reviewing BEPS recommendations to see what makes sense. Overall, virtual PEs and treaty access are of particular interest and countries are seeking to overcome fears of transfer pricing (including impartiality of officials, the nature of court rulings and the general lack of expertise) through capacity building via OECD training and TIWB. There is nervousness too about CBCR.

The takeaway

Developing countries are keen to participate in further BEPS discussions on monitoring and implementation. They seem to recognise that tax authorities will have to interact with all stakeholders to build a political consensus both at the domestic and the international levels.

With capacity constraints, regional cooperation to analyse the impact of the BEPS measures will be critical to many developing countries. This cooperation can be more effective with the support of the regional tax organisations. They offer an effective means of engaging countries to provide their input and to express their views.

Continuing to build tax capacity, both in BEPS-specific areas and more generally, is a key priority for most developing countries. Some of the newly established initiatives are already proving useful and more countries hope to benefit.

However, they remain vocal about the need to keep discussing the allocation of taxing rights, including in the framework of the OECD and the UN Model Tax Conventions. The persistence of a distribution of taxing rights perceived as inequitable can, they said, lead to a multiplication of both different standards in double tax treaties and tax disputes. When acknowledging that source versus residence still needs proper resolution, Pascal St Amans said that the appropriate place to hold that debate is “everywhere”!

Other issues that some developing countries and most NGOs see as critical are harmful tax practices and public CbCR.

For business, in order to reduce costs of investment and allow job creation, it needs clarity and predictability. Business representatives continue to urge countries to be coherent in their actions – in their decisions, in dealings between countries, and regarding other policies.

Let’s talk

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